



COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

March 11, 2013

United States Sentencing Commission  
One Columbus Circle, N.E., Suite 2-500  
Washington, D.C. 20002-8002  
Attention: Public Affairs

To the Members of the United States Sentencing Commission:

Thank you for the opportunity to provide comments regarding the Commission's Proposed 2013 Amendments to the U.S. Sentencing Guidelines ("U.S.S.G."). This letter specifically concerns the proposed amendment to Guideline § 2T1.1 that would permit a convicted tax offender to introduce previously unclaimed deductions at sentencing, a rule to which I am strongly opposed. In my view, permitting convicted tax offenders to introduce previously unclaimed deductions at sentencing would seriously undermine the public interest in preserving the integrity of the nation's tax system. As a corollary, the proposed rule would send a message to the public that those who are convicted of willfully underreporting their taxable income will be on the same footing as honest taxpayers when it comes to claiming deductions that are ordinarily only available to law-abiding filers.

As Acting Commissioner of the Internal Revenue Service ("IRS"), I oversee the criminal tax enforcement actions of IRS-Criminal Investigations ("CI"), which works closely with the Department of Justice and U.S. Attorneys' Offices around the country to bring tax offenders to justice. The work of CI is a crucial component of the IRS's overall mission to promote voluntary compliance. Underreporting of income remains the greatest single contributing factor to the estimated \$385 billion tax gap and is a persisting reason for low compliance. As the Commission has previously recognized in the Sentencing Guidelines, "The criminal tax laws are designed to protect the public interest in preserving the integrity of the nation's tax system . . . . Recognition that the sentence for a criminal tax case will be commensurate with the gravity of the offense should act as a deterrent to would-be violators." U.S.S.G. Ch.2, Pt.T, intro. comment. The calculation of "tax loss" for sentencing purposes is a critical component of deterrence and a tool for promoting voluntary compliance precisely because it factors prominently in the federal judiciary's calculation of a defendant's applicable sentencing range.

The Commission's proposed amendment would address a circuit conflict over whether a sentencing court, in calculating the tax loss under Guideline § 2T1.1, "may subtract the unclaimed deductions that the defendant legitimately could have claimed if he or she had filed an accurate tax return." Of the three options presented for resolving the conflict, IRS believes Option 2 is the correct position. Option 2 provides: "The

determination of the tax loss shall not account for any credit, deduction, or exemption, unless the defendant was entitled to the credit deduction, or exemption and claimed the credit, deduction, or exemption at the time the tax offense was committed." This option would not allow defendants to assert previously unclaimed credits, deductions or exemptions at sentencing as a means of reducing the court's tax loss calculation and thereby potentially obtaining a more lenient sentence.

It is the IRS's view that Option 2, which reflects the position of the majority of circuit courts, would support our goal of deterring tax offenses because it clarifies that "tax loss" for sentencing purposes is based on the manner in which the defendant willfully chose to file his or her fraudulent tax return. Conversely, IRS believes Option 1, which would account for any credits, deductions, or exemptions to which the defendant was entitled in the determination of the tax loss for sentencing purposes, and Option 3, which would allow such consideration only if the defendant presents contemporaneous documentation, would undermine the IRS's mission of promoting voluntary compliance and could result in sentences that are inconsistent with the severity of the offenses they are intended to punish. The defendant's offense is embodied by the false return he chose to file. Yet, under Options 1 or 3, the defendant would be sentenced as if he had filed an accurate tax return.

Finally, a sentencing hearing is not an appropriate forum for determining the precise amount of tax liability and items properly reported on a tax return. These are matters typically determined during administrative proceedings of the Internal Revenue Service that are sometimes subject to civil litigation.

I appreciate your consideration of these comments and respectfully urge you to adopt Option 2 and reject Options 1 and 3.

