# *Criminal Tax Bulletin*

***Department of Treasury*** ***Office of Chief Counsel***
***Internal Revenue Service*** ***Criminal Tax Division***

**March/April** **This bulletin is for informational purposes. It is not a directive.** **2005**

## SENTENCING GUIDELINES

### Supreme Court Declares Federal Sentencing Guidelines Merely Advisory

In ***United States v. Booker***, 125 S.Ct. 738 (2005), Freddie Booker was convicted of possession with intent to distribute at least 50 grams of cocaine base. The Seventh Circuit reversed his conviction and remanded the case for sentencing. Certiorari was granted. In the companion case, *United States v. Fanfan*, Duncan Fanfan was convicted by a jury of conspiracy to distribute and to possess with intent to distribute at least 500 grams of cocaine and the district court imposed sentence. The Supreme Court granted certiorari before judgment to the First Circuit. The question presented in both cases was whether an application of the federal sentencing guidelines violated the Sixth Amendment's jury trial requirement.

In the first part of a two-part majority opinion, the Supreme Court held the manner in which the sentencing guidelines were administered at that time were in violation of a defendant's right to a jury trial because judges routinely applied the guidelines and imposed sentences based upon facts which the jury did not find beyond a reasonable doubt.

In doing so, the Supreme Court initially recognized that "[i]t has been settled throughout our history that the Constitution protects every criminal defendant 'against conviction except upon proof beyond a reasonable doubt of every fact necessary to constitute the crime with which he is charged,'" and that, "[i]t is equally clear that the 'Constitution gives a criminal defendant the right to demand that a jury find him guilty of all the elements of the crime with which he is charged.'" *Id.* at 748 (internal citations omitted).

The Court then reviewed its recent decisions interpreting modern criminal statutes and sentencing procedures, *i.e.*, those cases upon which its opinion in *Blakely* was based, and concluded "there is no distinction of constitutional significance between the Federal Sentencing Guidelines and the Washington procedures at issue in that case [*Blakely*]." *Id.* at 749. The Court did note, however, "[i]f the Guidelines as currently written could be read as merely advisory provisions that recommended, rather than required, the selection of particular sentences in response to differing sets of facts, their use would not implicate the Sixth Amendment." *Id.* at 750.

The Court then reaffirmed its earlier decision in *Apprendi*, reiterating that "[a]ny fact (other than a prior conviction) which is necessary to support a sentence exceeding the maximum authorized by the facts established by a plea of guilty or a jury verdict must be admitted by the defendant or proved to a jury beyond a reasonable doubt." *Id.* at 756.

As for the second issue on appeal, *i.e.*, the question of remedy, the Court held that it would sever the provision of the Federal Sentencing Act of 1984 that makes the guidelines mandatory, along with the provision that establishes the applicable standards of review on appeal. So modified, the federal sentencing statute effectively renders the guidelines advisory such that sentencing courts are still required to consider them but can ultimately tailor a defendant's sentence based upon other equally applicable statutory concerns.

In choosing this system, the Court declined to adopt the approach set forth in Justice Steven's dissent which would have retained the Sentencing Act and guidelines as written, but engraft onto the existing system the Sixth Amendment "jury trial" requirement announced above, and instead chose an approach that "would make the Guidelines system advisory while maintaining a strong connection between the sentence imposed and the offender's real conduct – a connection important to the increased uniformity of sentencing that Congress intended its Guidelines system to achieve." *Id*. at 757.

It must be noted that the Supreme Court also found that the appellate courts would henceforth review sentencing determinations for "unreasonableness," and that its holding as to the applicability of the Sixth Amendment to

the sentencing guidelines and its remedial interpretation of the Federal Sentencing Act were applicable to all cases on direct review.

