

Confessions of a Tax Evader: Resolving Criminal Tax Cases with Guilty Pleas

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1

Agenda

- How do criminal cases begin
- How the IRS and DOJ work together to prosecute cases
- The *Kovel* accountant
- Sentencing issues

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2

How do criminal tax cases begin?

- Many begin as non-tax federal grand jury or other criminal investigations – tax fraud is the add-on and sometimes the easiest to prove
 - Examples: Department of Labor, State Revenue Cases, Mortgage Fraud, etc
- Structuring investigations - filing of CTRs and SARs triggers investigation; IRS is charged with investigating financial crimes under titles 26 and 31
- Civil Exams
- Civil Collections

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3

How do criminal tax cases begin?

- Fraud referrals from
 - Exams
 - Collection Cases
 - Whistleblowers/Ex-Spouses
 - Disgruntled ex-employees
- Bank Secrecy Act (BSA) Exams
 - IRM Section 4.26.6 – IRS is tasked with reviewing bank compliance with anti-money laundering laws
- Other Agencies
- State tax departments

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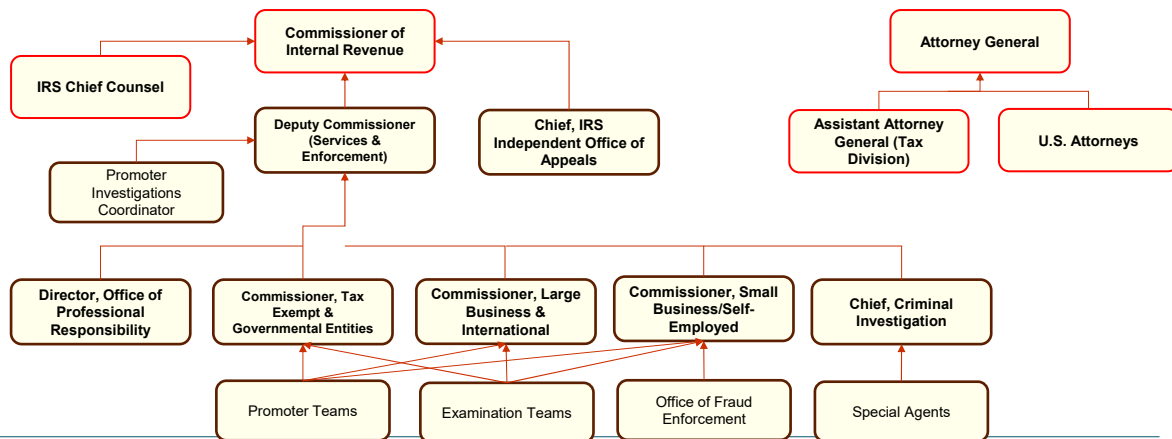
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Exams

- Civil Exam where examiner believes they have “firm indications of fraud”
- Examples include:
 - Significant unexplained differences in deposits vs. reported revenue
 - Significant, unexplained increases in net worth
 - Taxpayer is performing actions that would lead the examiner to believe there is criminal activity – check cashing, structuring deposits, 2nd set of book, dealing only in cash, etc.
 - Taxpayer and/or taxpayer’s representative has made affirmative misrepresentations in the course of the audit
- Collection

5

Simplified Overview of Federal Tax Enforcement



6

To Prosecute or Not?

- IRS-CI completes its field work
- IRS Counsel reviews the CI recommendation
- Taxpayer Conference:
 - Before a case is transferred to the DOJ for prosecution, the taxpayer will be offered a taxpayer conference with the special agent in charge as a matter of course. IRM 9.5.12.3
 - The taxpayer conference will not be held if the taxpayer is the subject of a grand jury investigation or if the special agent in charge determines that such a conference would not be in the best interest of the government.
- Sometimes local United States Attorney's offices will initiate grand jury investigations when tax crimes are identified as a possible mode of prosecution for other crimes being investigated (Tax Division permission required)

Referral to the Dept. of Justice

- DOJ Referral: Once IRS Criminal-CI finishes its work it may refer the case to the DOJ for prosecution.
 - If a grand jury investigation is already ongoing a referral may not be necessary.
- Case is reviewed by DOJ Tax Division
- DOJ may decline to prosecute
- If DOJ approves of the CI recommendation to prosecute, the case will be sent on to the local United States Attorney's office for further review and prosecution
 - The local United States Attorney's office has discretion *not* to prosecute