Sincerely,



Steven T. Miller  
Acting Commissioner

Enclosure



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

CHIEF  
CRIMINAL INVESTIGATION

March 8, 2013

MEMORANDUM FOR STEVEN T. MILLER  
ACTING COMMISSIONER

FROM: Richard Weber  
Chief, Criminal Investigation

SUBJECT: Proposed Amendment 4 To U.S. Sentencing Guidelines

This memorandum describes our concerns regarding Proposed Amendment 4 of the Sentencing Commission's Proposed 2013 Amendments to the Federal Sentencing Guidelines ("USSG"). Proposed Amendment 4 would address the current circuit conflict over whether the determination of tax loss under USSG §2T1.1 should account for previously unclaimed deductions. The Proposed Amendment presents three options for resolving the conflict: Options 1 and 3 would allow defendants to introduce previously unclaimed credits, deductions or exemptions at sentencing, whereas Option 2 would not. Because we believe the application of either Option 1 or 3 could be seriously detrimental to our efforts to deter tax crimes, IRS-Criminal Investigation ("CI") opposes those options and supports Option 2.

As you know, the IRS mission to promote voluntary compliance requires meaningful punishment for those who willfully evade their tax obligations. For this reason, we are concerned that Options 1 and 3 would potentially allow convicted defendants to minimize the seriousness of their crimes for sentencing purposes. In practice, the adoption of either Option 1 or 3 would lead convicted tax evaders to introduce evidence in court, such as records of "under-the-table" cash payments to employees and vendors, to support the inclusion of previously unclaimed deductions and potentially reduce their exposure to prison time. Such a rule would not only reward a convicted defendant for his affirmative acts of concealing income from the IRS, but would drastically undermine CI's fundamental goal of deterrence.

As the Sentencing Commission noted in its Synopsis of Proposed Amendment 4, six circuits – the Fourth, Fifth, Seventh, Eighth,<sup>1</sup> Ninth, and Eleventh – have concluded

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<sup>1</sup> As a point of clarification, we note that the Eighth Circuit has addressed the issue but has not taken a firm position on whether a court may consider unclaimed deductions in determining tax loss. In *United States v. Blevins*, 542 F.3d 1200 (8th Cir. 2008), the court determined that it need not decide whether an unclaimed tax benefit might ever offset tax loss, as the unclaimed deductions at issue were wholly unrelated to the offense of conviction. The court stated that "[t]aking into account unclaimed tax benefits wholly unrelated to the offense of conviction is contrary to the plain meaning of the definition of tax loss in § 2T1.1(c)(1), 'the total amount of loss that was the

that a defendant cannot reduce the §2T1.1 tax loss with previously unclaimed deductions.<sup>2</sup> For the reasons discussed below, CI agrees with the majority position and strongly opposes Options 1 and 3 as set forth in Proposed Amendment 4.

**I. DETERMINATION OF TAX LOSS SHOULD NOT ACCOUNT FOR ANY UNCLAIMED CREDIT, DEDUCTION, OR EXEMPTION**

**A. The purpose of determining tax loss for sentencing is to measure the gravity of the offense, not to calculate the exact amount of the defendant's civil tax liability.**

The Guidelines indicate that the purpose of determining tax loss at sentencing is not to calculate an exact amount of tax due. As defined in USSG §2T1.1(c)(1), "tax loss" is the "total amount of loss that was the object of the offense (*i.e.*, the loss that would have resulted had the offense been successfully completed)." Thus, tax loss is tied to the offense committed, not to any actual tax due amount. As the Tenth Circuit stated, in *United States v. Spencer*, 178 F.3d 1365, 1368 (10th Cir. 1999): "in tax loss calculations under the sentencing guidelines, we are not computing an individual's tax liability as is done in a traditional audit. Rather, we are merely assessing the tax loss resulting from the manner in which the defendant chose to complete his income tax returns."

Unlike the amount of civil tax liability, the tax loss figure is a means of ensuring that "the sentence for a criminal tax case will be commensurate with the gravity of the offense[.]" USSG Ch.2, Pt.T, intro. comment. The Application Notes to USSG §2T1.1 make clear that, "[i]n some instances, such as when indirect methods of proof are used, the amount of the tax loss may be uncertain; the guidelines contemplate that the court will simply make a reasonable estimate [of tax loss] based on the available facts." USSG §2T1.1, comment. (n. 1).

