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| **Cast** | | |
|  | Section chief | **Tom Sawyer** |
| **Scene** | Chief of IRS CI | **Don Fort** |
| 1 7201 Evasion | Trial Atty | **Sophia Siddiqui** |
|  | Section member | **Judge Colvin** |
| 2 7202 empl. tax | Trial Attorney | **Andrew Weiner** |
|  | Section member | **Craig Bell** |
| 3 7206(1) false return | Trial attorney | **Kyle Bishop** |
|  | Section member | **Craig Bell** |
| 4 7212 omnibus clause  1001 false statement | Trial Attorney | **Richard Goldstein** |
|  | Section member | **Ryan Kelly** |
| 5 FBAR | Trial attorney | **Richard Goldstein** |
|  | Section member | **Ryan Kelly** |
| *Members unable to attend: Glenn Melcher, Hillary March, Nancy Kuhn, Steven Johnson, Brian Arthur, Saul Mezei, Nadiya Beckwith-Stanley, Anne Gordon* | | |

**Scene: Indictment review. DOJ conference Room. Trial team is presenting a case with a draft indictment.**

TS Thanks everyone for coming to the indictment review for the Smith case. As luck would have it, Don Fort was in the building for a meeting with the AAG, and he’s interested in attending the indictment review. Don is the Chief of the IRS, Criminal Investigation Division. Welcome Don.

DF Happy to be here.

TS Before I turn it over to the trial team, let’s take advantage of Don’s presence. We are getting ready to indict a case. But let’s not lose sight of the big picture of where indictments fit in the scheme of tax enforcement.

With respect to violent crimes, like murder, police investigate, and prosecutors want to prosecute, all of them. We have specific deterrence, where we want to keep a specific person from committing a crime again. So we need to prosecute all of those that we can to keep violent people off the streets and rehabilitate those that return. But tax enforcement is done with relatively scarce resources. Don only has 2000 criminal agents. US citizens file 150 million tax returns each year. And we prosecute or authorize about 1500 cases a year. So we can’t pretend that we can prosecute every tax crime. Can you describe general deterrence and its importance in tax compliance and tax enforcement?

DF

TS Most of the attorneys in this room work the civil side of tax administration. Why should they care about the criminal side? Do they have a role? (I don’t know if you want to get into this, but in my work on tax shelters, we fought for a long time on the civil side, and it wasn’t until IRS started looking at criminal charges against respected tax lawyers and accountants that the tide really turned. Most of the civil practitioners acted appropriately, but when they don’t, they are putting their clients and themselves at risk).

DF

TS So those are some very big picture items. Don I didn’t give you much of an introduction. We are trying to learn about the criminal side of tax enforcement, so let’s move to the biggest player in that big picture, and that is IRS Criminal Investigation Division. Can you give us an overview of IRS CI, and if you don’t mind, maybe describe what roles have you had at IRS CI?

DF

TS Since IRS CI agents are considered the premier financial investigators in the country, their services are in demand in all sorts of crimes that involve complicated financial schemes. What actions do you take to make sure their skills are used to meet your tax mission?

DF

TS One last big-picture question before we get to some tax charges, how does CI select its priorities? [Depending on general deterrence discussion, that may have been covered]

DF

**Scene 1 7201 / Evasion of payment**

**Trial Attorney: Sophia Siddiqui**

**Section member: Judge Colvin**

TS Now to the case at hand. Joseph Smith. The setting is an indictment review in a conference room at DOJ. DOJ would have approved a grand jury investigation and the prosecution. Now when the case is ready for indictment, a draft indictment is prepared and discussed within the section. So collectively, the trial team presents the case to other members of the tax division, usually including senior attorneys and appellate attorneys. The sessions include a discussion of what might be the best charges to bring, whether the evidence is sufficient for those charges, whether venue is appropriate, what the relevant of the statute of limitations is and what events trigger it. We only have a few minutes here, so our focus will be on introducing a few of the major criminal charges. So I’ll turn it over first to Sophia Siddiqui as one of the trial team members, and Judge Colvin as one of the indictment review attendees.