New Offices

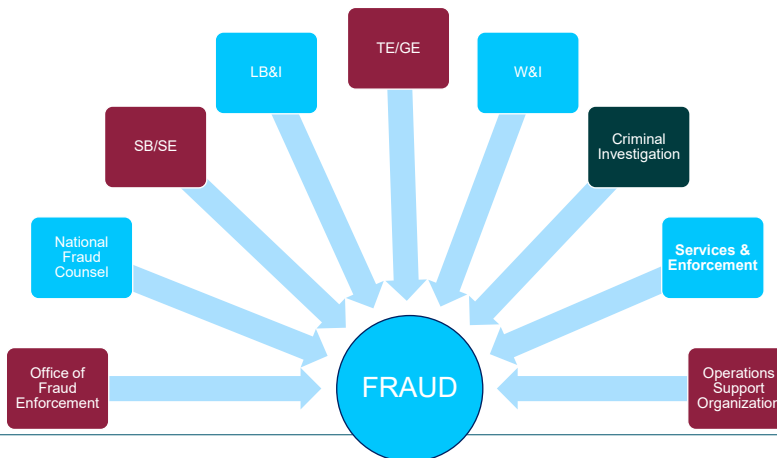
- Office of Promotor Investigations
- Office of Fraud Enforcement
- National Fraud Counsel



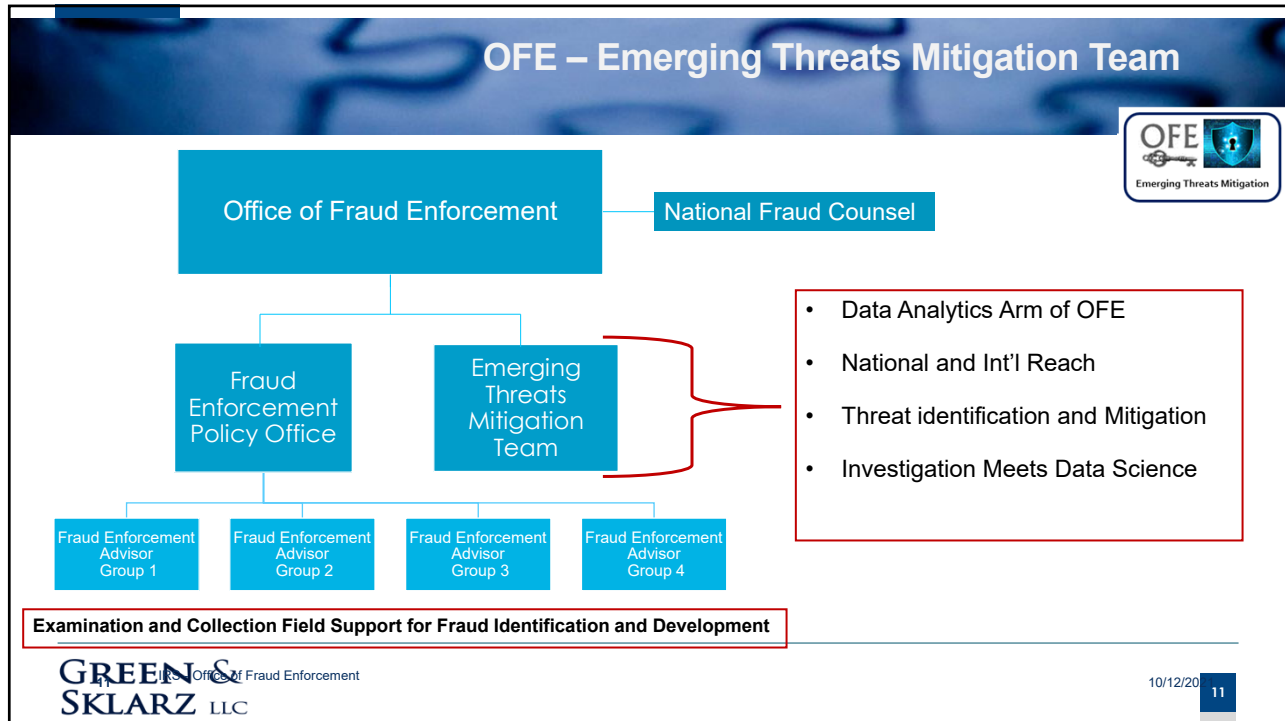
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Office of Fraud Enforcement