The difference between criminal and civil tax cases is underscored by the fact that late payment of taxes due reduces civil tax liability but has no effect on a defendant's criminal liability. USSG 2T1.1(c)(5) specifically states that "tax loss is not reduced by any payment of the tax subsequent to the commission of the offense." This point is illustrated by the case of *United States v. Willingham*, 289 F.2d 283 (5th Cir. 1961). In *Willingham*, the defendant admitted to claiming fictitious deductions during tax years 1952 and 1953, but argued that he should nevertheless be acquitted because a loss carryback from 1955 eliminated the 1953 liability. The court held that, although the defendant was entitled to the loss carryback, he was not relieved from criminal liability. The court stated:

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object of the offense (*i.e.*, the loss that would have resulted had the offense been successfully completed)." 542 F.3d at 1203.

<sup>2</sup> Two other circuits – the Second and Tenth – have concluded that such unclaimed deductions may be considered where a defendant offers "convincing proof" to substantiate those deductions.

A taxpayer may not, with impunity, willfully make false deductions in an attempt to evade the 1953 tax, and which has the actual effect of reducing the tax imposed for that year, after taking into account all deductions that are then available, whether claimed or not, because fortuitously in 1955 a loss occurs, which for tax purposes can be carried back to wipe out the 1953 liability.

We think the crime is complete when with willful intent, a false and fraudulent return is filed for a year as to which, with all benefits arising out of events up to that time taken in his favor, there would still be a tax due by him but for the fraud.... Any adjustment that may be permissible resulting from subsequent losses does not prevent the fraud committed in 1953 from being an attempt to 'evade or defeat any tax imposed by this chapter.'

289 F.2d at 288. *See also United States v. Keltner*, 675 F.2d 602, 604 (4th Cir. 1982).

**B. Unreported income is often not fully accounted for in tax loss determinations at sentencing.**

The potential difference between a defendant's civil tax liability and the tax loss for sentencing purposes reflects in part the difficulty of determining the full amount of unreported income in criminal tax cases. The Background Commentary to USSG §2T1.1 recognizes this fact, noting that "[c]riminally derived income is generally difficult to establish, so that the tax loss in such cases will tend to be substantially understated." Even if not criminally derived, unreported income is typically concealed in some way. Granting unclaimed deductions to convicted defendants whose unreported income is not fully captured as a result of their criminal conduct would likely result in sentences that do not adequately reflect the seriousness of their crimes.

**C. Unclaimed deductions may constitute evidence of concealment.**

In many cases, a defendant's decision not to claim deductions is itself evidence of the defendant's concealment of income. *See, e.g., Clark v. United States*, 211 F.2d 100, 103 (8th Cir. 1954) ("Sometimes the failure to claim deductions in a return may well be part of the taxpayer's scheme to cover up his unreported income as a matter of not creating suspicion on the face of his return."). As discussed in more detail below, in our responses to the Issues for Comment, a business owner who underreports gross receipts and pays employees in cash "under the table" would likely choose not to deduct the cash payments, because doing so might reveal his unreported income. In that context, the failure to claim deductions is itself part of the criminal scheme. If the unclaimed deductions are inextricable from the tax crime for which the defendant was convicted, it would seem inappropriate to allow the defendant to reduce the tax loss at sentencing by claiming those same deductions.

**D. Allowing a defendant to introduce unclaimed deductions could turn sentencing into a full-scale civil tax audit.**

A sentencing hearing is not an appropriate forum for determining a precise amount of tax liability, which involves issues "normally determined in administrative proceedings

of the Internal Revenue Service, sometimes subject to civil litigation.” *United States v. Martinez-Rios*, 143 F.3d 662, 670 (2d Cir. 1998). Permitting a convicted defendant to raise previously unclaimed deductions at sentencing would likely increase the duration and complexity of sentencing hearings, potentially turning hearings into Tax Court-like proceedings.

Additionally, proper validation or substantiation of unclaimed deductions would likely be time-consuming, placing additional strain on judicial resources. As the Fourth Circuit stated, in *United States v. Delfino*, 510 F.3d 468, 473 (4th Cir. 2007), if a sentencing court were required to reconstruct a convicted defendant’s income tax return *post hoc*, “it would be forced to speculate as to what deductions they would have claimed and what deductions would have been allowed. This would place the court in a position of considering the many ‘hypothetical ways’ that [defendants] would have completed their tax returns.” See also *United States v. Chavin*, 316 F.3d 666, 678 (7th Cir. 2002); *United States v. Spencer*, 178 F.3d 1365, 1368 (10th Cir. 1999) (“Even though it is conceivable that close scrutiny of all employee tax returns over the full course of [the defendant’s] fraudulent scheme may have generated a more accurate tax loss computation, it would be unreasonable to impose such a burden on the government or the court....Requiring precise calculations which entail the gathering of documents that are diffuse and/or difficult to obtain would reward a defendant whose tax fraud was particularly complex and/or spanned a significant period of time”).

