FROM BAD TO WORSE: WHEN AN AUDIT GOES CRIMINAL

PART II

Travis Austin Greaves
T. Joshua Wu

Greaves | Wu LLP
www.greaveswu.com
OUTLINE

- Criminal tax players and basic terminology
- Sources of criminal tax cases
- Handling a sensitive audit
  - Privilege issues
  - Ethical issues
  - Amending returns
  - Penalty issues
- The IRS referral process
- The DOJ Tax Division and U.S. Attorneys’ Offices
- Resolving cases before trial and sentencing
Polling Question #1

- Do you have experience with the IRS Criminal Investigation Division?
Referral Process: IRS Criminal Fraud Referrals

Referral of Potential Criminal Fraud Cases (IRM 25.1.3)

- When affirmative acts (firm indications) of fraud/willfulness exist and criminal criteria are met, the compliance employee (e.g., Revenue Agent, Revenue Officer, etc.) will refer the case through the Fraud Technical Advisor (FTA) to Criminal Investigation via Form 2797, Referral Report of Potential Criminal Fraud Cases.

- FTA assists in determining if firm indications of fraud/willfulness are present, criminal criteria has been met, etc.

- The compliance employee will suspend the examination/collection activity without disclosing to the taxpayer or representative the reason for suspension. However, if asked, the IRS must not give a false or deceitful response.
PARALLEL PROCEEDINGS

- IRM 9.5.1.5 – Parallel Investigations
- IRS Policy Statement 4-26 (10-05-2005) – Criminal and civil aspects in enforcement
- USAM Title 6 Tax Resource Manual 22: Coordination of Parallel Criminal, Civil, and Administrative Tax Proceedings
- *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977) – Fifth Circuit held that the improper use of civil process to gather evidence for a criminal prosecution by use of deceit, trickery, or misrepresentation about the nature of the civil inquiry was grounds for reversing conviction
Referral Process: IRS Criminal Fraud Referrals

- Case is assigned to an IRS CI Special Agent (SA) to evaluate the referral.
- If CI accepts the referral, then a criminal investigation commences.
- There are 2 types of investigations:
  - Administrative Investigations, IRM 9.5.1.2
  - Grand Jury Investigations, IRM 9.5.2
**ADMINISTRATIVE INVESTIGATIONS**

- **Case Initiation**
  - E.g., Civil Tax Audit Referral, Informant, CI Initiation, etc.

- **CI Investigation**
  - Evidence Gathering:
    - Search Warrants
    - Undercover Surveillance
    - Trash Runs

- **Case Evaluation**
  - Criminal Tax Review & Analysis of Case
  - Special Agent Report (SAR)

- **Criminal Referral**
  - DOJ Tax Division
  - Prosecution
Administrative Investigation

- Interview with Subject of Investigation
- Special Agent tools:
  - Summons (generally prohibited if DOJ referral)
  - Search Warrants (requires probable cause)
  - Witness Interviews
  - Undercover Operations
  - Trash Runs
- Practice Tip: Special Agent in Charge (SAC) and Supervisory Special Agent (SSA) conference opportunity.
  - Perform your own investigation and point out the weaknesses in the government’s case.
Grand Jury Investigations

- The IRS or US Attorney’s office may initiate a request for a Grand Jury investigation.
- The Grand Jury Request must be authorized by the DOJ Tax Division.

Evidence Gathering:
- Subpoena power
- Forced Witness Testimony
- Grand Jury Secrecy provisions

Grand Jury Evaluation
Special Agent Report

Criminal Referral

DOJ Tax Division
Prosecution
**Grand Jury Investigation**

- Must be authorized by DOJ Tax Division
- IRS may request the use of a Grand Jury either before, during, or after conducting an administrative investigation. IRM 9.5.2.2.
  - Form 9131, Request for Grand Jury Investigation.
  - CT Counsel reviews Form 9131 and prepares a Criminal Evaluation Memorandum (CEM) to the SAC recommending action.
GRAND JURY INVESTIGATION

- An Assistant United States Attorney (AUSA), may initiate the Grand Jury Investigation and ask for IRS CI’s assistance whenever the information available to the AUSA indicates possible commission of crimes under the jurisdiction of the IRS. IRM 9.5.2.2.