SS Okay, no pressure here with not only my boss here, but the chief of CI. So I sent around a copy of the draft indictment. We are proposing to present to the grand jury a multi-count indictment that really runs the gamut.

First we’re going to talk about tax evasion. In our starting lineup of tax charges, tax evasion is our Cy Young award winner. The IRS’s Max Scherzer.

In this case, Joseph Smith owns all of the stock of a US corporation called Sip & Sing. It operates popular karaoke bars in the Washington and Baltimore area. The bars use a logo on their signs and advertising. Smith copied the logo from an Australian pub. He formed an Irish shell company, and he purported to contribute that intellectual property to it. The Irish shell company leased the exclusive use of the stolen logo to Sip & Sing. Smith, by the way, also had a minority interest in a UK corporation that also operated karaoke bars in England.

Smith opened a Swiss bank account in the name of the Irish shell company. Consistent with Swiss know your customer rules, the bank opening documents listed Smith as the beneficial owner, but an Irish citizen was the sole signatory on the account.

For the years 2011 to 2017, Sip & Sing paid royalties to the Irish shell company. The royalty fees were so high that, after payroll and rent expenses, Sip & Sing reported losses for each and every year. This is despite the fact that the bars frequently had lines out the door.

So the first charge on the indictment is tax evasion.

JC Well let’s start with the corporation. What kind of corporation is this, a C corp. or S corp?

SS This is a C corporation.

JC We prefer to prosecute individuals. What use is it to prosecute a C corporation like Sip & Sing.

SS We’re not charging Sip & Sing, but Smith in his personal capacity. Tax evasion can be charged against a person even if he’s not the taxpayer so long as the tax evasion elements can be proven.

JC Okay, so there are three primary elements of tax evasion. First, an affirmative act constituting an attempt to evade. Second, a tax deficiency. And third, willfulness. So, what is the affirmative act of evasion.

SS We have multiple acts. We have the creation of the improper tax deduction for the use of property, the business logo. Smith stole the logo. He doesn’t even own it. Second, even if he did own it, he grossly overvalued its worth. Third, he diverted the money to a foreign shell corporation and deposited that money in foreign bank accounts.

JC What about the additional tax due and owing. Frequently a difficult aspect of a tax evasion charge is proving an additional tax.

SS Plainly, the deduction was improper. Our agent has calculated the tax deficiency, and without the improper deduction for the use of the stolen logo, the corporation would have owed significant taxes. And as a protective measure, we even valued the logo. If he had he owned it, he would have been entitled to only a deduction of less than one quarter of what he claimed. Again, in that circumstance, he would have still owed significant taxes.

JC What about Smith’s personal income tax returns, you haven’t set out any evasion count for his 1040s.

SS The form 1120 corporate liability seems to be the easier route. There is plainly a diversion of corporate funds for his personal use. Money in the Irish shell company account went to two purposes. He did divert some of the funds to Sip & Sing’s secret cash payroll. But most of the money went to Smith’s UK investment, which was a corporation wholly separate from the US Sip & Sing corporation. In order to make out a 1040 tax evasion case, we would have to prove that the diverted money was a dividend. But he might claim that it was a non-taxable return of capital to him. IRS has decided to take civil action against him for fraudulent 1040 income taxes. The cleaner case seems to be an evasion case for the 1120 corporate liability. We have to address that the cash wages could be deductible, but even with a generous allowance for that, we still have a significant deficiency.

JC Finally, what about willfulness. What is your theory.

SS The Supreme Court in *Cheek* defined willfulness as a “voluntary, intentional violation of a known legal duty.” So, to establish willfulness, we must show that he had a duty under the tax laws, that was aware of his obligations, and that he intentionally violated them. Here, he knew that business expenses could be deducted. He told his accountant what they were. He just never told his accountant that the property on which a deduction was claimed had been stolen and that the Irish shell company had no right to charge for the use of the logo.