**E. Convicted defendants should not be able to reduce their tax loss after conviction.**

As noted above, the Sentencing Guidelines do not allow reduction of tax loss for any payment of tax subsequent to the commission of an offense. In the words of Chief Judge Briscoe, in her dissenting opinion in *United States v. Hoskins*: “Surely, if §2T1.1 tax loss cannot be reduced by the defendant’s subsequent payment of taxes, §2T1.1 tax loss cannot be reduced by unclaimed deductions proffered in an unfiled return after conviction.” 654 F.3d 1086, 1101 (10th Cir. 2011). To permit a convicted defendant to introduce previously unclaimed deductions would be to allow him or her to undo the crime, because “the unclaimed deductions were not ‘part of the manner in which the defendant chose to complete [her] tax returns.’” *Spencer*, 178 F.3d at 1368; see also *Chavin*, 316 F.3d at 678 (“[T]he defendants’ intention is embodied in the tax return that was filed with the IRS.”) *Id.* at 1102. As highlighted by Chief Judge Briscoe, allowing consideration of unclaimed deductions at sentencing yields a paradoxical result:

When affirming Hoskins’s conviction for tax evasion in violation of 26 U.S.C. § 7201, the majority concludes that Hoskins’s signature on the false return was the affirmative act of tax evasion for which “she cannot now escape criminal liability.” *Op.* at 1091. However, when reviewing the sentence imposed for this criminal act, the majority shifts gears and permits an after-the-fact “do over,” by concluding we should consider for sentencing purposes a hypothetical tax return that did not serve as the basis for her criminal conviction. The majority’s

new rule would allow a defendant to escape the full consequences of the return the defendant chose to file.

*Id.*; see also *United States v. Helmsley*, 941 F.2d 71, 85 (2d Cir. 1991) (“Having selected a particular depreciation method – whether or not it was a method authorized under the law – Mrs. Helmsley was not free to recalculate her taxes by resorting to one of the four depreciation methods in [the accelerated cost recovery system] solely to defend an evasion charge”).

Allowing defendants to reduce tax loss at sentencing would also be at cross-purposes with the goal of USSG §2T1.1, which is, in part, “to somewhat increase average sentence length” for tax crimes.

**F. Restitution is not relevant to the determination of tax loss at sentencing.**

Restitution is a legal remedy available in criminal cases that requires a criminal defendant to pay money or render services to his or her victim in order to redress the harm inflicted as a result of the offense. A court may not order restitution as an independent element of the sentence for Title 26 offenses. See 18 U.S.C. §§ 3663(a)(1)(A); 3663A(c)(1). However, restitution may be ordered in Title 26 cases as a condition of probation or supervised release (see 18 U.S.C. §§ 3563(b)(2), 3583(d)); or pursuant to a plea agreement under 18 U.S.C. § 3663(a)(3).<sup>3</sup> Courts have long held that the United States and its governmental entities, including the IRS, qualify as victims for purposes of restitution under these statutes. See, e.g., *United States v. Tucker*, 217 F.3d 960, 962 (8th Cir. 2000).

The Firearms Excise Tax Improvement Act of 2010, Pub. L. 111-237, 124 STAT. 2497, amended certain provisions of the Internal Revenue Code, and directed the IRS to assess and collect criminal restitution ordered for “failure to pay any tax” in the same manner as if the ordered restitution were a tax. See 26 U.S.C. § 6201(a)(4).