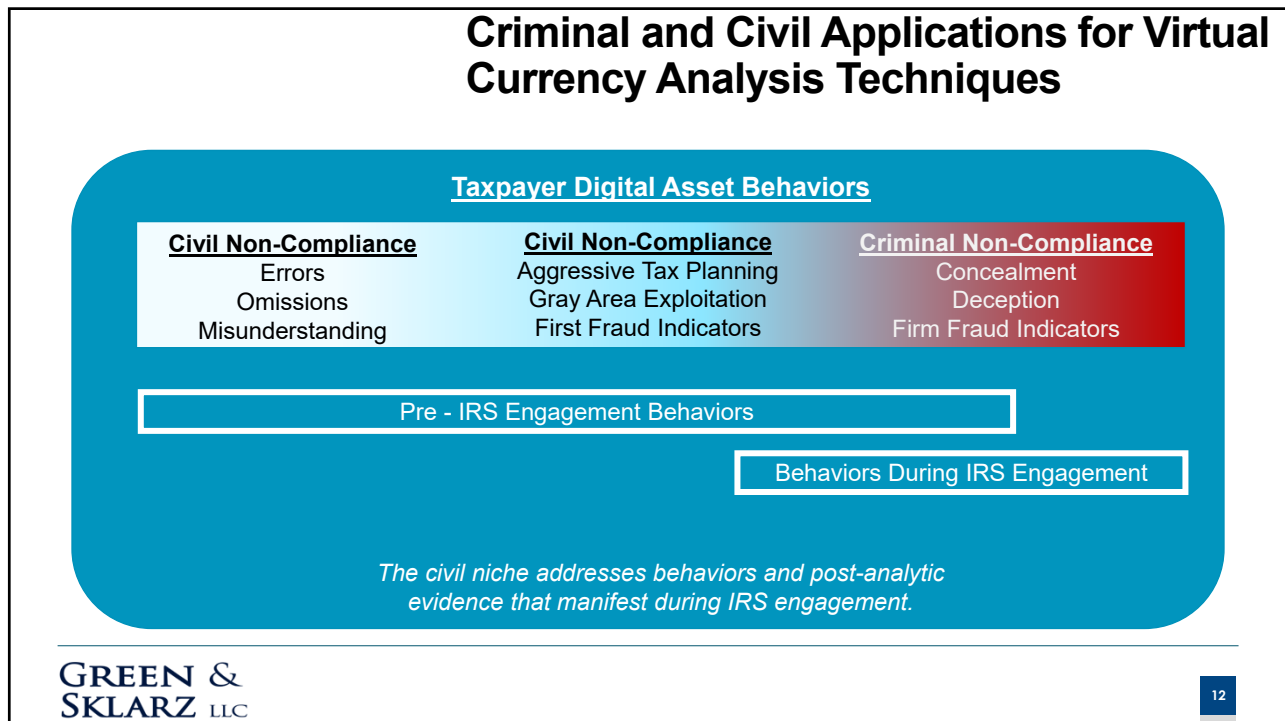
- Collaboration and The Fraud Development Plan



10



11



12

OFE offers End-to-End Service-Wide Collaboration & Support for Virtual Currency Cases

OFE Services & Support

- Training & Consultation
- Basis Tracking
- Gain Computation
- Blockchain Tracing
- Altcoins and Tokens
- Dark Web Activity
- De-anonymization Support
- Fraud Development


Enhance Service-Wide Fluency in Digital Asset Concepts and Investigation

Accessible Blockchain Analytics and Tracing Capacity Across IRS

OFE VC Case Support

Support Full Title-26 & Title-31 Compliance in the Digital Asset Space

Populate IRS BODs with Relevant Digital Asset Tools and Training Support



13

13

13

Once the case arrives in CI?

- Administrative vs Grand Jury
- District by District
- Issues with witnesses (subpoenas)?
- Who is the potential target?


14

14

14

Once the case arrives in CI?

- First steps – where did the referral come from?
- Evaluate what information is available
- Verify what is being alleged?
- Crime Committed?