- USCS Fed Rules Crim Proc. R. 6(e) generally prohibits the disclosure of Grand Jury material or information.
  - Grand Jury information may not be shared with the civil operating division.
**Administrative v. Grand Jury?**

- Why one over the other?
  - A request for a Grand Jury investigation may be beneficial in certain circumstances:
    - Subpoena Power
    - Uncooperative Witnesses can be forced to testify
    - Grand Jury Secrecy Provisions (keeping the investigation quiet)
    - AUSA / DOJ Trial Attorney involvement with complex litigation issues.
Polling Question #2

- True or False: The DOJ Tax Division must accept a case referred to it by CID for a grand jury investigation.
IRS CI Special Agent Report

SAR is used for all tax-related investigations (both administrative and grand jury). IRM 9.5.8, Investigative Reports. It includes the following:

- Recommended charges and prosecution years
- Returns filed and statute of limitations
- Venue
- Investigative contact(s) with Subject(s) and/or representative(s)
- Theory of the investigation
- Books and records and preparation of tax return(s)
- Elements of the offense
- List of Appendices (List of Witnesses, etc.)
- Disposition of proceeds
- Relevant conduct
- Current lifestyle / recent and post-offense factors
- Explanations and / or defenses of Subject
- Conclusions and recommendations.
REFERRAL TO DOJ TAX DIVISION

- CT Counsel reviews the SAR and prepares a Criminal Enforcement Memorandum (CEM).
- The SAR and CEM are provided to the DOJ Tax Division for review.
- If a Grand Jury Investigation was utilized, then the USAO will provide a recommendation to DOJ Tax Division.
Department of Justice - Tax Division

Tax Division has over 350 attorneys in criminal, civil, and appellate sections

- Criminal Enforcement Sections (CES) (Northern, Southern, and Western)

Scope of Review

- Tax Division reviews all prosecutions involving Title 26 offenses and other offenses “arising under the internal revenue laws.” 28 C.F.R. § 0.70.

  - Arising under the internal revenue laws:
    - Evasion of some responsibility imposed by the IRC
    - Obstruction of the IRS
    - Attempt to defraud the government or other via mechanisms established by the IRS for the filing of documents or payment, collection, or refund of taxes
**TAX DIVISION AUTHORITY**

- Tax Division must approve prosecution. USAM 6-1.110 and 6-4.200.
  - After Tax Division approves, the USAO is authorized to file an Information or Indictment

- USAO may expand non-tax investigation to inquire into possible tax violations
  - Must seek Tax Division approval before filing of Information/Indictment. USAM 6-4.122.

- Tax Division works with USAO to assist with prosecution.
  - Tax Division attorney may prosecute certain cases where USAO declines or has insufficient staff to proceed
Referral Work Flow

Administrative Investigation

Evidence Gathering by IRS CI → IRS – CI Special Agent Report (SAR) → IRS - CT Counsel Case Evaluation Memo (CEM) → DOJ Review & Prosecution Memo → Forward to USAO/DOJ for Prosecution

Grand Jury Investigation - Tax

IRS CI Requests Grand Jury From DOJ Tax → DOJ Tax Either Recommends GJ to US Attorney’s Office or sends back to IRS → If approved, sent to USAO for GJ Investigation → Following GJ Investigation, the IRS CI prepares SAR and CT Counsel Prepares the CEM → DOJ Review & Prosecution Memo → Forward to USAO/DOJ for Prosecution

Grand Jury Investigation – Expanded Case

USAO Request Grand Jury From DOJ Tax → DOJ Tax May Approve or Deny Request → If approved, sent back to USAO for GJ Investigation → During GJ Investigation, USAO engages IRS CI. IRS CI later prepares SAR and CT Counsel Prepares the CEM → DOJ Review & Prosecution Memo → Forward to USAO/DOJ for Prosecution
ARRIVAL OF THE CASE AT THE TAX DIVISION

- Case arrives at CES and includes:
  - SAR and exhibits
  - Case evaluation memo
  - SAC referral memo