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<sup>3</sup> Restitution may also be ordered when tax-related violations are charged under Title 18. Section 5E1.1 of the Guidelines addresses restitution. USSG §5E1.1(a)(1) requires that, in the case of an identifiable victim, the court shall enter a restitution order for the full amount of the victim’s loss, if such order is authorized under the pertinent statutes. Alternatively, a court is required to impose a term of probation or supervised release with a condition requiring restitution for the full amount of the victim’s loss, if the offense is not an offense for which restitution is authorized under 18 U.S.C. § 3663(a)(1) but otherwise meets the criteria for an order of restitution under that section. USSG §5E1.1(a)(2). Section 5E1.1(b) provides exceptions to the court’s obligation to impose restitution.

**i. The purpose of tax loss for sentencing differs from the purpose of restitution.**

As discussed above, the purpose of determining tax loss at sentencing is to measure the gravity of the offense. By contrast, the purpose of restitution in criminal tax cases is to repay the taxes owing to the IRS as a result of the crime. Just as the §2T1.1 tax loss amount may differ from the defendant's civil tax liability, so too may the tax loss differ from the amount of restitution. Moreover, such an outcome does not constitute an inconsistent result. See *United States v. Germosen*, 139 F.3d 120, 130 (2d Cir. 1998) (“[A]n amount-of-loss calculation for purposes of sentencing does not always equal such a calculation for restitution”).

The difference between tax loss for sentencing purposes and restitution is underscored by the fact that restitution, unlike tax loss for sentencing, may be reduced if a defendant pays his civil tax liability. Compare USSG §2T1.1(c)(5) (“The tax loss is not reduced by any payment of the tax subsequent to the commission of the offense.”), with *United States v. Jenkins*, 884 F.2d 433, 440 (9th Cir. 1989) (“If the district court on remand ‘judicially establishes’ the amount of tax loss, it then may order restitution up to that amount, *unless* either [of the defendants] have paid all or part of the tax liability” ) (emphasis in original).

**ii. The calculation of restitution is intended to be more precise than the calculation of tax loss for sentencing.**

Title 18 U.S.C. § 3664 provides detailed procedures for a court to use in determining the amount of loss for restitution purposes. In contrast to the determination of tax loss at sentencing, “Congress contemplated that a restitution order might require a district court to resolve complex questions regarding the amount of loss.” *United States v. Minneman*, 143 F.3d 274, 284 (7th Cir. 1998). For this reason, a court that seeks to impose restitution may refer any issue, including the amount of the loss, to a magistrate judge or special master for proposed findings of fact and recommendations as to disposition. 18 U.S.C. § 3664(d)(6). As noted in *Jenkins*, the statute also provides for the reduction of a restitution order based on any recovery by the victim from insurance or through civil proceedings. 18 U.S.C. § 6334(j).

That the restitution amount may differ from the tax loss amount used to determine base offense level for sentencing is illustrated in the *Minneman* case. There, the district court included unclaimed business deductions in calculating restitution but declined to consider those deductions when determining the base offense level. On appeal, the Seventh Circuit affirmed the sentences imposed by the district court, including the restitution order. See 143 F.3d at 285-86.



## II. RESPONSES TO ISSUES FOR COMMENT

### 1.A. Should a legitimate but unclaimed deduction be counted only if the defendant establishes that the deduction would have been claimed if an accurate return had been filed? If so, should this determination be a subjective one or an objective one?

We do not believe it would be appropriate to mitigate the gravity of a tax offense by considering what a defendant would have done if he or she had not committed the offense. As Chief Judge Briscoe stated in her dissenting opinion in *Hoskins*: “The fact that the defendant might have done things differently had she known she would be caught does not alter what she actually did, which was file a return without the deductions now proposed.” 654 F.3d at 1102. Further, requiring a sentencing court to consider “a hypothetical tax return that did not serve as the basis for [the defendant’s] criminal conviction” would allow “a defendant to escape the full consequences of the return the defendant chose to file.” *Id.* Such an exercise might even give the defendant a benefit not available to honest taxpayers, *i.e.*, the ability to amend a return after the statute of limitations had expired. See 26 U.S.C. § 6511(a) (“Claim for credit or refund of an overpayment of any tax ... shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, ... or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.”).

As to whether the determination of what the defendant would have done on an accurate return should be subjective or objective, we believe either approach would be problematic. An objective determination based on the actions of a “reasonable taxpayer in the defendant’s position” would put courts in the paradoxical position of sentencing convicted defendants based on the actions of a hypothetical innocent person. Further, courts would effectively be asked to engage in tax planning for criminal defendants.