## MONEY LAUNDERING

### Tax Savings Not Proceeds for Money Laundering

In ***United States v. Maali***, *et al.*, 358 F.Supp.2d 1154 (M.D.Fla. 2005), codefendants Portlock and Khanani were found guilty of conspiracy to conceal, harbor, or shield from detection, or to encourage aliens to illegally enter or reside in the United States; mail and wire fraud; and, conspiracy to commit money laundering. Portlock and Khanani had previously moved for acquittal on the conspiracy to commit money laundering count, in violation of 18 U.S.C. § 1956(h), such motion being preserved until after the jury returned its verdict. The court subsequently granted their motion for acquittal on the money laundering conspiracy count.

Khanani was a part owner of multiple retail stores, including two stores that employed undocumented aliens not authorized to work in the United States. Khanani and Portlock implemented a scheme whereby they paid the undocumented workers with monies skimmed from two of the businesses they channeled into four shell companies. They failed to report the income paid to the undocumented workers and failed to remit federal or state employment taxes on these workers' wages. Defendants also failed to pay these undocumented workers time-and-a-half wages for overtime work, as required by federal law. As a result, defendants enjoyed increased profits and decreased tax liabilities.

At trial, the government argued the defendants laundered or engaged in financial transactions involving "proceeds" derived from violations of the mail and wire fraud statutes and related to bringing in and harboring aliens, all of which are predicate offenses under the money laundering statute. Specifically, "the government claimed that the tax and cost savings from hiring illegal aliens constituted 'proceeds' which [d]efendants then deposited into the accounts of shell companies for the purposes of concealing their unlawfully derived income and promoting their illegal employment scheme. In their motions, Khanani and Portlock argued they never completed a predicate offense which yielded "proceeds" they could have laundered and neither the tax nor labor cost savings they enjoyed from hiring illegal aliens constituted "proceeds."

The court granted Khanani and Portlock's motion because it found the government's cost saving theory was at odds with the plain and ordinary meaning of "proceeds." The court looked to the various sources for a definition of "proceeds," finding "that 'proceeds' are something which is obtained in exchange for the sale of something else as in, most typically, when one sells a good in exchange for money." Thus, the court found the plain and ordinary definition of "proceeds" did not contemplate profits or revenue indirectly derived from labor or from the failure to remit taxes.

### Supreme Court Holds Conviction for Conspiracy to Commit Money Laundering Does Not Require Proof of an Overt Act

In ***Whitfield v. United States***, 125 S.Ct. 687 (2005), a federal grand jury returned a 20-count indictment against petitioners and five co-defendants. In pertinent part, the indictment charged petitioners with conspiracy to launder money, a violation of 18 U.S.C. § 1956(h). Although the indictment described the "manner and means" used to accomplish the objectives of the alleged conspiracy, petitioners were not charged with the commission of any overt act in furtherance thereof.

At the close of evidence during trial, petitioners asked the district court to instruct the jury that the government was required to prove beyond a reasonable doubt that at least one of the co-conspirators had committed an overt act in furtherance of the money laundering conspiracy. After the district court denied the request, the jury returned a verdict of guilty on the conspiracy charge.

On appeal, the Eleventh Circuit affirmed the convictions, in pertinent part, holding that the jury instructions approved by the district court were proper because § 1956(h) does not require proof of an overt act. In doing so, the Eleventh Circuit relied upon *United States v. Shabani*, 513 U.S. 10 (1994), wherein the Supreme Court held that the drug conspiracy statute, 21 U.S.C. § 846, does not require proof of an over act. Since the language of § 1956(h) was "nearly identical" to that of 21 U.S.C. § 846, the Eleventh Circuit opined it was obligated to follow the reasoning set forth in *Shabani* and held that § 1956(h) requires no proof of an overt act. The Eleventh Circuit did note, however, that some other circuits have held otherwise.

After granting certiorari to resolve the conflict between the circuits on this issue, the Supreme Court affirmed.