15

The Role of Chief Counsel

- Support the CI Special Agents in the field
- Review cases for criminal determination
- Review special agent reports, plea agreements, warrants, etc
- They DO NOT prosecute cases

16

Role of DOJ

- Tax charges need to be authorized by DOJ Tax
- Have the opportunity for a conference
- Other crimes do not (ie. Title 31 FBAR Charges)

17

Role of the United States Attorney

- Grand Jury Investigation
- Prosecution (prosecute or not)
- Proffer and/or Reverse Proffer

18

The *Kovel* Accountant

KOVEL DOCTRINE 1961

The *Kovel* Doctrine was born out of a case styled *United States v. Kovel* (2d Cir. 1961). “Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases. Hence, the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege.”

Kovel Agreements

- *Kovel* Agreements allow an attorney to retain a third party, such as accountants or expert witnesses, to assist in providing legal advice. The *Kovel* Agreement clearly states that the non-lawyer’s role is to assist the lawyer.
 - *U.S. v. Kovel*, 269 F.2d 918, 921-24 (2d Cir. 1961).
- This allows communication with the third party to be protected under the umbrella of attorney-client privilege.
- In order to ensure attorney-client privilege, the attorney should:
 - directly hire the third party;
 - make clear that the third party is hired only for the purpose of assisting the attorney to provide legal advice; and
 - require the third party to sign a *Kovel* agreement.

When Can a Party Pierce the Attorney-Client Privilege

- A third party attempting to pierce attorney-client privilege because of its belief that the attorney participated in the furtherance of a criminal or fraudulent transaction must show:
 1. a *prima facie* showing that the client was engaged in or planning criminal or fraudulent conduct when the client sought the advice of counsel, or that the client committed a fraud or crime subsequent to receiving the benefit of counsel's advice; and
 2. that the attorney's assistance was obtained in furtherance or closely related to a crime or fraud.

Tax Accrual Workpapers

- The discoverability of tax accrual workpapers is complex.
- Many accrual workpapers are not prepared in anticipation of litigation, and thus are not protected under the work product doctrine.
- However, if workpapers were prepared in anticipation of disputes or litigation they potentially could be protected work product, even if the workpapers' preparation had dual purpose.
- Workpapers prepared as part of an independent auditor's review may be discoverable by the IRS. However, the IRS is only supposed to request workpapers in limited cases.

Accountant-Client Privilege

- IRC §7525
 - (a)(1): With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.
 - (a)(2): "Tax advice" is defined as advice given by an individual with respect to a matter that is within the scope of the individual's authority under federal law to practice before the Service.
 - Federally authorized tax practitioners includes CPAs and enrolled agents.
 - Applies only to non-criminal tax matters before the IRS and non-criminal tax proceedings in federal court.

23

Exceptions to Accountant-Client Privilege

- Does not apply in state tax proceedings.
 - States may provide for their own version of accountant-client privilege.
- Does not apply in non-tax regulatory proceedings (i.e. SEC proceedings)
- Can be waived in the same manner as attorney client privilege
- Tax Shelter Exceptions
 - IRC §7525 does not apply to written communications between federally authorized tax practitioners and individuals in connection with the promotion of or participation in a tax shelter.

24

How to Properly Use the *Kovel* Accountant

- Must work *for* lawyer
- Lawyer directs work
- Should not communicate with the Government *except* through lawyer
- All work-papers must be returned to the lawyer at the end of the engagement
- **Careful**, the *Kovel* later becomes the regular accountant of the taxpayer, *Kovel* protections are likely lost for prior work

25

Sentencing: DOJ Major Count Policy

- Felony counts have priority over misdemeanor counts.
- Tax evasion counts (IRC 7201) have priority over all other substantive tax counts.
- The count charged in the indictment or information that carries the longest prison sentence is the major count.
- As between counts under the same statute, the count involving the greatest financial detriment to the US (*i.e.*, greatest additional tax due and owing) is the major count.
- As between counts, if the financial detriment does not differ significantly, the relative flagrancy of the offense is determinative.
- US Attorney may request Tax Division to consider other factors not included above.
- Tax Division may need to designate more than a single count as a major count when the computed guideline sentencing range exceeds the maximum sentence that the court can impose under a single count.
- When the major count is a felony, US Attorney may not accept a plea to a lesser-included offense nor substitute a misdemeanor offense. Absent unusual circumstances, Tax Division will not approve the reduction of a charge from a felony to a misdemeanor merely to secure a plea.

