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Comments on Proposed Changes in the Tax Guidelines

1. Introduction -- This panel has been asked to comment on two sets of proposed amendments to the guidelines affecting the sentencing of tax cases. The proposals under Options 1 and 2 in the Proposed Guideline Amendments for Public Comment, and the recently circulated Option 3, essentially seek to raise and harmonize the loss calculations and the consequent sentences resulting under the fraud, theft, and tax guidelines. The Synopsis of Proposed Amendment states that "[t]he purpose of both options [and now presumably all three] is to raise penalties for economic offenses that have medium to high dollar losses in order to achieve better proportionality with the guideline penalties for other offenses of comparable seriousness."

These remarks are my own, but the members of the panel: Justin A.Thornton, Paula M. Junghans, and Charles M. Meadows, Jr. are all practitioners with extensive experience handling the sentencing aspects of tax cases. They have asked me to advise the Commission that, although our reasons may vary, we are in complete harmony in our bottom line recommendations. In this connection, we favor retaining the current tax loss table without regard to whether the fraud and theft loss tables are changed. We also agree that the 12 level increase for low tax loss offenses in both Options 1 and 2 for "sophisticated means" or "sophisticated concealment" should be rejected and that this specific offense characteristic should remain a two level increase at all tax loss levels. I will discuss some of our reasons for urging these results, and the other panelists will be expressing their views after Mr. Matthews has had an opportunity to offer the Justice Department's view.

Prior to the November 1993 amendments the tax and fraud loss tables were essentially mirror images of each other. In 1993, the Commission severed this relationship at the request of the Justice Department's Tax Division and the Internal Revenue Service. I was one of the Justice Department representatives that appeared before the Commission, endorsing the view that the existing tax table should be adjusted upward to produce higher sentences for tax crimes regardless of what was done with the fraud table. In fact, during that amendment cycle the fraud table was not touched. The Commission nevertheless, adopted the Department of Justice and IRS's view that the tax table needed to be raised, and the existing tax table reflects those increases.

Today, I have the privilege of appearing before a new Chairman and a number of new members of the Commission -- again in support of the 1993 tax table. My 23 years of experience as a practitioner representing both the IRS and taxpayers convinces me that changing the tax table at this time is unnecessary, potentially harmful, and may not achieve "better proportionality" with the penalties for other offenses. As the supervisor of roughly 100 prosecutors in the Tax Division during the years 1989 through part of 1993, I helped compile the Tax Division's annual wish list for submission to this body. In most, if not all, of those years we urged one or another adjustment in the tax guidelines -- sometimes to respond to a troubling court decision and others to address practical problems prosecutors were having in the field -- always seeking change. I believe I was involved in requesting some change -- from minor tightening to a major change in the tax loss table -- in every amendment cycle I was there. But I did not spend any time considering what change, even well-intentioned, rock-solid, impeccably logical change, does at the in-court, practitioner level where those changes have to be implemented.

One thing I did not foresee in 1993 was that in 1998 different guideline books would still govern the outcome of tax cases sentenced the same year. In fact, the Justice Department is still handling in 1998, and will be handling for the next couple years, cases that involve 1990, 1991, 1992, and conceivably earlier tax returns. Many of those cases will be sentenced using the pre-1993 tax loss table. As a result, the Commission's sentencing statistics are unlikely to reflect much experience using the 1993 tax loss table. Knowing how cases are sentenced under the current table, when all cases are sentenced under that table, would give the Commission better information about whether the tax table needs to be adjusted to make it proportional to the punishments for other offenses. But more significantly, two defendants charged with roughly similar crimes involving roughly similar dollar amounts can be sentenced on the same day under two different tax tables and receive disproportionate sentences. I have come to the firm conclusion that changing fundamental elements of the sentencing of tax offenses creates disproportionality within the sentencing of those offenses over time and creates the appearance of arbitrariness when the same tax offense for different tax years results in vastly different sentences.

Part of this results from skillful charge bargaining by prosecutors and defense counsel but the rest is an unavoidable consequence of the non-retroactivity rule. Today the Commission is being asked to consider and adopt one of three options that would markedly increase guideline levels for taxpayers who commit their offenses on returns filed after November 1, 1998. Cases involving those returns will start entering the prosecution pipeline three or more years after that. Therefore, sentencing disparities and sharp charge bargaining to avoid the increases in the 1998 tax loss table will unavoidably span at least the next five years.   In my view, it trivializes the sentencing guidelines when the length of a defendant's sentence is dependent upon the year the tax crime was committed, and I believe that the arithmetic problems the government will urge on the Commission -- i.e., not a high enough percentage of tax defendants go to prison for a long enough time -- can and ought to be remedied by the IRS's giving the courts more substantial cases and more thorough investigations to sentence.