In doing so, the Court noted § 1956 did not include a conspiracy provision when it was originally enacted such that the government relied upon the general conspiracy statute, *i.e.*, 18 U.S.C. § 371, to prosecute money laundering conspiracies. In 1992, however, Congress enacted the money laundering conspiracy provision which is at issue in this case, and which has since been codified at 18 U.S.C. 1956(h) with no reference to a required overt act. The Court then referred to its earlier decisions in *Nash v. United States*, 229 U.S. 373 (1913), and *Singer v. United States*, 323

U.S. 338 (1945), for the premise that where Congress had omitted from the relevant conspiracy provision any language expressly requiring an overt act, the Court would not read such a requirement into the statute.

Lastly, the Court opined that *Shabani* set forth the following governing principle for interpreting conspiracy statutes: "*Nash* and *Singer* give Congress a formulary: by choosing a text modeled on § 371, it gets an overt-act requirement; by choosing a text modeled on the Sherman Act, 15 U.S.C. § 1 [which, like 21 U.S.C. § 846, omits any express overt-act requirement], it dispenses with such a requirement." *Id.* at 688 (internal quotations and citations omitted).

Thus, the Court ultimately held "[b]ecause the text of § 1956(h) does not expressly make the commission of an overt act an element of the conspiracy offense, the government need not prove an overt act to obtain a conviction." *Id.*

Although not particularly important given its above-stated analysis, the Court also found no merit to petitioners' argument that § 1956(h) did not create a new conspiracy offense and that money laundering conspiracies must continue to be prosecuted under § 371, to which *Shabani* does not apply. Nor did the Court find compelling their argument that § 1956(i), a venue provision added in 2001 which states a conspiracy prosecution "*may* be brought in the district…where an overt act took place," indicates Congress' intent to require proof of an overt act in such prosecutions

### Money Laundering Conviction Upheld where Money Represented as Proceeds from SUA

In ***United States v. Castellini***., 392 F.3d 35 (1st Cir. 2004), defendant appealed his conviction for conspiracy and money laundering. Defendant was caught in the government's sting operation involving individuals associated with Anderson Ark and Associates (AAA), a company that used offshore trusts to conceal the money of its investors. The IRS began the sting operation by targeting a promoter of offshore trusts who eventually led investigators to the leaders of AAA. An undercover agent represented himself as a business owner being forced into personal and corporate bankruptcy. He approached the promoter for assistance in concealing $100,000 in cash and $300,000 in corporate funds. The promoter eventually enlisted the aid of the defendant and arranged an introduction. The defendant had a complex business organization (CBO) he could use to help launder the corporate funds. The undercover agent indicated that the money represented an asset he hoped to conceal from the bankruptcy counsel prior to filing his petition. Through a series of fake invoices and the movement of funds through offshore bank accounts, the defendant successfully transferred $60,000 of the money. The defendant then referred the agent to another coconspirator associated with AAA for further money transfers.

Defendant was charged with money laundering under 18 U.S.C. § 1956(a)(3) based on the fictional specified unlawful activity of bankruptcy fraud; and with conspiracy to launder money under § 1956(h). Following a conviction, defendant appealed to the First Circuit.
First, defendant argued the evidence was insufficient because the undercover agent never represented the money as proceeds of the unlawful activity. At most, defendant argued, his concealment of the money could only constitute aiding and abetting the underlying bankruptcy fraud since he had no reason to infer it was illegal proceeds. In addition, defendant argued there was no specified unlawful activity because the bankruptcy fraud statute criminalizes the act of concealing funds, not merely the intention.

The First Circuit addressed defendant's arguments by noting conversations between defendant and the undercover agent in which they discussed hiding the money from the bankruptcy court through a series of transactions, which can only be described as classic money laundering. The Court specifically pointed out portions of the taped conversations where defendant discussed using false invoices and even used the word "laundering." The First Circuit then addressed whether defendant's actions could constitute money laundering if the underlying crime of bankruptcy fraud remained incomplete. The Court noted that money laundering criminalizes transactions in proceeds. Proceeds may be obtained from an incomplete or on-going underlying crime. Once the basic elements of the underlying crime are sufficiently met to create proceeds, the proceeds can be laundered.