26

Tax Loss

The Basics:

- Object of the offense - U.S.S.G. § 2T1.1(c)(1)
- Government bears the burden - preponderance of evidence
- Tax loss need not be determined with precision
- Court needs only to make a “reasonable estimate” of loss defendant intended to inflict, not actual loss

Calculating Tax Loss:

- Unreported income - tax loss = 28% of unreported gross income (34% for corporations) plus 100% of false credits claimed
- False deduction or exemption - tax loss = 28% of improperly claimed deduction or exemption (34% for corporations) plus 100% of any false credits claimed
- Failure to file returns – tax loss = 20% of the gross income (25% for corporations) less tax withheld or otherwise paid
-*unless a more accurate determination of the tax loss can be made.* USSG § 2T1.1(c)

Tax Loss

- Tax loss does not include interest or penalties, except in willful evasion of payment under IRC § 7201 and willful failure to pay under IRC § 7203
- Where tax loss is not reasonably ascertainable, the presumptions should be used ***unless the government or defense provides sufficient information for a more accurate assessment***
- In the face of a disagreement regarding tax loss, the court must allow for an evidentiary hearing unless the court presided over a trial and the record supports a calculation of tax loss. Criminal Tax Manual, § 43.03[1] (2015) (*citing United States v. Marshall*, 92 F.3d 758, 760 (8th Cir. 1996))
- Tax loss includes the tax associated with offense of conviction and any relevant conduct, including acquitted or dismissed charges, and state and local tax loss. U.S.S.G. § 1B1.3(a)(2)

Previously Unclaimed Credits, Deductions, and Exemptions

- Court “should account for the standard deduction and personal and dependent exemptions to which the defendant was entitled.” USSG §2T1.1, comment. (n.3)
- Court “should account for any unclaimed credit, deduction, or exemption that is needed to ensure a reasonable estimate of the tax loss,” but only to the extent that three conditions are met:
 - credit, deduction, or exemption must be related to the tax offense and claimable at the time the tax offense was committed
 - credit, deduction, or exemption must be “reasonably and practicably ascertainable”
 - defendant must present “information to support the credit, deduction, or exemption sufficiently in advance of sentencing to provide an adequate opportunity to evaluate whether it has sufficient indicia of reliability to support its probable accuracy”
- Court shall not account for payments made in a manner that encouraged or facilitated a separate violation of law. See *US v. Sanchez*, 2016 WL 1103849 (E.D.N.Y.) (January 4, 2016) (disallowing unclaimed deductions for cash wages paid to undocumented workers and check cashing fees where defendant could have cashed checks without fees at his bank)
- Burden is on defendant to establish credit, deduction, or exemption by preponderance of evidence

Relevant Conduct

- Same course of criminal conduct or common scheme or plan
- Substantially connected by at least one common factor: victims, accomplices, or purpose, or similar *modus operandi*
- “all conduct violating the tax laws should be considered as part of the same course of conduct or common scheme or plan unless the evidence demonstrates that the conduct is clearly unrelated.” USSG § 1B1.3(a)(2), § 2T1.1 comment. (n. 2)
- Includes:
 - State and Local Taxes
 - Foreign Taxes
 - Tax Loss from Other Periods
 - Tax Loss of Related Taxpayers
 - Preparer Cases
 - Acquitted Conduct

Impact of Civil Tax & Other Collateral Issues

- “Under collateral estoppel, once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation.” *Montana v. US*, 440 U.S. 147, 153-154 (1979)
- Estoppel applies to specific facts (i) proven at trial, (2) stipulated in a plea agreement, or (3) admitted by client or counsel in proceedings
- Estoppel applies to years/periods of conviction
- May eliminate defense of limitations on assessment
- May eliminate defense to civil fraud penalties
- May result in nondischargeability in bankruptcy
- Other Collateral Consequences:
 - Professional Licensing
 - Debarment
 - Immigration

31

Guilty Pleas: The Pros

- Eliminates the uncertainty of trial for a predictable outcome
- Reduces the criminal charges
- Reduces the sentence that a conviction after trial would produce
- Saves substantial attorneys' fees
- Produces a faster resolution
- Eliminates or reduces adverse publicity

32

The Cons:

- To plead guilty, you must be guilty of the crime to which you are pleading and to which you will allocute
- May require cooperation against friends, family or others
- The defendant will have a criminal conviction on his or her record
- Waives substantial rights:
 - to a jury trial
 - to a speedy trial
 - to confront witnesses
 - to remain silent and avoid self-incrimination
 - to have guilt established beyond a reasonable doubt
 - to appeal

