U.S. Department of Justice

Tax Division

Office of the Assistant Attorney General

Washington, D.C. 20530

March 8, 2013

The Honorable Patti B. Saris, Chair
United States Sentencing Commission
One Columbus Circle, NW
Suite 2-500, South Lobby
Washington, DC 2002-8002

Dear Judge Saris:

On behalf of the Department of Justice, the Tax Division submits the following comments on Proposed Amendment 4 to the Commentary to § 2T1.1 of the United States Sentencing Guidelines, which was published in the Federal Register on January 18, 2013, along with several other proposed amendments. The Department will comment separately on the other proposed amendments.

Proposed Amendment 4 sets forth three options for consideration. The Tax Division urges the Commission to adopt Option 2, and to reject Option 1 and Option 3.

The current definition of "tax loss" has been part of the Guidelines for twenty years. Option 2 adopts the position of the majority of the Circuit Courts in rejecting the contention that unclaimed deductions may be considered in determining tax loss. Options 1 and 3, which take different approaches to allowing unclaimed deductions, do not reflect the position of any of the Circuit courts that have addressed this issue.

"Tax loss" under the Guidelines is distinct from a tax deficiency in a civil tax case or an order of restitution. Tax loss, by definition, should address the entirety of the harm intended by the defendant, including for example the harm caused by concealment through omitting certain deductions. It is only through civil enforcement that the government should be charged with determining the correct tax liability, and restitution serves merely as an aid in the collection of that liability.

The Tax Division, along with the sentencing courts, has extensive experience in considering claims concerning uncharged expenses in Guidelines calculations. As demonstrated by several examples included below, any attempt to determine whether and when to allow a deduction that the defendant did not report on an original tax return will require inappropriate speculation, and may implicate complex tax issues and result in unjust anomalies. At a minimum, it will turn routine sentencing hearings into tax mini-trials. Further, in civil tax enforcement, the taxpayer bears the burden of claiming and substantiating deductions, and the IRS's determinations are accorded a presumption of correctness – fundamental principles that are

not incorporated into Options 1 or 3. Either of these proposed amendments runs the risk of giving convicted tax evaders advantages over taxpayers with honest disputes with the IRS.

As explained more fully below, Option 2 is grounded in the Guideline's purpose of measuring harm by tax loss, is consistent with fundamental tax enforcement, and best serves justice and judicial economy.

I. Background

A. Proposed Amendment 4

The synopsis of Proposed Amendment 4 states that it is addressed to "a circuit conflict over whether a sentencing court, in calculating the tax loss in a tax case, may subtract the unclaimed deductions that the defendant legitimately could have claimed if he or she had filed an accurate return." The proposal frames the issue as "whether a defendant is allowed to present evidence of unclaimed deductions that would have the effect of reducing the tax loss for purposes of the guidelines and thereby reducing the ultimate sentence, or whether the defendant is categorically barred from offering such evidence." Three options for resolving this apparent conflict, along with two related issues, are set forth for comment.

- Option 1 provides: "The determination of the tax loss shall account for any credit, deduction, or exemption to which the defendant was entitled, whether or not the defendant claimed the deduction at the time the tax offense was committed."

Option 1, which categorically mandates the allowance of all unclaimed deductions that could have been claimed on an honest return, is not the law in any circuit.

- 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."

As the Commission recognizes, Option 2 is the majority view and reflects the law in six of the eight circuit courts of appeal that have considered the issue. *See United States v. Chavin*, 316 F.3d 666 (7th Cir. 2002); *United States v. Phelps*, 478 F.3d 680 (5th Cir. 2007); *United States v. Delfino*, 510 F.3d 468 (4th Cir. 2007); *United States v. Blevins*, 542 F.3d 1200 (8th Cir. 2008); *United States v. Clarke*, 562 F.3d 1158 (11th Cir. 2009); *United States v. Yip*, 592 F.3d 1035 (9th Cir. 2010).