TS There is a lot here, and we want to run thru a bunch of criminal tax charges. The handout that we sent around had a list of some of the tax charges and elements, and at the end was chart with various limitations periods. As you can see from the chart, a lot of the limitations periods are 6 years, but they are set out. And unlike the civil side, determining the triggering event is not always easy. For example in tax evasion, the triggering event is the date of the last affirmative act. In many cases, that might be the filing of the return, but it could also be a date later than that. So here it is possible that the acts are as late as 2018 when he closed the shell company bank account and moved the money to the UK. In a typical indictment review, there are a lot of questions about events that trigger a limitations period, or what acts might have been committed in the judicial district where the case is being filed.

Anyway, as Sophia noted, tax evasion is our premier charge. And a key element of nearly all tax crimes is willfulness. Don, where do you find evidence of willfulness, and how do you deal with it as an IRS agent?

DF

**Scene 2 Employment taxes**

**Trial Attorney: Andrew Weiner**

**Section member: Craig Bell**

TS Turning to failure to withhold and pay over, Andrew Weiner, formerly of the Tax Division’s appellate and court of federal claims sections, and now the head of Temple University’s graduate tax program, will play the role of the trial attorney. And Craig Bell will play the role of an attendee at the indictment review. But first, another question for Don. The Tax Division in its 2019 budget submission, notes that a huge portion of the IRS’s collections, something like 70 percent, is comprised of withholding and employment taxes. Don, can you speak to employment tax enforcement, whether it is a priority for CI, and how you select which employment tax cases to investigate for possible criminal charges?

DF

AW We also are proposing a 7202 charge because Smith has underpaid his employment taxes. Smith paid his employees in two ways. First, he made regular payroll, but only about half the wages were paid that way. Second, he made cash payments using some of the funds that had been paid over to the Irish shell company, which he controlled. He never withheld from the cash wage payments, and the employment tax returns that he signed showed only the regular payroll amounts.

CB So what is your case?

AW We need to prove that he had a duty to account for the withholdings, that he failed to collect or account and pay them over, and that he did so willfully.

CB Can you prove it?

AW I think we have a good case. He obviously had a duty to collect and pay over the taxes. He signed the returns and he paid the wages. And he followed the correct rules when he made the regular portion of the payroll properly. It is a clear indication of willfulness with respect to the cash portion that he knew how payroll worked and that withholding was required.

CB Didn’t you say that that extra portion was paid in cash?

AW Yes

CB Well we might be able to get an instruction that the use of cash is an indicator of willfulness, or it least can be a strong argument to the jury. You should add a reference to the cash in the indictment.

AW Is that important, as I said, I think we have enough without it. Why add something extra to the indictment.

CB Well, an important part of our cases is to create a deterrent effect. And we do that to some degree with our press releases. If we put that in the indictment, we can put it in our press release. We want to make sure we get the word out that using cash to pay wages in this manner unlawful.

**SCENE 3 7206(1) fraudulent return**

**Trial Attorney: Kyle Bishop**

**Section Attorney: Craig Bell**

TS We had a brief reference here to press releases. Press coverage of tax crimes is extremely important, because we need to maximize the deterrent effect of each case. If we want to put people on notice that payment of wages in cash might be a suspicious factor, and we want to mention it in a press release, it needs to be in the indictment. Likewise, if we want to get the press coverage of a tax evasion case, we might want to put the tax loss figure in the indictment, so we can describe it in the press release.

So let’s move to 7206(1), a fraudulent return. Kyle Bishop will play the role of the trial attorney, and Craig Bell remains in the role of the attendee at the indictment review.