The subjective approach – which would likely be based on the defendant’s testimony, contemporaneous documentation, or both – raises additional concerns. The defendant’s testimony presumably would always support the claiming of the deduction unless the defendant was unaware that a deduction was available.<sup>4</sup> Moreover, as discussed above, allowing legitimate but unclaimed deductions only if the defendant were able to substantiate them would encourage meticulous record-keeping by criminals and reward knowledge of the Internal Revenue Code and the Sentencing Guidelines. Arguably, such knowledgeable tax offenders are more clearly willful than less sophisticated criminals.<sup>5</sup>

<sup>4</sup> The possibility that a sophisticated defendant could take advantage of unclaimed deductions in determining tax loss, but a less sophisticated defendant could not, appears to contradict the Guidelines’ inclusion of an enhancement for sophisticated means under USSG §2T1.1(b)(2).

<sup>5</sup> We also note that the subjective/objective distinction may be complicated by the fact that most taxpayers use return preparers or computer software to complete their tax returns. See *Return Preparer Review*, IRS Publication 4832, December 2009, p. 1

**1.B. Should a legitimate but unclaimed deduction be counted only if it is related to the offense?**

Previously unclaimed deductions should not be counted regardless of whether they are related or unrelated to the offense.

Allowing unclaimed deductions that are related to the offense appears inconsistent with the Guidelines' goal of ensuring that sentences are "commensurate with the gravity of the offense." USSG Ch.2, Pt.T, intro. comment. As Chief Judge Briscoe observed in her dissent in *Hoskins*: "it might make more sense to permit unrelated deductions precisely because they are unrelated to the offense and, thus, not part of the tax evasion scheme to be addressed at sentencing." 654 F.3d at 1103.

However, as indicated by the cases cited in the Issues for Comment, including unclaimed deductions that are not related to the offense appears inconsistent with the Guidelines' definition of tax loss. See also *United States v. Blevins*, 542 F.3d 1200, 1203 (8th Cir. 2008) ("Taking into account unclaimed tax benefits wholly unrelated to the offense of conviction is contrary to the plain meaning of the definition of tax loss in §2T1.1(c)(1), 'the total amount of loss that was the object of the offense (*i.e.*, the loss that would have resulted had the offense been successfully completed).").

Finally, given that tax crimes often involve myriad types of conduct, determining whether an unclaimed deduction is related or unrelated to the offense may prove problematic and further complicate the sentencing process.

**1.C. Are there differences among the various types of tax offenses that would make it appropriate to have different rules on the use of unclaimed deductions? If so, what types of tax offenses warrant different rules, and what should those different rules be?**

Unclaimed deductions should not be considered in sentencing for any of the tax offenses to which USSG §2T1.1 applies. Moreover, creating different rules for different tax offenses would only add to the complexity of the sentencing process.

**Additionally, are there certain cases in which the legitimacy of the deductions, credits, or exemptions and the likelihood that the defendant would have claimed them had an accurate return been filed is evident by the nature of the crime?**

It is difficult to envision cases in which the legitimacy of deductions, credits, or exemptions and the likelihood the defendant would have claimed them had an accurate return been filed would be evident from the nature of the crime. Tax crimes, even when charged under the same statute, may take many different forms and involve an endless variety of factual scenarios. As a result, they do not lend

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("For 2007 and 2008, over 80 percent of all federal individual income tax returns were prepared by paid tax return preparers or by taxpayers using consumer tax preparation software.").

themselves to a general classification whereby the legitimacy of any unclaimed deductions would be readily apparent from the nature of the crime.

**For example, if a restaurant owner failed to report some gross receipts and made some payments to employees or vendors in cash, but actually keeps two sets of books (one accurate and one fraudulent), should the unclaimed deductions reflected in the accurate set of books be counted?**

The unclaimed deductions reflected in a double set of books should not be counted for sentencing purposes, because doing so would potentially reward affirmative acts of concealment.