2. <u>Are the Sentences in Tax Cases too low?</u>

a. Attitude of the Sentencing Courts --The A, B, and C ranges of the Sentencing Table provide the courts in the lower ranges of almost all tax offenses the flexibility to adjust the duration and terms of imprisonment to reflect the seriousness of the crime, the need for deterrence, the possibility of recidivism, and steps taken to redress the wrong. Although the Justice Department is unlikely ever to say so, it must either perceive that judges are uniformly biased against prison sentences in the smaller variety of tax cases or that these same judges are uniformly unenlightened as to their power to sentence tax offenses to prison at the upper end of the range. The Justice Department's apparent view is that the current tax guidelines are inadequate, because they do not *compel* courts to sentence low-range tax violators to prison rather than probation, home or community confinement, or some other alternative to prison.[1]

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[1] This view may be a consequence of prosecutors and IRS agents who have become accustomed to handling money laundering, currency, and related offenses and are jaded by the relatively severe prison sentences produced by those guidelines and the leverage they extend to the government. Unless an offense draws a lengthy, virtually mandatory sentence, these agents believe it is not worth investigating. But pandering to this "agents' mind-set" could easily undermine any systematic criminal enforcement of the tax laws, where the IRS cannot show that the reasonable judicial discretion contemplated by the

When the guidelines permit a judge to sentence a tax defendant to probation, the judge, nevertheless, has the authority under the current tax table to sentence the defendant to prison in the upper end of the range. Option 2, favored by the Justice Department, is calculated to narrow the court's discretion to sentence a tax defendant to anything other than a full term of prison only in the most minuscule tax cases -- cases that are too small to meet the IRS's internal guidelines imposing dollar limits for recommending prosecution.

The available statistics reveal an almost uniform rejection by the district courts of prison sentences for low-end of the tax table violators. Part of this may be historic. Pre-guideline tax cases, even very large cases, most often resulted in probation. The original guidelines were intended to send a higher percentage of tax violators to prison, and it appears that they have. But they have done so at a time when the IRS's criminal enforcement program has been in severe decline. In the early 1970's, the IRS's criminal enforcement activities were almost exclusively directed to what were called "general program" cases. The program was focussed on investigating and prosecuting "pure" tax violations, unadorned by non-tax crimes, and on deterring the taxpaying public at large from engaging in tax fraud and evasion -- in sum, enforcing the tax laws exclusively. In the late 1970's or early 1980's, the Service began diverting its criminal agents' time away from general program cases to narcotics, organized crime, general white collar crime, and participation in a variety of criminal enforcement "task forces" with FBI and other law enforcement agencies. Today, despite efforts to reverse the trend, relatively few general program cases are developed, and the few that are prosecuted are of considerably lower quality than the

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current tax loss table has been harmful, rather than beneficial. It certainly does not justify increasing the tax loss table to shift discretion away from judges to prosecutors and agents in sentencing low-end tax cases.

cases developed by the IRS in past years.

Despite efforts to rejuvenate the general program by instituting “non-filer” initiatives or by attacking the “tax gap,” the fact remains that the Service’s criminal tax enforcement program appears to be at a loss for a rationale. This lack of a rationale has resulted in questionable case selection, low quality cases, disproportionate enforcement, and, most troubling of all, investigative short cuts. I have heard these concerns expressed by many tax prosecutors and CID agents and have absolutely no doubt that district court judges, who see the parade of cases produced by the Service today, are making their sentencing decisions in low-end cases based upon these same concerns. The inescapable perception that a low-end tax violator before the court is simply the victim of bad luck, while the IRS’s own statistics reveal the existence of vast hordes of worse violators who are not even investigated, cannot give any judge confidence that he or she is doing justice by sending that violator to prison.