33

Collateral consequences of a guilty plea

- Restitution (18 USC §3556)
- Possible forfeiture of property
- Probation office reporting and restrictions
- Immigration consequences, including possible deportation
- Loss or suspension of a professional license
- Gun ownership restrictions
- Loss of benefits
- Difficulty obtaining employment
- Inability to vote
- Collateral estoppel potential for the 75% civil fraud penalty

34

Alford Pleas

- An Alford plea is a plea in which the defendant pleads guilty while claiming innocence. North Carolina v. Alford, 400 U.S. 25, 38-39 (1970). the Supreme Court
- Prosecutors in a tax case may consent to an Alford plea only in the most unusual circumstances and only with the approval of the Assistant Attorney General of the Tax Division.
- Whenever a defendant enters an Alford plea, the prosecutor makes an offer of proof of all known facts to support the conclusion that the defendant in fact is guilty. See United States Attorneys' Manual §§ 9-16.015 and 9-27.440.
- Prosecutors discourage Alford pleas by refusing to agree to terminate the prosecution when such a plea is proffered to fewer than all of the charges pending.
- If, over the government's objection, the court accepts an Alford plea to fewer than all charges in a tax case, the prosecutor must proceed to trial on the remaining counts unless the Assistant Attorney General of the Tax Division approves the dismissal of the remaining charge

35

Nolo Contendere Pleas

- A plea of nolo contendere is one in which the defendant pleads no contest to the charges and accepts the conviction without admitting guilt.
- DOJ policy requires all prosecutors to oppose the acceptance of a nolo contendere plea.
- Only in the most unusual circumstances and only after approval by the Assistant Attorney General of the Tax Division, may a prosecutor consent to a nolo plea in a tax case. See United States Attorneys' Manual, §§ 9-16.010 and 9-27.500-.530.
- The nolo plea does not allow the government to use collateral estoppel in subsequent civil tax proceedings.

36

Sentencing Advocacy

- 18 USC 3553 – 7 factors
- Tax loss is only one factor
- Role of the Kovel accountant

37

Federal Sentencing Guidelines

- Sentencing for federal crimes are done pursuant to 18 USC 3553
- The statute lays out 7 factors for courts to consider
- 1 Factor is the guidelines set forth by the federal sentencing commission

38

Federal Sentencing Guidelines

- United States v. Booker, 543 U.S. 220 (2005) (guidelines are advisory)
- Gall v. United States, 552 U.S. 38, 49 (2007) (“[T]he Guidelines should be the starting point and the initial benchmark.”)
- In practice today the guidelines are still the starting point in any discussion with the United States Attorneys

Federal Sentencing Guidelines (cont.)

Establishing the base level of offense:

- Calculate the tax loss. Criminal Tax Manual 43.03[1]
 - Where tax loss is contested, that is a triable issue
 - Government bears the burden of proof of the tax loss by a preponderance of evidence. United States v. Singletary, 458 F.3d 72, 80 (2d Cir. 2006)
- Include relevant conduct.
- Apply departures.

If there is no tax loss, the base level offense is 6. U.S. Sentencing Guidelines, 2T1.1(a)(2).

Federal Sentencing Guidelines (cont.)

Upward Departures

- Illegal source income
- Sophisticated means: “[S]ophisticated means” means especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense. Conduct such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore financial accounts ordinarily indicates sophisticated means.” *Application Note* No. 3 to U.S. Sentencing Guidelines 2T1.4
 - See Criminal Tax Manual 43.03[2][b] for a list of what constitutes sophisticated means
- Part of a pattern
- Professional in return preparation/Abuse of trust
- Encouragement to evade taxes
- Prior similar misconduct

Federal Sentencing Guidelines (cont.)

Downward Departures:

- Acceptance of responsibility
- Providing “substantial assistance” to the government
- Voluntary disclosure
- Extraordinary circumstances
 - Pre-conviction civic life
 - Superior rehabilitation efforts
 - Effect on existing business to innocents
 - Special family responsibilities

Tax Table – Sentencing Guidelines

§2T4.1. Tax Table

<u>Tax Loss (Apply the Greatest)</u>	<u>Offense Level</u>
(A) \$2,500 or less	6
(B) More than \$2,500	8
(C) More than \$6,500	10
(D) More than \$15,000	12
(E) More than \$40,000	14
(F) More than \$100,000	16
(G) More than \$250,000	18
(H) More than \$550,000	20