Defendant also challenged the admission of out-of-court statements made by a coconspirator in a taped conversation played for the jury. The First Circuit reviewed the district court's *Petrozziello* rulings (based on *United States v. Petrozziello*, 548 F.2d 20 (1st Cir. 1977)) made during trial after defense counsel objected to the admission of the taped conversations. It appears the district court found by a preponderance of the evidence that there was an existing conspiracy at the time the statements were made, the statements were made in furtherance of the conspiracy, and the defendant was a member of the conspiracy at some point.

## SEARCH AND SEIZURE

### Ninth Circuit Holds Search of Automobile Incident to Arrest Notwithstanding Fact it Preceded Defendant's Arrest

In ***United States v. Smith***, 389 F.3d 944 (9th Cir. 2004), Kory Ray Smith was placed under arrest after he was stopped for speeding and provided false, identifying information to two officers of the California Highway Patrol ("CHP"). While he was being questioned by one of the officers about the discrepancies with the information he provided, but before he was actually placed under arrest, the other officer began a search of Smith's vehicle and discovered a black wallet wedged underneath the backseat. Inside the wallet was a fake driver's license issued under the name Steven Stone and an authentic identification card issued to Smith, both of which had Smith's picture on them.

While the search of the vehicle was taking place, Smith admitted having given false information and informed the first officer his real name was Kory Ray Smith. He was then arrested for impersonating another person and placed in the officers' patrol car. Because the wallet contained currency, Smith was given the option of leaving the bills in the wallet while he was booked or leaving them with the companion with whom he was traveling. Smith told the officers to leave the money with his companion. When the bills were removed from the wallet, the officers discovered the purported money was counterfeit.

Ultimately, Smith was indicted for knowingly possessing falsely made, forced, and counterfeited obligations and securities in violation of 18 U.S.C. §§ 2 and 472. Smith moved to suppress the evidence discovered during the search of his vehicle on the ground the search did not fall under either the search incident to an arrest or automobile exception to the Fourth Amendment's prohibition against warrantless searches. After reconsidering its initial decision to grant Smith's motion, the district court held: (1) the search was valid as incident to arrest because the officers had probable cause to arrest Smith before the second officer searched the vehicle; and (2) the second officer had probable cause to search the car under the automobile exception.

Smith then entered into a plea agreement whereby he reserved the right to appeal the district court's ruling along with any sentence in excess of the high end of the applicable guidelines range.

On appeal, and in pertinent part, the Ninth Circuit held: (1) at the time of the search, the police officers already had probable cause to arrest Smith for misrepresenting his identity such that the search was deemed incident to his arrest, and therefore permissible, even though it preceded his actual arrest; and (2) Smith had waived any right to appeal his sentence.

In doing so, the Ninth Circuit noted "[a] search incident to arrest need not be delayed until the arrest is effected. Rather, when an arrest follows 'quickly on the heels' of the search, it is not particularly important that the search preceded the arrest rather than vice versa." *Id.* at 951 (internal citations omitted). Thus, in pertinent part, it held "the search was a valid search incident to arrest because, at the time of the search, the officers had probable cause to arrest Smith, and the search was roughly contemporaneous with his arrest." *Id.*

With regard to Smith's right to appeal his sentence, the Ninth Circuit recognized courts will enforce a defendant's waiver of his or her right to appeal so long as the language of the waiver encompasses the grounds claimed on appeal and the waiver was made knowingly and voluntarily. Ultimately, it was satisfied Smith's sentence fell within the guidelines range for which he specifically waived any right to appeal, and that the record clearly indicated his waiver was made knowingly and voluntarily.