- Option 3 provides: "The determination of the tax loss shall not account for any unclaimed credit, deduction, or exemption, unless the defendant demonstrates by contemporaneous documentation that the defendant was entitled to the credit, deduction, or exemption."

Option 3 resembles, but is different from, the approaches adopted by the Second and Tenth Circuits. *See United States v. Gordon*, 291 F.3d 181, 187 (2d Cir. 2002) ("Gordon, however, bears the full burden of proof in establishing the appropriateness of consideration of

such an unclaimed deduction."); *United States v. Hoskins*, 654 F.3d 1086, 1094 & n.9 (10th Cir. 2011) ("nothing in the Guidelines *requires* a sentencing court to engage in the 'nebulous and potentially complex exercise of speculating about unclaimed deductions'") (emphasis in original; citation omitted).

B. The History of "Tax Loss" Under the Guidelines

The conflict regarding unclaimed deductions arose after § 2T1.1 was amended in 1993. The prior version defined "tax loss" as "the greater of (1) the total amount of tax that the taxpayer evaded or attempted to evade or (2) 28% of the amount by which the greater of gross income and taxable income was understated"; a comment explained that alternative (2) "should make irrelevant the issue of whether the taxpayer was entitled to offsetting adjustments that he failed to claim." U.S.S.G. § 2T1.1 & cmt. n. 4 (1992). The 1993 amendment deleted this comment, leading the Second Circuit to suggest in dicta that § 2T1.1 no longer precluded using legitimate unclaimed deductions to offset a tax loss. *United States v. Martinez–Rios,* 143 F.3d 662, 670–671 (2d Cir. 1998). The Seventh Circuit disagreed, concluding that the comment was deleted "because the new tax-loss definition specifically excludes consideration of unclaimed deductions on its face by defining tax loss as the 'object of the offense.'" *Chavin*, 316 F.3d at 678. *See* also *Blevins*, 542 F.3d at 1203 (discussing the amendment and subsequent case law).

Currently, § 2T1.1(c) (1) defines tax loss as "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)." Addressing different factual patterns, the Notes to § 2T1.1 provide for the use of default calculations – *e.g.*, 28% of an individual's unreported gross income –"unless a more accurate determination of the tax loss can be made." The Guidelines thus provide for the use of a default calculation unless the loss that would have resulted had the offense been successfully completed can be determined with more accuracy than the loss number produced by the default calculation. Neither the default calculation nor the "more accurate determination" provision purports to define tax loss with reference to a perfect and honest tax return that was never filed and was never intended to be filed. Rather, the sentencing court is charged with making a reasonable estimate of the harm that was intended to result from the criminal offense. As the majority of circuits have held, the best evidence of the object of the offense is what the defendant actually did, without claiming theoretical deductions for the first time at sentencing. *See, e.g., Chavin*, 316 F.3d at 678 ("the defendant's intention is embodied in the tax return").

II. Overview of the "Tax Loss" Determination

The concept of "tax loss" as defined in § 2T1.1 serves to advise the district court of an appropriate range within which to sentence a defendant convicted of a criminal tax offense. Contrary to the apparent presumption of Options 1 and 3, criminal tax loss cannot be equated with a defendant's civil tax liability. If district courts are required by the Sentencing Guidelines to account for unclaimed deductions, as Options 1 and 3 mandate, the unintended consequences would include sentencing hearings that rival IRS tax examinations in technical complexity, and Guidelines ranges that fail to reflect the "total amount of loss that was the object of the offense."

A. Consideration of Unclaimed Deductions Would Unjustifiably Expand Sentencing Inquiries

The Tax Division's concerns with the options that mandate the allowance of unclaimed deductions in sentencing are not theoretical, but grounded in litigation experience. For example:

- In *United States v. Helmsley*, 941 F.2d 71 (2d Cir. 1991), the taxpayer attempted to eliminate her tax deficiency by retroactively changing the method of depreciation that she elected when she filed her returns. In that case (which predated the 1993 tax Guidelines amendments), the Second Circuit rejected the taxpayer's revisionism, observing that taxpayers with complicated returns should not be permitted, when caught committing evasion, to manipulate subsequent events in an attempt to cancel an existing tax deficiency. *Id.* at 86-87. Options 1 and 3, however, would allow convicted defendants to engage in such strategic, after-the-fact elections and characterizations at sentencing.