KB We have a count in our indictment for a fraudulent employment tax return. Smith filed a 941 that falsely reported only the wages paid to Sip & Sing employees that were recorded in its books. That is, Sip & Sing paid its employees regular wages. But then it also paid bi-weekly regular cash bonuses to employees that were not reported on the 941s. No taxes were withheld or paid over on this cash portion, nor did Sip & Sing pay the employer’s share of employment taxes.

CB Again, what is your case. We need to prove that he filed a return that was false as to a material matter, that it was signed under the penalty of perjury, that Smith did not believe the document to be true as to every material matter, and that he did all of this willfully.

KB We have strong evidence to support the charges. First we obtained the Swiss bank records of the Irish shell company pursuant to a tax treaty request. From the bank account of that nominee Irish shell company belonging to Smith, we see that he wired money to several personal accounts in the US. We’ve subpoenaed those domestic records too, and we see regular cash withdrawals of about $7,000 per week. All of the figures were low enough that they did not trigger currency transaction reports to FinCEN, and he spread out the banks he used, presumably to avoid raising suspicions of structuring by any particular bank such that they would file a SAR, a suspicious activity report.

CB How do you know how much he paid to his employees in cash?

KB That is difficult, and that’s why we chose 7206(1) instead of 7201 tax evasion. We have difficulty proving the amount of the employment tax loss, especially when compared to the corporate form 1120 loss, which was a far easier computation given the scheme. But we have grand jury testimony from more than a dozen employees who testified that they were paid weekly bonuses in cash, and those bonuses never showed up on their year-end W-2s.

CB How do you know that he did not believe the 941s to be accurate?

KB Because his accountant’s questionnaire included a section on any cash payments made to employees, and he had said that all of the wages were paid from the wage checking account of Sip & Sing.

TS There was a mention of a treaty request here. Let’s keep in mind that there are several events that toll the statute of limitations periods, both in civil and criminal cases. A few relate to the time that a person spends outside of the US and the time during a John Doe summons challenge. But one, in a criminal matter, relates to the time that a treaty request, such as an MLAT or double tax treaty exchange of information request. Here, a tax treaty request was made to Switzerland. And it is possible that the government filed a tolling motion. The problem for criminal targets is that these are done in sealed, ex parte, proceedings. So you might not know about this until after the indictment.

**SCENE 4 7212(a) Interference with Internal Revenue Laws / 1001 False Statements**

**Trial Attorney: Richard Goldstein**

**Section Attorney: Ryan Kelly**

TS Section 7212(a) of the Code contains what is sometimes referred to as the “omnibus clause” and involves an endeavor to obstruct or impede the administration of the IRS. A 7212 omnibus charge, according to the Supreme Court in Marinello, “does not cover routine administrative procedures that are … applied to all taxpayers, … [but it] refers to specific interference with targeted governmental tax-related proceedings,” such as an investigation or audit. In this scene, Richard Goldstein plays the trial attorney, and Ryan Kelly the inquisitive section member.

RG So I have a 7212(a) charge in the indictment, and I’d like everyone’s opinion on whether you think it is the right charge. After Smith learned of the IRS income and employment tax audits, he misled the investigators. He never disclosed the Swiss bank accounts nominally held by the Irish shell corporation, nor that he transferred funds to his UK corporation.

RK Well, we’re getting ready to indict. I assume the IRS didn’t rely on any of that bad information.

RG It appears that it did help him. Nothing came of that audit. It wasn’t until he continued the scheme into the next year that the IRS finally caught on to what was going on.

RK So what is the 7212 case? You need to show that he (1) corruptly, (2) endeavored, (3) to obstruct or impede the administration of the Code. And *Marinello* adds that the defendant had to know of the ongoing audit or otherwise was trying to impede a specific targeted enforcement effort.

RG To act “corruptly” means to act with the intent to secure an unlawful advantage. He lied to his accountant, who in turn lied to the IRS agent investigating the tax. He also took the money that had wrongly been deducted and transferred overseas, and buried it further by supposedly loaning it to another corporation in which he had only a minority interest. We’ve never been able to find that money. So he essentially stopped the audit with his actions and his movement of money will prevent easily collecting it.