- CES attorney prepares prosecution memo
  - Reviews each element of the potential charges and relevant evidence
  - Supplemental memo describing any conference with taxpayer

- CES attorney agrees, modifies, or declines prosecution proposal
  - May return for additional investigation
  - May offer recommendations to improve case
TAX DIVISION REVIEW STANDARD

- Standard of Proof for Approval (USAM 6-4.211)
  - Sufficient evidence to support prima facie case
  - Reasonable likelihood of conviction
    - Note: In Grand Jury Investigation must consider whether articulated facts support reasonable belief that a target or subject has committed a tax crime.

- Other Considerations
  - Whether prosecution would be appropriate use of resources
  - Civil remedies generally not adequate alternative to prosecution
  - Physical and mental ability of defendant to stand trial
  - Deterrence effect
**STATUS DESIGNATIONS**

- **Target**
  - Person as to whom the prosecutor has substantial evidence linking him/her to the commission of a crime and who, is a putative defendant.

- **Subject**
  - Person whose conduct is within the scope of the investigation.

- **Witness**
  - **Immunity**
    - Transactional immunity
    - Derivative use immunity
    - Use immunity
    - “Bridge agreement” or “Queen for a Day”
POLLING QUESTION #3

• Have you had a client that was either a target, subject or witness of a criminal tax investigation?
TAX DIVISION CONFERENCE

- Must be requested before prosecution is authorized (USAM 6-4-214).
  - “If and when letter”
- Discuss proposed charges, method of proof, years at issue and amounts at issue
- Taxpayer may present defenses and evidence
  - No vicarious admissions policy, but if taxpayer attends and makes statements, such statements are admissions, and leads can be developed from counsel statements.
- Issues not discussed:
  - Plea bargains (in grand jury cases)
  - Civil settlements
approving prosecution

- Tax Division CES chief of region will authorize or decline prosecution
  - If case declined, a letter is sent to the IRS
- Case forwarded to USAO or assigned to Tax Division attorney
  - Must be charged in same manner as approved
- Taxpayer may request conference with AUSA
  - Deputy Assistant Attorney General must approve dismissal of case after charges filed
- USAO must proceed and can seek indictment from grand jury, enter plea agreement, or file information upon wavier of indictment.
TIPS FOR DEFENDING A TAXPAYER BEFORE INDICTMENT

- Conduct factual investigation of case
  - Learn what evidence prosecutor has in hand
  - Fact check client assertions

- Consider role of client in scenario
  - Immunity as witness

- Limit client’s statements
  - Client should speak to government via attorney
  - Client should not share information with others

- Consider weaknesses in government’s case
  - Methods of proof
# Criminal Investigation Statistics

<table>
<thead>
<tr>
<th></th>
<th>FY 2015</th>
<th>FY 2014</th>
<th>FY 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigations Initiated</td>
<td>3,853</td>
<td>4,297</td>
<td>5,314</td>
</tr>
<tr>
<td>Prosecution Recommendations</td>
<td>3,289</td>
<td>3,478</td>
<td>4,364</td>
</tr>
<tr>
<td>Informations/Indictments</td>
<td>3,208</td>
<td>3,272</td>
<td>3,865</td>
</tr>
<tr>
<td>Convictions</td>
<td>2,879</td>
<td>3,110</td>
<td>3,311</td>
</tr>
<tr>
<td>Sentenced*</td>
<td>3,092</td>
<td>3,268</td>
<td>2,812</td>
</tr>
<tr>
<td>Percent to Prison</td>
<td>80.8%</td>
<td>79.6%</td>
<td>80.1%</td>
</tr>
<tr>
<td>Conviction Rate</td>
<td>93.2%</td>
<td>93.4%</td>
<td>93.1%</td>
</tr>
</tbody>
</table>
POST INDICTMENT – WHAT NOW?
AN OVERVIEW OF THE PROCESS TO COME

- Indictment
- Pretrial
- Trial
- Sentencing (if necessary)
- Post Trial
- Appeals
- * Plea Bargaining
COMMON DEFENSES IN CRIMINAL TAX CASES