It is well-established that keeping two sets of books may constitute an affirmative act of concealing income from the IRS. See *United States v. Gross*, 626 F.3d 289, 297 (6th Cir. 2010) (“the types of actions that qualify as ‘affirmative’ acts of tax evasion” include “keeping a double set of books”); *United States v. Miller*, 588 F.3d 897, 907 (5th Cir. 2009) (“Affirmative acts ... [of tax evasion] may include keeping double sets of books”); *Spies v. United States*, 317 U.S. 492, 499 (1943) (“we would think affirmative willful attempt [to evade tax] may be inferred from conduct such as *keeping a double set of books*, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal.”) (emphasis added).

Similarly, undisclosed cash payments to employees or vendors may be affirmative acts of concealment for purposes of supporting a tax evasion charge. See *United States v. Farr*, 701 F.3d 1274, 1282-83 (10th Cir. 2012) (testimony that defendant paid employees in cash “was relevant for purposes of establishing that [defendant] intended to evade payment of the quarterly employment taxes and resulting trust fund recovery penalty, and that she willfully committed an affirmative act, i.e., concealment of her financial assets, in furtherance of that intent.”); *United States v. Valenti*, 121 F.3d 327, 333 (7th Cir. 1997) (“When done with the intent to evade, the extensive use of cash can be an affirmative act ... Valenti's extensive use of cash was not innocuous; rather, it was an integral part of his plans to avoid paying taxes. ... Valenti paid his employees in cash and deliberately did not report their wages to the IRS ... [W]e hold the evidence was clearly sufficient to establish that Valenti committed an affirmative act constituting an evasion or attempted evasion of tax.”); see also *United States v. Daniel*, 956 F.2d 540 (6th Cir. 1992).<sup>6</sup>

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<sup>6</sup> In addition to keeping a double set of books and paying employees or vendors in cash, we note that the restaurant owner in this example would likely also have made false statements to his return preparer, another affirmative act of concealment. See, e.g., *United States v. Bishop*, 264 F.3d 535, 552 (5th Cir. 2001) (affirmative acts of evasion evidenced by defendant providing inaccurate and misleading information to his return preparers).

Under these circumstances, admitting evidence of cash payments and/or a double set of books to support the inclusion of previously unclaimed deductions would allow a defendant at sentencing to benefit from an element of his crime.

Another reason why sentencing courts should not consider previously unclaimed deductions based on a second set of books is that doing so would provide a benefit for defendants who waited until sentencing to expose previously unknown criminal conduct. Had the government been aware of the cash payments and double set of books at the time of indictment, the prosecution might have included numerous other violations.<sup>7</sup> As an example, additional charges against the defendant could be based on the submission of false Employer's Quarterly Federal Tax Returns (Forms 941) to the IRS, as well as on the issuance of false Wage and Tax Statements (Forms W-2) to employees. Moreover, the defendant's cash payments might have facilitated underreporting by the employees or vendors. Possible uncharged violations could include tax evasion (26 U.S.C. § 7201); false returns (26 U.S.C. § 7206); conspiracy (18 U.S.C. § 371); and state tax crimes. Allowing the defendant to mitigate the gravity of the offense without simultaneously addressing these potential uncharged violations could provide a windfall to the defendant and undermine the goal of deterrence.

We further note that a defendant who *failed* to keep a double set of books would likely be unable to provide records of previously unclaimed deductions. Thus, two similarly-situated defendants could receive disparate treatment based solely on their record-keeping practices. The tax evader with adequate records of "under-the-table" payments of cash to employees and/or vendors would be treated less severely than the tax evader without such records. Such a rule could have the unintended consequence of encouraging careful, meticulous tax evasion.

**2. Should the Commission expand the language to clarify that the list of "credits, deductions, or exemptions" includes any type of deduction?**

If the Commission were to adopt Option 2, we suggest they clarify that the determination of tax loss should be based on the defendant's actions at the time of the offense and should not account for any hypothetical actions that might have been taken had the offense not been committed.

### **III. CONCLUSION**

For the reasons stated above, CI concurs with the position articulated by the majority of circuit courts and supports the addition of Option 2 to USSG §2T1.1, which would not allow for the determination of tax loss at sentencing to account for any credit, deduction, or exemption not claimed at the time the offense was committed. We strongly oppose both Options 1 and 3.

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<sup>7</sup> We note that this situation may also raise potential Fifth Amendment issues, if the statute of limitations on the previously unknown criminal conduct has not run.