RK It sounds like it could be a false statement, and an 18 USC 1001 charge might be considered.

RG I thought we preferred cases under title 26?

RK We do, but we frequently bring title 18 cases as part of tax administration. False statements and conspiracy among them. A 7212 case might be the strongest if he intimidated witnesses. Did his employees cooperate with the agents when they asked questions to them?

RG They were not the least bit forthcoming. Probably in part because they knew they had some of their own tax issues, since they were getting paid on the side in a manner that allowed them to keep a bigger part of their paycheck. But there are no indications that he threatened or tampered with them in any way.

RK Let’s go thru the false statement elements. Did Smith make a statement or representation to the IRS?

RG He told us he had no foreign bank accounts, even though they were directly related to the request.

RK Was the representation false?

RG Yes. Even though the account was not in the corporation’s name, it clearly fell within the scope of the request and should have been disclosed.

RK Was the statement material?

RG Again, yes. The Irish shell corporation was at the heart of the evasion scheme, and it was used to fund the cash payments that were central to false 941 tax returns.

RK Was the statement made knowingly and willfully?

RG Yes. We know that because when we were later preparing to interview him, he fessed up and told his accountant, who immediately canceled the interview and brought in a criminal defense lawyer to try to contain the damage.

RK And finally, we’re outside of title 26, and an element is that the statement pertained to an activity within the jurisdiction of the agency. I don’t suspect that is a problem.

RG No, of course not. This was an IRS audit.

RK You mentioned that the accountant made representations to the IRS. Did he also assist in helping set up the offshore scheme? Can we make any conspiracy charge? In offshore type cases, we like to make cases against facilitators, and we can frequently do so using the conspiracy statute.

RG I don’t think we are particularly close to that here. Under 18 USC § 371 we need to show an agreement of two or more persons, to defraud the US, and he must knowingly and voluntarily participate in the conspiracy, and he must commit an overt act to further the conspiracy. Here, we really can’t get past the first element. I don’t see that any of the taxpayer’s advisors were part of an agreement to the scheme. In fact, probably to the contrary. Smith lied to his accountant.

TS Our final charge will be the FBAR again with Ryan Kelly and Richard Goldstein. But first, a last question for Don before we open it up. This skit had a few international aspects to it. The hypothetical taxpayer owned an interest in a foreign corporation where some money was ultimately diverted. He created a shell company where again money was diverted. And he failed to report his control over the shell company’s foreign bank accounts. Done, how has CI’s international focus changed over the years; has the IRS’s focus over the last decade improved compliance, and with all of the progress that you’ve made, is international still a focus?

DF

**Scene 5 FBAR**

**Trial Attorney: Richard Goldstein**

**Section Attorney: Ryan Kelly**

RG The final charge is a title 31, failure to file an FBAR.

RK Right. As I understand it, Smith formed a shell company in Ireland, and he opened a Swiss bank account in the name of the shell company. He was not a signatory on the account.

RG No, he didn’t have signature control over the account. But under the Swiss banking due diligence rules, it had to determine who was the beneficial owner of the account. Following those rules, it determined that he was the beneficial owner. So on the famous Swiss Form A, Smith is shown there as the beneficial owner even though he did not technically was not shown as the legal owner of the account.

RK So he didn’t report the account to the IRS because he technically didn’t think that he had to, isn’t that right?

RG Well let’s break down the elements. First, did he have an interest in the account? Yes, it’s clear he did. Money was wired to him from the account, and when he closed the account, it was paid over to his UK corporation. We can easily show that element.

RK What about willfulness?

RG That’s always more difficult. Again, the basic standard is the same as in title 26 cases, that is, a voluntary, intentional violation of a known legal duty. He knew enough that he needed to lie to his accountant. And on his personal returns, he checked the “no” box on Schedule B. I feel pretty good about our chances in front of the jury.