## Federal Rules of Criminal Procedure Rule 41 (G)

In ***In re: Search of 2847 East Higgins Road, Elk Grove Villiage, Illinois***, 390 F.3d 964 (7th Cir. 2004), the search warrant target, Michael Wellek, filed a motion under Fed.R.Crim.P. 41(g) for the return of $12 million in cash and business records seized by the government during a search of his warehouse. Wellek owns several strip clubs and is suspected of violating federal tax laws.

First, the Seventh Circuit addressed the seizure of cash. The $12 million in cash found in the warehouse was deposited by the government into a bank account, changing the nature of the bills into a claim against the bank. The government conceded that the bills themselves were not evidence of a crime, nor was the cash fruit of Wellek's crime. The currency was income from Wellek's lawful business. The Seventh Circuit noted that income from a lawful business is not a fruit of a crime even if the recipient of the income refuses to pay the tax owing on the income.

The Seventh Circuit held that the 41(g) motion should have been granted since the currency had no evidentiary value and was not the fruit of a crime. The government had already filed a $3 million tax lien against Wellek's property, and the IRS made a jeopardy assessment for $11.5 million as well. The reversal of the denial of the 41(g) motion revests Wellek with the property as of the date of the motion. This allows Wellek to argue the money should be applied to his unpaid tax bill as of that date, negating any accrued interest from that point. The court pointed out that once the money was deposited into a bank account, Wellek was technically prohibited from filing a 41(g) motion since the proper procedure for seeking restitution would be commencement of a suit in the Court of Federal Claims. Rule 41(g) cannot be used to sue for restitution because the rule does not

waive the sovereign immunity of the United States. The Seventh Circuit explained that since the government failed to raise the defense of sovereign immunity, the court can ignore it and grant the 41(g) motion. In this case, the effect of reversing the district court's denial of the motion is recharacterizing the government's possession of the money as based on the jeopardy levy rather than the search warrant.

Next, the Seventh Circuit addressed Wellek's 41(g) motion to return the business records seized during the search of the warehouse. Although the warrant sought records up to 2001, many of the records seized were for subsequent years. The court noted that records of subsequent years, found along with a large amount of currency, could contain evidence bearing on Wellek's violations of tax laws for current and past conduct. The issue becomes whether the government needs the original documents. The court indicated that the original documents contained handwriting that may need to be examined and tested. Those tests may be harder to conduct on copies. Wellek has been given full access to the documents and is allowed to make copies. The Seventh Circuit ruled the denial of the 41(g) motion with regard to the documents was proper. The decision of the district court was affirmed in part and reversed in part.

## Tenth Circuit Finds Protective Detention and Questioning of Defendant Reasonable on Officer Safety Grounds

In ***United States v. Maddox***, 388 F.3d 1356 (10th Cir. 2004), two federal marshals and a local deputy sheriff executed an arrest warrant on a third-party fugitive who was wanted for narcotics trafficking and known to be staying in a residence located in a dangerous, high crime area. During the arrest of the fugitive, the deputy sheriff observed Maddox, after arriving with several companions, place or retrieve an object from under the seat of the vehicle he occupied. Interpreting Maddox's actions as an "unknown threat," the deputy requested that Maddox and his companions remain seated in the carport of the residence while the two marshals completed their arrest of the third-party inside the residence.

Once additional deputies arrived, Maddox was separated from the group because the first deputy considered him a potentially deadly threat. He was then asked to produce identification and questioned whether he had any drugs or weapons on his person. When Maddox replied that he was carrying a concealed gun, he was handcuffed and disarmed. Maddox was again questioned whether he was in possession of any drugs and indicated that he had methamphetamine and a scale on his person. The deputy then took possession of the contraband and arrested Maddox. The entire encounter took approximately a half hour.