- Good-Faith Belief, Lack-of-Willfulness Defense
- Good-Faith Reliance Defense
- Extra-Deductions, No-Tax-Owed Defense
- Cash Hoard Defense
- Amended Returns
- Statute of Limitations
THE SENTENCING GUIDELINES

- Pre-1984
- Sentencing Reform Act of 1984
- Guidelines are only advisory, but serve as the starting point in every sentencing proceeding
- Court may “depart” or “vary” from Guidelines
The Guideline's Tax Loss Table

§2T4.1. Tax Table

<table>
<thead>
<tr>
<th>Tax Loss (Apply the Greatest)</th>
<th>Offense Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) $2,500 or less</td>
<td>6</td>
</tr>
<tr>
<td>(B) More than $2,500</td>
<td>8</td>
</tr>
<tr>
<td>(C) More than $6,500</td>
<td>10</td>
</tr>
<tr>
<td>(D) More than $15,000</td>
<td>12</td>
</tr>
<tr>
<td>(E) More than $40,000</td>
<td>14</td>
</tr>
<tr>
<td>(F) More than $100,000</td>
<td>16</td>
</tr>
<tr>
<td>(G) More than $250,000</td>
<td>18</td>
</tr>
<tr>
<td>(H) More than $550,000</td>
<td>20</td>
</tr>
<tr>
<td>(I) More than $1,500,000</td>
<td>22</td>
</tr>
<tr>
<td>(J) More than $3,500,000</td>
<td>24</td>
</tr>
<tr>
<td>(K) More than $9,500,000</td>
<td>26</td>
</tr>
<tr>
<td>(L) More than $25,000,000</td>
<td>28</td>
</tr>
<tr>
<td>(M) More than $65,000,000</td>
<td>30</td>
</tr>
<tr>
<td>(N) More than $150,000,000</td>
<td>32</td>
</tr>
<tr>
<td>(O) More than $250,000,000</td>
<td>34</td>
</tr>
<tr>
<td>(P) More than $550,000,000</td>
<td>36</td>
</tr>
</tbody>
</table>
## SENTENCING TABLE

(in months of imprisonment)

