

PROPOSED AMENDMENT: COMPUTING TAX LOSS UNDER §2T1.1

Synopsis of Proposed Amendment: *This proposed amendment addresses a circuit conflict regarding how tax loss under §2T1.1 (Tax Evasion) is computed for cases that involve a defendant's under-reporting of income on both individual and corporate tax returns. Such a case often arises when (1) the defendant fails to report, and pay corporate income taxes on, income earned by the corporation, (2) diverts that unreported corporate income for the defendant's personal use, and (3) fails to report, and pay personal income taxes on, that income. The proposed amendment clarifies that the amount of the tax loss is the aggregate amount of federal income tax that would have been due by both the corporation and the individual defendant.*

More specifically, the circuits are split on which methodology should be used to calculate tax loss in these cases. Two circuits use a sequential calculation method the aggregate tax loss. Under this method, the court determines the corporate federal income tax that would have been due, subtracts that amount from the amount diverted to the defendant personally, then determines the personal federal income tax that would have been due on the reduced diverted amount. See United States v. Harvey, 996 F.2d 919 (7th Cir. 1993); United States v. Martinez-Rios, 143 F.3d 662 (2d Cir. 1998). In contrast, one circuit holds that the court should determine the aggregate tax loss by adding the corporate federal income tax that would have been due on the total amount of unreported income and the personal federal income tax that would have been due on that total amount. See United States v. Cseplo, 42 F.3d 36 (6th Cir. 1994).

The amendment adopts the Harvey approach, clarifying the existing rule in Application Note 7 of §2T1.1 that "if the offense involves both individual and corporate tax returns, the tax loss is the aggregate tax loss from the offenses taken together".

The amendment also clarifies that the loss in §2T1.1 refers to federal, and not state and local, tax loss. The alternative interpretation of this provision would greatly complicate the guideline because of the multitude of state and local tax rates and provisions.

The amendment also adds an application note to §2T1.1 clarifying that a tax evasion count and a count charging the offense that provided the income on which tax was evaded are grouped together under §3D1.2(c). This application note is consistent with the longstanding view of the staff as to how such counts should be treated for grouping purposes.

Proposed Amendment:

§2T1.1. Tax Evasion; Willful Failure to File Return, Supply Information, or Pay Tax; Fraudulent or False Returns, Statements, or Other Documents

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(c) Special Instructions

For the purposes of this guideline --

- (1) If the offense involved tax evasion or a fraudulent or false return, statement, or other document, the 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).

Notes:

(A) If the offense involved filing a tax return in which gross income was underreported, the tax loss shall be treated as equal to 28% of the unreported gross income (34% if the taxpayer is a corporation) plus 100% of any false credits claimed against tax, unless a more accurate determination of the tax loss can be made.

(B) If the offense involved improperly claiming a deduction or an exemption, the tax loss shall be treated as equal to 28% of the amount of the improperly claimed deduction or exemption (34% if the taxpayer is a corporation) plus 100% of any false credits claimed against tax, unless a more accurate determination of the tax loss can be made.

(C) If the offense involved improperly claiming a deduction to provide a basis for tax evasion in the future, the tax loss shall be treated as equal to 28% of the amount of the improperly claimed deduction (34% if the taxpayer is a corporation) plus 100% of any false credits claimed against tax, unless a more accurate determination of the tax loss can be made.

(D) If the offense involved (i) conduct described in paragraphs (A), (B), or (C); and (ii) both individual and corporate tax returns, the tax loss is the aggregate tax loss from the offenses taken together.

- (2) If the offense involved failure to file a tax return, the tax loss is the amount of tax that the taxpayer owed and did not pay.

Notes:

(A) If the offense involved failure to file a tax return, the tax loss shall be treated as equal to 20% of the gross income (25% if the taxpayer is a corporation) less any tax withheld or otherwise paid, unless a more accurate determination of the tax loss can be made.

(B) If the offense involved (i) conduct described in paragraph (A), and; and (ii) both individual and corporate tax returns, the tax loss is the aggregate tax loss from the offenses taken together.

- (3) If the offense involved willful failure to pay tax, the tax loss is the amount of tax that the taxpayer owed and did not pay.

- (4) If the offense involved improperly claiming a refund to which the claimant was not entitled, the tax loss is the amount of the claimed refund to which the claimant was not entitled.

- (5) The tax loss is not reduced by any payment of the tax subsequent to the commission of the offense.

Commentary

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Application Notes:

1. "Tax loss" is defined in subsection (c). The tax loss does not include interest or penalties. Although the definition of tax loss corresponds to what is commonly called the "criminal figures," its amount is to be determined by the same rules applicable in determining any other sentencing factor. In 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 based on the available facts.

"Tax loss" means federal tax loss; it does not include state or local tax loss.

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7. If the offense involves both individual and corporate tax returns, the tax loss is the aggregate tax loss from the offenses taken together. Accordingly, in a case in which a defendant fails to report income derived from a corporation on either the defendant's individual tax return or the corporate tax return, the tax loss is the aggregate amount due to the treasury from the offenses taken together. For example, the defendant, the sole owner of a corporation, fraudulently understates the corporation's income in the amount of \$100,000 on the corporation's tax return, uses the funds for his personal use, and does not report these funds on the defendant's individual tax return. For purposes of this example, assume that the applicable tax rate is 34% and the applicable individual tax rate is 28%. The tax loss attributable to the defendant's corporate tax returns is \$34,000 (\$100,000 multiplied by 34%). The tax loss attributable to the defendant's individual tax return is based on the unreported \$100,000 in income less the \$34,000 in corporate tax on these same funds. This avoids "double counting" because the \$34,000 in corporate tax reduces the defendant's effective income from \$100,000 to \$66,000. The tax loss attributable to the defendant's individual tax return is \$18,480 (\$66,000 multiplied by 28%). Consequently, the aggregate tax loss for the offenses, taken together, is \$52,480 (\$34,000 plus \$18,480).
8. If the defendant is sentenced for a count charging an offense from which the defendant derived income and a count charging a tax offense involving that criminally derived income, the counts are to be grouped together as closely related counts under subsection (c) of §3D1.2 (Groups of Closely Related Counts). Such counts are to be grouped together whether or not the amount of criminally derived income is sufficient to warrant the enhancement under subsection (b)(1).

Issue for Comment: The proposed amendment uses a sequential method to determine tax loss in cases in which the defendant is both the individual and the corporate tax payer. Commission invites comment on whether §2T1.1 instead should be amended to provide that, in such cases, the aggregate tax loss is the sum of (A) the total amount of unreported income multiplied by the corporate tax rate; and (B) the total amount of unreported income multiplied by the individual tax rate.