After being charged with a variety of offenses, Maddox moved to suppress the introduction of the gun and methamphetamine into evidence. The district court denied this motion after considering the totality of the circumstances. Shortly thereafter, in exchange for the government's agreement to drop all of the charges except a single violation of 18 U.S.C. §§ 922(g)(1), felon in possession of a firearm, Maddox entered into a conditional plea agreement, reserving the right to appeal the motion to suppress and any subsequent sentencing errors. At sentencing, the district court enhanced Maddox's sentence pursuant to 18 U.S.C. § 924(e) and U.S.S.G. § 4B1.4 to account for his earlier failure to return to prison from a work-release program.

On appeal, the Tenth Circuit held that: (1) the first deputy sheriff had reasonable suspicion to temporarily detain Maddox, on officer safety grounds, outside the home where the third-party fugitive was being arrested; (2) the scope of the seizure was reasonable for purposes of the Fourth Amendment; (3) the second deputy sheriff who arrived at the scene was justified in asking Maddox whether he had any weapons or drugs on his person; and (4) Maddox's previous failure to return to prison from a work-release program constituted an escape from prison and, therefore, a "violent felony" under 18 U.S.C. § 924(e) and U.S.S.G. § 4B1.4.

In doing so, the Tenth Circuit also considered the totality of the circumstances and found the first deputy's "articulable and reasonable suspicion of potential danger" justified the temporary, protective detention of Maddox. As for the reasonableness of the detention, the court found the deputy used only such force as was necessary for officer protection while temporarily detaining Maddox.

As for Maddox's arguments challenging the voluntariness of the admissions he was armed and carrying methamphetamine, the Tenth Circuit noted that, under *Terry*, the reasonableness of a search or seizure depends on "whether the officer's action was justified at its inception, and whether it was reasonably related in scope to the circumstances which justified the interference in the first place." *Id*. at 1368 (internal citations omitted). Since it had already determined Maddox's initial detention was reasonable, the court opined the officer's could have, consistent with *Terry*, performed a protective patdown of defendant's person. Thus, merely questioning defendant about his possible possession of firearms and narcotics, which is less intrusive than a frisk, was equally justified under these conditions.

Lastly, Maddox challenged the district court's decision to enhance his sentence under 18 U.S.C. § 924(e)(1) and U.S.S.G. § 4B1.4, arguing that his failure to return to prison following a work-release program did not constitute a violent felony. Without further comment, the Tenth Circuit

simply noted that Maddox's counsel candidly admitted Tenth Circuit precedent foreclosed any such argument.

## TITLE 26

### "Substantial" Tax Deficiency not an Element of § 7201

In ***United States v. Daniels***, 387 F.3d 636 (7th Cir. 2004), the co-defendants, Gregory Daniels and his wife Susan, were charged with two counts of attempted income tax evasion under 26 U.S.C. § 7201. The jury convicted them on both counts. The defendants appealed the convictions to the Seventh Circuit.

Gregory Daniels is a chiropractor, and his wife Susan Daniels manages his practice. The Daniels filed joint income tax returns for the years 1994 and 1995. On September 26, 2000, the Daniels were indicted on two counts of attempted tax evasion under 26 U.S.C. § 7201. The indictment alleged the defendants filed fraudulent income tax returns on April 15, 1994 and April 15, 1995. The defendants moved to dismiss both counts, based on the government's failure to allege a substantial tax due and owing, and the failure to indict within the six-year statute of limitation for the 1994 count. The government filed a superseding indictment, which changed the dates of the fraudulent filings to October 15, 1994 and August 15, 1995. Defendants claim count one materially amended the initial charge so it could not relate back to the original indictment. The district court denied the motion to dismiss and the defendants appealed.

The Seventh Circuit performed a de novo review of the indictment. The court found that its previous use of the word "substantial" when reciting the elements of a § 7201 charge did not mean substantiality of the tax deficiency became part of the required elements of the crime. To rule otherwise would contradict the clear language of the statute, reasoned the court. Also, if the government were required to prove a substantial tax deficiency, it would enable taxpayers to cheat on their taxes in small amounts without fear of prosecution. To clarify, the Seventh Circuit expressly ruled that the tax loss element of a § 7201 charge need not be substantial.