Criminal History Categories

Points (U.S. Sentencing Guidelines Chapter 4, Part A)

1. 3 points for prior sentencing exceeding 1 year and 1 month
2. 2 points for prior sentences exceeding 60 days
3. 1 point for prior sentences less than 60 days
4. 2 points of defendant committed current offense while on probation, supervised release, was in prison

**For 1-3 max. points are 4. This is a partial list.

Sentencing Zones

There are four sentencing Zones A, B, C, and D

- **Zone A** is eligible for probation, and no term of imprisonment is required.
- **Zone B** is also eligible for probation, home confinement or supervised release but at least one month of the sentence must be served in prison.
- **Zone C** requires offender to serve at least half their sentence in prison.
- **Zone D** requires the offender to serve at least the minimum sentence in the column. Offenders are eligible for time off for good behavior and must typically serve at least 85% of their sentence.

SENTENCING TABLE
(in months of imprisonment)

Offense Level	Criminal History Category (Criminal History Points)					
	I (0 or 1)	II (2 or 3)	III (4, 5, 6)	IV (7, 8, 9)	V (10, 11, 12)	VI (13 or more)
1	0-6	0-6	0-6	0-6	0-6	0-6
2	0-6	0-6	0-6	0-6	0-6	1-7
3	0-6	0-6	0-6	0-6	2-8	3-9
4	0-6	0-6	0-6	2-8	4-10	6-12
5	0-6	0-6	1-7	4-10	6-12	9-15
6	0-6	1-7	2-8	6-12	9-15	12-18
7	0-6	2-8	4-10	8-14	12-18	15-21
8	0-6	4-10	6-12	10-16	15-21	18-24
9	4-10	6-12	8-14	12-18	18-24	21-27
10	6-12	8-14	10-16	15-21	21-27	24-30
11	8-14	10-16	12-18	18-24	24-30	27-33
12	10-16	12-18	15-21	21-27	27-33	30-37
13	12-18	15-21	18-24	24-30	30-37	33-41
14	15-21	18-24	21-27	27-33	33-41	37-46
15	18-24	21-27	24-30	30-37	37-46	41-51
16	21-27	24-30	27-33	33-41	41-51	46-57
17	24-30	27-33	30-37	37-46	46-57	51-63
18	27-33	30-37	33-41	41-51	51-63	57-71
19	30-37	33-41	37-46	46-57	57-71	63-78
20	33-41	37-46	41-51	51-63	63-78	70-87
21	37-46	41-51	46-57	57-71	70-87	77-96
22	41-51	46-57	51-63	63-78	77-96	84-105
23	46-57	51-63	57-71	70-87	84-105	92-115
24	51-63	57-71	63-78	77-96	92-115	100-125
25	57-71	63-78	70-87	84-105	100-125	110-137
26	63-78	70-87	78-97	92-115	110-137	120-150
27	70-87	78-97	87-108	100-125	120-150	130-162
28	78-97	87-108	97-121	110-137	130-162	140-175
29	87-108	97-121	108-135	121-151	140-175	151-188
30	97-121	108-135	121-151	135-168	151-188	168-210
31	108-135	121-151	135-168	151-188	168-210	188-235
32	121-151	135-168	151-188	168-210	188-235	210-262
33	135-168	151-188	168-210	188-235	210-262	235-293
34	151-188	168-210	188-235	210-262	235-293	262-327
35	168-210	188-235	210-262	235-293	262-327	292-365
36	188-235	210-262	235-293	262-327	292-365	324-405
37	210-262	235-293	262-327	292-365	324-405	360-life
38	235-293	262-327	292-365	324-405	360-life	360-life
39	262-327	292-365	324-405	360-life	360-life	360-life
40	292-365	324-405	360-life	360-life	360-life	360-life
41	324-405	360-life	360-life	360-life	360-life	360-life
42	360-life	360-life	360-life	360-life	360-life	360-life
43	life	life	life	life	life	life

Orders of Restitution

- Criminal Tax Manual 6-4.370: “The Department of Justice authorizes and encourages United States Attorneys to seek restitution in criminal tax cases.”
- Orders of restitution cannot be compromised by IRS through an OIC, or discharged in bankruptcy.

Civil Fallout

- Restitution (cannot be compromised)
- Fine
- Civil Assessment
- 75% civil fraud penalty
- Interest

Questions

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49