- In *United States v. Blevins*, 542 F.3d 1200 (8th Cir. 2008), the defendant, a tax preparer, filed federal income tax returns for his "investors" that falsely claimed Schedule C business losses, Schedule E rental losses, and Form 4797 losses from the sale of business property. At sentencing, the government calculated the tax loss by aggregating the amount of underpaid income tax determined by an IRS examination of each fraudulent return. Blevins attempted to counter with an expert report that claimed that each investor suffered "a total loss" and that these "appear to be capital losses." Based on the assumption that each investor would use these losses to offset ordinary income each year until the losses were exhausted, Blevins argued that the total of these purported capital loss deductions should reduce the total loss figure. The court avoided this speculative technical tax argument by finding that the supposed capital losses were not related to the object of the offense.

- In *United States v. Safiedine* (E.D. Mich.), *appeal pending*, No. 12-2453 (6th Cir.), a recent case within the jurisdiction of the Sixth Circuit – which has yet to adopt either the majority or the minority rule – the defendant was found guilty of conspiring to defraud the United States by concealing from the IRS income payments made to one of the defendant's several businesses. At sentencing, the government proposed a calculation of tax loss based upon the presumptive formula, which on the facts resulted in a tax loss figure of $193,200, with a corresponding advisory sentencing range of 27-33 months. The defendant's expert contended that the income earned should be "offset by deductible business expenses, depreciation, and leasehold improvement amortization," none of which had been previously claimed. The defendant's expert further opined that the income and expenses should be reallocated among business entities, in disregard of the corporate forms that the defendant chose. Using this approach, the defendant asserted that the tax loss was $2,000, with a corresponding advisory guidelines range of 6-12 months. The trial court rejected the defendant's

contentions, holding that a sentence should be based on what the defendant did, rather than on what he might have done.

The Tax Division's concerns about making criminal sentencings more like civil tax proceedings are also informed by experience with the civil tax proceedings that have followed criminal sentencings. For example:

- In *Williams v. Commissioner*, 2012 WL 6014572 (4th Cir. Dec. 4, 2012), Williams had pleaded guilty to evading income tax over an eight-year period in connection with a secret Swiss bank account. On appeal to the Fourth Circuit from the Tax Court, Williams argued that the Tax Court had erred in limiting charitable contribution deductions to his tax basis in certain donated art, rather than allowing deductions for the art's higher fair market value. The Fourth Circuit, in sustaining the Tax Court's decision, reviewed state law to determine whether options to buy the art constituted a contract for sale that triggered the holding period required for long-term capital gain, ultimately holding that the holding period had not been satisfied and that the charitable deductions thus were limited to basis. If the Sentencing Guidelines had required consideration of unclaimed deductions in determining intended tax loss, then the sentencing court in the criminal case would have been required to engage in the technical analysis of the charitable deduction claim, including the state law inquiry.

- In *Plotkin v. Commissioner*, 2012 WL 5907440 (11th Cir. Nov. 27, 2012), Plotkin had been convicted following a bench trial of filing false returns that failed to report income that he had diverted from a nursing home owned through a complex group of related entities. In the subsequent appeal of his Tax Court case, Plotkin argued that because, in the criminal case, the district court had found an entity in the chain of ownership to be a sham, the Tax Court should have imputed a partnership interest owned by that entity directly to him, thereby reducing the impact of his diversions by the imputed basis. The Eleventh Circuit sustained the Tax Court's conclusion that Plotkin was not a partner and held that the tax was not reduced by basis. If the Sentencing Guidelines had required consideration of unclaimed deductions in determining intended tax loss (even if limited to those "related to the offense"), then the sentencing court in the criminal case would have been required to analyze the partnership basis claim.