Upping the tax table at this juncture in the IRS’s history is unlikely to help it restore rationality to its investigative program and may, in fact, be harmful. Tax crimes are different from other theft/fraud-type offenses largely because (1) they generally involve taxpayers’ concealing their own income or assets from the IRS rather than affirmatively taking anything from anybody;[2] (2) the vast majority of tax violators have no other criminal involvement and would never consider engaging in some other form of fraud, theft, or criminal wrongdoing; and (3) statistics show that tax violators -- in spite of the sentences the IRS finds so offensively low -- are extremely rare recidivists. Another practical difference, for the purpose of guideline sentencing,

[2] False refund cases, although nominally tax cases, are generally prosecuted as violations of 18 U.S.C. §§ 286 or 287 and are sentenced under the fraud guidelines using the fraud loss table in U.S.S.G. § 2F1.1.

is the extensive role played by relevant conduct in computing tax loss. The guidelines allow the sentencing court to take into account losses in uncharged tax years, tax losses occurring outside the six-year statute of limitation, and the duration of a tax scheme. The IRS virtually always investigates and recommends prosecution of multiple-year cases. As a result, fair and proportionate calculation of tax loss and appropriate sentencing presupposes a thorough investigation of the offense charged and all relevant conduct.

For example, a taxpayer who makes $40,000 per year and is charged with evading $5,500 in one year may not at first blush appear to be an appropriate candidate for prison. But what if a thorough investigation reveals that the same taxpayer's scheme spanned eight years? Without a thorough investigation, the current tax table would initially produce level 8 and permit the court to sentence the taxpayer to probation. But with the benefit of a thorough investigation and all the facts, the court would sentence an eight year tax violator in level 13, facing almost certain prison and no chance for probation even with acceptance of responsibility. An increase in the tax loss table that rewards agents' poor case selection and sloppy or less-than-thorough investigations will do little to help the Service restore its enforcement program and risks making the punishment for such offenses less proportional with the severity of the sentences for the remaining handful of thorough investigations, tax offenses of shorter duration, and non-tax offenses generally.

b. Role of Charge and Loss Bargaining -- The Commission's sentencing statistics for tax crimes reveal that a lower percentage of tax violators are sentenced to prison than the Department of Justice believes should be. What these statistics do not show is the extent to which this percentage is skewed by charge and loss bargaining to produce particular sentences.

I have already mentioned the problem of incomplete investigations that prevent the sentencing court from knowing the full extent of the defendant's conduct. A related problem stems from the fact that tax offenses are often used to "plead down" more severe non-tax offenses to obtain cooperation or dispose of another type of offense. In task force investigations, tax offenses often appear as statistical add-ons to give the IRS some credit for participating in a joint effort. Today it is the rare case that is investigated and prosecuted as a tax violation without some other criminal involvement. In such cases, dispositions are achieved, not based on what is good for the tax enforcement program or the taxpaying public at large, but to achieve a preordained result for a non-tax purpose.

In addition, courts often see, indeed expect to see, cases in which a defendant is sentenced to an agreed upon tax loss. The process of disputing tax loss at a sentencing hearing is cumbersome and time consuming. As a result, prosecutors and agents agree, with considerable regularity, to present the sentencing court with an agreed-upon tax loss that effectively preordains a non-prison outcome. To the extent that the sentencing statistics reflect this phenomenon, reliance on the statistics to adjust the tax table upward would be severely misleading and unfair to tax violators who cannot benefit from such agreements.

This poses a particularly troubling problem. We know that the overwhelming majority of tax cases result in pleas and that a large proportion of these are the result of bargains. This is a practical necessity, because tax trials consume disproportionality large amounts of court time. But when we use statistics generated as the result of such plea bargains to assess proportionality with the sentences for other tax offenses and non-tax offenses generally, we are likely to leave those who are unable to bargain with extraordinarily disproportionate sentences. If the Commission's sentencing statistics are at all skewed by charge and loss bargaining, is it reasonable to change the current tax table in the name of achieving some undefined, perhaps undefinable, proportionality?

In fact, raising the tax loss table under either formulation, together with the proposed changes in the "sophisticated means" or "sophisticated concealment" offense characteristics, will increase prosecutors' leverage, and tax defendants' incentive, to obtain more and earlier bargained-for pleas. There is no criminal tax defense lawyer alive who has not been told that if he or she does not plead the client immediately, the tax loss will increase with further investigation and sophisticated means will be added. The proposed increases in the tax loss table will raise the stakes and intensify pressure to work out some kind of early "deal." As a result, the Justice Department and IRS are likely to be back five years from now, after a stretch of rampant charge and loss bargaining, wringing their hands over statistics that continue to show that tax crimes produce too low a percentage of prison sentences or sentences that appear to them disproportionately low.