<table>
<thead>
<tr>
<th>Offense Level</th>
<th>I (0 or 1)</th>
<th>II (2 or 3)</th>
<th>III (4, 5, 6)</th>
<th>IV (7, 8, 9)</th>
<th>V (10, 11, 12)</th>
<th>VI (13 or more)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0-6</td>
<td>0-6</td>
<td>0-6</td>
<td>0-6</td>
<td>2-8</td>
<td>0-6</td>
</tr>
<tr>
<td>Zone A</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>0-6</td>
<td>0-6</td>
<td>0-6</td>
<td>2-8</td>
<td>4-10</td>
<td>6-12</td>
</tr>
<tr>
<td>5</td>
<td>0-6</td>
<td>0-6</td>
<td>1-7</td>
<td>4-10</td>
<td>6-12</td>
<td>9-15</td>
</tr>
<tr>
<td>6</td>
<td>0-6</td>
<td>1-7</td>
<td>2-8</td>
<td>6-12</td>
<td>9-15</td>
<td>12-18</td>
</tr>
<tr>
<td></td>
<td>0-6</td>
<td>2-8</td>
<td>4-10</td>
<td>8-14</td>
<td>12-18</td>
<td>15-21</td>
</tr>
<tr>
<td>9</td>
<td>0-6</td>
<td>4-10</td>
<td>6-12</td>
<td>10-16</td>
<td>15-21</td>
<td>18-24</td>
</tr>
<tr>
<td>Zone B</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>6-12</td>
<td>8-14</td>
<td>10-16</td>
<td>15-21</td>
<td>21-27</td>
<td>24-30</td>
</tr>
<tr>
<td>11</td>
<td>8-14</td>
<td>10-16</td>
<td>12-18</td>
<td>18-24</td>
<td>24-30</td>
<td>27-33</td>
</tr>
<tr>
<td>Zone C</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>10-16</td>
<td>12-18</td>
<td>15-21</td>
<td>21-27</td>
<td>27-33</td>
<td>30-37</td>
</tr>
<tr>
<td>13</td>
<td>12-18</td>
<td>15-21</td>
<td>18-24</td>
<td>24-30</td>
<td>30-37</td>
<td>33-41</td>
</tr>
<tr>
<td>Zone D</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>78-97</td>
<td>87-108</td>
<td>97-121</td>
<td>110-137</td>
<td>130-162</td>
<td>140-175</td>
</tr>
<tr>
<td>29</td>
<td>87-108</td>
<td>97-121</td>
<td>108-135</td>
<td>121-151</td>
<td>140-175</td>
<td>151-188</td>
</tr>
<tr>
<td>30</td>
<td>97-121</td>
<td>108-135</td>
<td>121-151</td>
<td>135-168</td>
<td>151-188</td>
<td>168-210</td>
</tr>
<tr>
<td>32</td>
<td>121-151</td>
<td>135-168</td>
<td>151-188</td>
<td>168-210</td>
<td>188-235</td>
<td>210-262</td>
</tr>
<tr>
<td>33</td>
<td>135-168</td>
<td>151-188</td>
<td>168-210</td>
<td>188-235</td>
<td>210-262</td>
<td>235-293</td>
</tr>
<tr>
<td>34</td>
<td>151-188</td>
<td>168-210</td>
<td>188-235</td>
<td>210-262</td>
<td>235-293</td>
<td>262-327</td>
</tr>
<tr>
<td>35</td>
<td>168-210</td>
<td>188-235</td>
<td>210-262</td>
<td>235-293</td>
<td>262-327</td>
<td>292-365</td>
</tr>
<tr>
<td>36</td>
<td>188-235</td>
<td>210-262</td>
<td>235-293</td>
<td>262-327</td>
<td>292-365</td>
<td>324-405</td>
</tr>
<tr>
<td>37</td>
<td>210-262</td>
<td>235-293</td>
<td>262-327</td>
<td>292-365</td>
<td>324-405</td>
<td>360-life</td>
</tr>
<tr>
<td>38</td>
<td>235-293</td>
<td>262-327</td>
<td>292-365</td>
<td>324-405</td>
<td>360-life</td>
<td>360-life</td>
</tr>
<tr>
<td>39</td>
<td>262-327</td>
<td>292-365</td>
<td>324-405</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
</tr>
<tr>
<td>40</td>
<td>292-365</td>
<td>324-405</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
</tr>
<tr>
<td>41</td>
<td>324-405</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
</tr>
<tr>
<td>42</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
<td>360-life</td>
</tr>
<tr>
<td>43</td>
<td>life</td>
<td>life</td>
<td>life</td>
<td>life</td>
<td>life</td>
<td>life</td>
</tr>
</tbody>
</table>

---

- 404 – November 1, 2015
THE § 3553(a) FACTORS

- The court shall impose a sentence sufficient, but not greater than necessary, to comply with the purposes set forth in paragraph (2) of this subsection. The court, in determining the particular sentence to be imposed, shall consider—

- (1) the nature and circumstances of the offense and the history and characteristics of the defendant;

- (2) the need for the sentence imposed—
  
  (A) to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment for the offense;
  
  (B) to afford adequate deterrence to criminal conduct;
  
  (C) to protect the public from further crimes of the defendant; and
  
  (D) to provide the defendant with needed educational or vocational training, medical care, or other correctional treatment in the most effective manner;
THE § 3553(A) FACTORS

- (3) the kinds of sentences available;
- (4) the kinds of sentence and the sentencing range established [by the Guidelines]
- (5) any pertinent policy statement
- (6) the need to avoid unwarranted sentence disparities among defendants with similar records who have been found guilty of similar conduct; and
- (7) the need to provide restitution to any victims of the offense.
Polling Question #4

- What was the most valuable thing you learned on today’s webinar?
QUESTIONS?
SPEAKERS

Travis Austin Greaves  
(202) 412-0019  
tgreaves@greaveswu.com  
LinkedIn

T. Joshua Wu  
(571) 294-3850  
jwu@greaveswu.com  
LinkedIn