Even more challenging tax issues can be anticipated if the majority rule is rejected and Sentencing Guidelines are amended to require consideration of unclaimed deductions. For example, where the tax loss includes state taxes, *see United States v. Powell*, 124 F.3d 655, 663 (5th Cir. 1997), the sentencing court would be required to account for deductions that could have been claimed on a state return. Further, Option 1 and Option 3 would increase the likelihood that novel tax issues (for instance, regarding the deductibility of expenses arising from the operation of an illegal business) would be decided as matters of first impression at sentencing hearings in criminal cases. The resulting increased complexity of sentencing hearings would not be justified by an improved calculation of tax loss, because defendants simply would be allowed to further

reduce – as explained *infra* – the government's already-conservative estimate of the provable tax loss.

B. Consideration of Unclaimed Deductions at Sentencing Hearings Would Upend Fundamental Principles of Civil Tax Enforcement

1. Overview of Key Civil Tax Enforcement Principles

In the first instance, a taxpayer's civil income tax liability is self-assessed; that is, the taxpayer files an income tax return reporting the tax the taxpayer calculates as due and owing based on the taxable income for the period (usually a calendar year). The taxable income is the gross income shown on the return less the deductions claimed by the taxpayer. In most cases, the taxpayer pays (by withholding credits or estimated payments) the tax calculated by the taxpayer and that is the end of the matter.

When a deduction is disputed, the burden of claiming the deduction in the first instance, and the ultimate burden of proof as to the appropriateness of the deduction, is on the taxpayer. In the argot of the tax practitioner, deductions are a matter of legislative grace. It is the taxpayer's job to prove entitlement. *See INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992) (noting the "'familiar rule' that 'an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer' " (quoting *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593 (1943))); Tax Court Rule 142(a)(1) (stating that, with certain exceptions, the "burden of proof shall be upon the petitioner.").

A key aspect of the taxpayer's burden is substantiation: does the taxpayer have credible proof (most often, documentation; other times, testimony) that the claimed expense was incurred? It is the taxpayer who must come forward with the evidence to support deductions.

The IRS is not foreclosed from questioning the credibility of the taxpayer's assertions. Indeed, the IRS has tools by which to probe the veracity and accuracy of the taxpayer's assertions. It may, for example, issue an information document request to the taxpayer for supporting documentation. The IRS may additionally initiate a more formal civil examination, which can include administrative summonses to the taxpayer and third parties for relevant records or testimony. Barring agreement between the IRS and the taxpayer, the taxpayer has various administrative appeal or alternative resolution options.

The taxpayer may ultimately litigate a disagreement, either by filing a Tax Court petition or by paying the disputed liability and filing a refund action in federal court. In either setting, it is significant to note that the IRS's proposed assessment is presumed correct and the taxpayer has the burden of proving otherwise by a preponderance of evidence. Where deductions are at issue, the taxpayer has both the burden of production and the burden of proof.

2. Criminal Tax Cases

A criminal tax case has far more in common with any other criminal case than it does a civil tax case. Most notably, of course, it is the government, not the taxpayer, that has the burden

of proof, and is held to the standard of beyond a reasonable doubt at trial and by a preponderance of the evidence at sentencing. By constitutional right, a defendant taxpayer need not, and often does not, produce evidence at trial. There is nothing in a criminal case analogous to the IRS's ability to seek testimony and documents from a taxpayer in a civil examination. Rather, a defendant taxpayer has the right to refuse to answer incriminating questions during a criminal investigation and to refrain from testifying during a criminal trial. *See, e.g., Kosinski v. Commissioner*, 541 F.3d 671, 677-678 (6th Cir. 2008) (citing the substantial differences between a criminal sentencing and a civil tax proceeding in denying issue preclusion as to tax loss).