Perhaps the correct gauge of whether tax sentences are long enough or involve enough prison would be to consider only cases tried to conviction. In those cases, the courts see the taxpayers' entire crime, and prosecutors have no incentive, and defendants no means, to hold anything back. With nothing more than anecdotal evidence to back me up, I am virtually certain that the percentage of substantial prison sentences in tax cases tried to conviction is extremely high. Of course, this manner of calculation would focus on an inordinately small number of cases. Change is certainly not warranted when we cannot determine with statistics and experience whether the current tax loss table is capable of generating appropriate, proportional results.

c. Will raising the tax loss table deter tax fraud?

In 1993, the primary reason the Tax Division and IRS urged for increasing the tax guidelines was that higher sentences for tax convictions would deter other taxpayers from doing the same. Every year more than 100 million tax returns are filed with the IRS, and IRS projects that each year there is a "tax gap" (an under-reporting and under-paying of taxes actually due) in excess of $100 billion. In enforcing the tax laws the IRS conducts civil audits to collect additional taxes and penalties for about 1% of the returns filed. Less than 1/100th of a percent of all returns are examined for criminal liability. Since it would be impossible to prosecute anywhere near all of the taxpayers who are believed to commit tax crimes, the historical focus of the IRS's criminal enforcement program had been careful, systematic case selection aimed at deterring other taxpayers from committing fraud.

When the IRS and I asked the Commission in 1993 to raise the guidelines to deter tax fraud, I was not asked whether I had any statistical or other support for my contention. I did not, and I suspect that Mr. Matthews still does not. The IRS has tried, but has not been able to demonstrate persuasively, that the criminal prosecution of one taxpayer has ever resulted in greater tax collections from others. The more difficult, and again unanswerable, question is whether increasing *prison* sentences for the few haphazardly selected tax prosecutions now produced will result in greater collections from other taxpayers. One commentator, Professor Michael Graetz of Yale Law School, has suggested that greater investigative coverage by IRS criminal investigators, rather than the results of the few investigations conducted, would deter more would-be tax violators. In his non-statistical view, systematic investigative presence, not the size of the ultimate penalty creates deterrence. In fact, there is no statistical basis for determining whether the 1993 increase in guideline sentences has had the slightest impact on deterrence.

On the basis of the same intuitive, arithmetic argument we made in 1993, the Department of Justice now asks for a further, even more substantial increase. Perhaps, the argument should run that if we had only asked for and gotten more from the Commission in 1993 the tax gap would now be gone. If deterrence is the standard, we may never know when we have reached the one “right” level for the tax loss table, but increasing the tax loss table in the name of deterrence, without knowing whether the changes are likely to deter anyone from doing anything, hardly seems justified.

3. Sophisticated Means or Sophisticated Concealment?

The Commission is also considering another amendment consisting of two options relating to the “sophisticated means” specific offense characteristic found in several tax guidelines. Contrary to the statistics showing its application in only approximately 16% of all tax cases, experience tells us that this increase is threatened or used in most every tax case and that very few of the more recent cases are not treated as "sophisticated." The change in definition proposed in Option 2 will probably only lead to litigation. Furthermore, neither Option appears definitively to resolve the question whether individual conduct or offense conduct of others ought to control.

Our primary concern with both of these options is the increase to offense level 12 for tax losses too small otherwise to generate a level 12. Under any of the three proposed tax loss tables, and even under the current table, a $1,000 tax loss accompanied by sophisticated means or sophisticated concealment would generate punishment at level 12 (before acceptance). With the increasing prevalence of this specific offense characteristic in presentence reports, this amendment would generate unduly harsh results for nearly minuscule tax violations. There is no reason to believe that under the current guidelines a judge concerned about particularly egregious concealment conduct by a low-end taxpayer would not sentence the defendant to prison in the upper end of the range or decline to provide an alternative to prison in Zones B or C.

Conclusion

For all these reasons, the members of this panel favor maintaining the *status quo* for tax offenses. The need for increased sentences is, at best, unclear. Indiscriminate raising of sentences relating to low-end taxpayers will not cure long-standing, fundamental defects in IRS's criminal enforcement program and might actually create harmful disincentives to reform. There is no evidence that when presented with a thoroughly investigated tax offense the courts will not use the tools available to them under the current guidelines to sentence appropriately. In sum, there is no reason to believe that the current tax loss table is inadequate to meet this need or that there is a need to increase it by bolstering the existing "sophisticated means" offense characteristic.