In most criminal tax cases the government must establish that the defendant acted "willfully," the highest level of scienter known to the law. These differences have two consequences of note. First, the willfulness standard, in conjunction with proof beyond a reasonable doubt, cautions the prosecutor against overstating the case against the defendant. The government must prove what the government charges. In most cases, as a result of this heightened standard, the amount of the deficiency proven by the government in a prosecution will be less than the amount of the deficiency that may be established in a civil proceeding.

Second, as a corollary to the above, a criminal trial, unlike a civil trial, does not (indeed, cannot) establish the full extent of a defendant's tax liability. Criminal investigative resources are directed towards acquiring admissible evidence of a provable crime. A judgment of conviction simply is not a civil tax judgment. Nonetheless, the amount of tax lost to the government obviously has relevance to fitting the punishment to the crime. The problem is acute when there is neither time nor process available to the government between conviction and sentencing that would allow the government to establish the defendant's true tax liability. Consequently, the government's estimate of tax loss under current practice already is a conservative one.

In sum, the differences between civil tax examinations and criminal proceedings demonstrate the flaws in attempting to reduce tax loss by unclaimed deductions. Foremost, to do so runs counter to the presumption of correctness accorded to the government in civil tax administration and to the principle that the taxpayer has the burden, in the first instance, of claiming the deductions, and the subsequent burden of substantiating the deductions. These basic tenets are further undercut by rules that hamstring the government's ability to obtain discovery and to evaluate the claimed deductions.

III. Comments with Respect to Particular Options

If the Commission decides to resolve the circuit conflict this amendment cycle, we strongly urge the Commission to adopt Option 2 as the approach that is most faithful to the concept of intended tax loss, the most reflective of the defendant's culpability, and the most practicable proposal for estimating the harm that was the object of a criminal tax offense. Options 1 and 3, conversely, would produce Guidelines sentences that fail to reflect the seriousness of the offense or to afford adequate deterrence, and would result in unwarranted disparities, both among different defendants and between criminal defendants and honest taxpayers.

A. Option 1

It bears repeating that Option 1, which categorically mandates the allowance of all unclaimed deductions that could have been claimed on an honest return, is not the law in any circuit. This alone calls its wisdom into question. But Option 1 has many other infirmities.

Option 1 would benefit defendants whose failure to claim "legitimate" deductions was intended to facilitate concealment of the crime. For example, a defendant who operates an off-the-books business can be expected to forego claiming deductions as part of an effort to keep the business hidden. *See, e.g., Blevins*, 542 F.3d at 1203. In the example provided in the Issues for Comment, a restaurant owner who willfully underreports gross receipts keeps a second set of books substantiating cash payments to employees and vendors but purposefully refrains from claiming those "legitimate" expenses as deductions on the return. In a fair analysis, the defendant's decision to forgo claiming a deduction should be viewed as an act of concealment and part of the "object of the offense." Option 1, however, allows the unclaimed deductions to reduce the intended tax loss. This result would not be lessened by allowing an unclaimed deduction "only if it is related to the offense" (*see* Issue for Comment 1. (B)), because it is the very deductions that are "related" to the omitted income that are foregone to further the concealment.

Further, the payments underlying unclaimed deductions often result in additional tax loss. In the example of a restaurant owner who uses unreported income to make cash payments to employees, the tax crimes are routinely compounded by the defendant's failure to pay employment taxes and the employees' failure to report the cash payments as income. To mandate that a defendant get the benefit of a wage expense that is first claimed at sentencing, when the full extent of the associated tax losses are unknown, would result in a Guidelines "tax loss" that potentially far understates the seriousness of the offense.

Option 1 also presents a real risk of turning sentencing hearings into a battle of tax experts. As illustrated in the *Safiedine* case, discussed *supra*, that risk is not merely theoretical in the courts not yet governed by the majority rule.

Counting an unclaimed deduction "only if the defendant establishes that the deduction would have been claimed if an accurate return had been filed" (*see* Issues for Comment 1.(A)), not only would continue to benefit defendants who concealed their crime by not claiming deductions, but also would introduce a considerable amount of judicial speculation. As examples, the types of issues a sentencing court could be asked to discern include: what kind of tax return(s) a defendant would have filed absent an attempt to hide income from the IRS; what credits or deductions a serial non-filer would have elected had a return been filed; what filing status a non-filer would have claimed; what method of accounting a defendant would have used; how a defendant would have organized his or her business had the business been conducted with the goal of legitimate tax-minimization; what depreciation method a defendant would have chosen; and myriad more.

Often, there simply are not clear answers to these kinds of questions. Particularly in more complex scenarios, there is seldom consensus as to what an "efficient," law-abiding

taxpayer in the defendant's shoes would have done. And again, even if it were possible, with the benefit of years of hindsight, to reconstruct a "perfect" tax return, this would not necessarily be probative of what the taxpayer would have done *ex ante* – a question that may be unanswerable in the context of a taxpayer who acted with the willful intent to evade taxes. *See Helmsley*, *supra*. Option 1, however, would not only allow but virtually mandate such after-the-fact revisions.

Moreover, Option 1 could, perversely, result in a convicted tax criminal receiving the benefit of deductions an honest taxpayer could not claim in a civil tax proceeding. The statute of limitations for most tax crimes is six years, *see* 26 U.S.C. § 6531, and that statute is often triggered by the filing of a late tax return. *See United States v.* Habig, 390 U.S. 222, 223 (1968). A sentencing hearing may, as a result, take place many years after the fraudulent return was filed. By contrast, an honest taxpayer with a civil dispute must bring a claim for credit or refund within the later of three years from the filing of a return or two years from payment. 26 U.S.C. § 6511(a); *see United States v. Brockcamp*, 519 U.S. 347, 352 (1997) (declining to read an "equitable tolling" provision into § 6511, as this "could create serious administrative problems by forcing the IRS to respond to, and perhaps litigate, large numbers of late claims").

For the above reasons, the majority of courts have concluded that justice and judicial economy are ill-served by placing trial courts "in the position of considering the many 'hypothetical ways' that [defendants] could have completed their tax returns." *Delfino*, 510 F.3d at 473 (*quoting Chavin*, 316 F.3d at 678). Sharing these concerns, the Tax Division strongly urges the Commission to reject Option 1.

B. Option 2

Option 2 precludes a defendant from asserting entitlement to unclaimed deductions at sentencing in an attempt to reduce the tax loss figure used for computing the Sentencing Guidelines range, essentially adopting the majority view and providing for "assess[ment of] tax loss resulting from the manner in which the defendant chose to complete his income tax returns." *Delfino*, 510 F.3d at 473 (citing *United States v. Spencer*, 178 F.3d 1365, 1368 (10th Cir. 1999)). The Tax Division believes that this is the approach most faithful to the concept of intended tax loss and most reflective of the defendant's culpability. Option 2 also avoids the procedural quagmires of the other options, and is the most workable solution.

It is important, in this context, to consider the distinction between tax loss under the Sentencing Guidelines, and actual loss in the context of either restitution or a deficiency determination. When restitution is to be ordered, a sentencing court must consider unclaimed deductions to prevent a windfall to the government. But the computation of restitution and the computation of Sentencing Guidelines tax loss serve different purposes. Tax loss under the Sentencing Guidelines is intended to be an estimate of the "the total amount of loss that was the object of the offense." Restitution, in contrast, "serves both punitive purposes and compensatory" purposes. *United States v. Fumo*, 655 F.3d 288, 320 (3d Cir. 2011). It is not uncommon for the two figures to be different. *See United States v. Psihos*, 683 F.3d 777, 782 (7th Cir. 2012) ("Psihos is correct that the 'intended loss' for guideline purposes is broader than

the loss for purposes of restitution; a restitution order, unlike a calculation of loss under the guidelines, must be based on the amount of the loss actually caused by the defendant.")

The IRS's relatively new authority to assess restitution under 26 U.S.C. §6201(a) (4) does not change the analysis. Prior to the enactment of § 6201(a) (4), restitution payable to the IRS was collected by the Financial Litigation Units ("FLU") of U.S. Attorney's Offices. Because restitution was not assessable by the IRS, the IRS could not use its administrative tools to collect restitution; instead, the IRS would separately assess and collect the tax, crediting the tax debt for any restitution collected by the FLU. By allowing the IRS to assess and collect restitution, § 6201(a) (4) merely substitutes the IRS in place of the FLU as the primary collector of restitution owed to the IRS.

Restitution has always been, and remains, ancillary to what a sentencing court does. A court must engage in a Guidelines computation prior to sentencing, 18 U.S.C. §3553(a)(4), but can defer a restitution hearing up to 90 days after sentencing if a complex issue arises. 18 U.S.C. § 3664(d) (5). It may also decline to order restitution where determining the amount of loss would unduly complicate or prolong the sentencing process. *See* 18 U.S.C. § 3663A(c)(3)(B) (leaving tax assessment disputes to the administrative and civil mechanisms that are specially designed to resolve them). And in any case, a restitution order is not a final determination of a tax liability. The IRS retains the ability to conduct an examination and to determine a different tax deficiency. It is common that restitution orders impose a liability that is below the amount of tax that is ultimately determined to be due by the IRS.

C. Option 3

By proposing consideration of unclaimed deductions that a defendant "demonstrates by contemporaneous documentation," Option 3 apparently seeks to limit a sentencing court's inquiry to situations in which the unclaimed deductions would be less speculative than might be the case under Option 1. But Option 3 suffers from many of the same infirmities as Option 1.

Under Option 3, the Guidelines calculation would, like Option 1, fail to determine tax loss as "the total amount of loss that was the object of the offense." Option 3, like Option 1, would benefit defendants whose failure to claim "legitimate" deductions was purposeful and intended to facilitate concealment of the crime. In fact, it would create an unwarranted disparity between a defendant whose crime includes creating two sets of books, one accurate and one false, and a defendant who kept no records, by according the more sophisticated and arguably more culpable defendant the benefit of a lower Guidelines range. Option 3, moreover, would provide substantial incentive for falsification, forgery, and backdating.

Indeed, Option 3 is particularly prone to abuse. Unlike Options 1 and 2, it is not limited to deductions to which the defendant was entitled "at the time the tax offense was committed." This would resurrect the "lucky loser" effect, for example, by enabling a defendant to reduce or eliminate the tax loss for the prosecution year by carrying back a net operating loss – the quintessential example of a deduction that was not available "at the time the tax offense was committed" – incurred in a subsequent year. The argument that a defendant should benefit from a net operating loss carryback has been rejected both in the context of the deficiency element

required to prove tax evasion and in the context of sentencing, *see, e.g., Willingham v. United States*, 289 F.2d 283, 288 (5th Cir. 1961) (conviction); *United States v. Wick*, 34 Fed. Appx. 273, 278-279 (9th Cir. 2003) (sentencing), and should not now be countenanced.

Finally, Option 3 could be read as eliminating the judicial discretion permitted even under the minority view. *See United States v. Hoskins*, 654 F.3d 1086, 1094 & n.9 (10th Cir. 2011) ("nothing in the Guidelines requires a sentencing court to engage in the "nebulous and potentially complex exercise of speculating about unclaimed deductions," but they also do not categorically prohibit a district court from considering unclaimed deductions). Disagreements as to whether an unclaimed deduction is one to which a defendant would have been "entitled" will no doubt increase the number of sentencing appeals based upon alleged procedural error. That is an especially bad trade-off in a sentencing regime that permits a sentencing court, in its discretion, to grant a variance from the Guidelines range when the sentencing range overstates the severity of the offense.

IV. Conclusion

In sum, the Tax Division submits that the majority position, as set out in Option 2, currently best reflects these principles, meets the goal of the Sentencing Guidelines of deterrence and of punishment that is based on the tax loss that is the object of the offense, and accords both justice and judicial economy.

We thank you for the opportunity to provide these comments.

Very truly yours,

KATHRYN KENEALLY
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