Next, the Court addressed defendants' argument that the superseding indictment did not relate back to the original indictment because it materially amended the charge by changing the filing dates. The Court noted that the crime was committed when defendants actually filed the returns. The defendants filed extensions and mailed the 1994 return on October 10th of that year. The superseding indictment relates back to the original indictment because it neither broadened nor substantially amended the charges. The defendants were on notice they were being prosecuted for filing the false 1994 income tax return. The Court affirmed the convictions. Since the original indictment was filed on September 26, 2000, it fell within the six-year statute of limitation.

## IDENTITY THEFT

In ***United States v. Harrison***, No. 03 CR.369, 2004 WL 2884310 (S.D. NY Dec. 10, 2004), Harrison was charged with identity theft in violation of 18 U.S.C. § 1028(a)(7) and aiding and abetting in violation of 18 U.S.C. § 2, for providing identifying information to a third party which was used to file false claims for refunds. Harrison had access to unsuspecting individuals' names, social security numbers, and other identifying information through her position as a clerk at the NYC Human Resources Administration. For a fee, Harrison provided identifying information to Kontoh, an unrelated third party, who used it to file false income tax returns. Harrison waived her right to a jury trial and stipulated to the facts and evidence used by the court at trail.

In finding Harrison guilty, the district court found Harrison had knowingly transferred, without lawful authority, the identifying information of another person with the intent to aid or abet Kontoh in the commission of his crime. Agreeing the "intent to aid or abet" required by §1028(a)(7) was the same as the intent required under §2, the court determined the government had to "…prove [Harrison] knew of the proposed crime…and had an interest in furthering it." The court concluded Harrison's post-arrest statement that she provided Kontoh the information "knowingly…in order for Kontoh to use these identities to file fraudulent income tax returns," provided the direct evidence that she intended to further Kontoh's tax fraud scheme. Further, the court found her statement was "…a clear reflection of both her knowledge of Kontoh's illegal purpose and her desire to advance it." Moreover, the court noted Harrison attempted to maximize the quantity of information she provided Kontoh even thought there was no indication the amount she received varied. Accordingly, the court held the government met its burden.

## TENTH CIRCUIT HOLDS TAXPAYER WAS NOT DENIED ACCESS TO THE COURTS

In ***United States v. Ambort***, 392 F.3d 1138 (10th Cir. 2004), Ernest Ambort conducted tax seminars throughout the United States wherein he instructed attendees that, although they were United States residents, they could legally claim to be "nonresident aliens" exempt from most federal income taxes. He also assisted attendees in filing amended return forms claiming a refund for past years' taxes. In exchange, Ambort received an instructional fee and a share of any subsequent refund.

Ambort was indicted on one count of conspiracy and sixty-nine counts of aiding and assisting in the preparation of false tax returns under 26 U.S.C. § 7206(2). Twice, he sought pretrial appellate relief, only to have the Tenth Circuit reject both requests. Ambort was ultimately convicted of the charged crimes and sentenced to a term of incarceration.

While his criminal action was pending, Ambort filed a civil action in the district court alleging that he was denied his constitutional and statutory right to challenge currently existing interpretations of the tax laws without risking prosecution. He also asserted that IRS procedures deter lawful claims for refunds via vague and ambiguous tax forms, instructions, and regulations. In sum, Ambort sought a declaration that he could make his tax refund claims without being subject to criminal prosecution, and an injunction restraining the government from criminally prosecuting him for making such claims.

The district court dismissed the case for lack of subject matter jurisdiction after relying upon the Anti-Injunction Act which prohibits individuals from maintaining any suit for the purpose of restraining the collection of any tax, as well as the Declaratory Judgment Act which prohibits declaratory judgments in matters relating to an individual's federal taxes. Ambort then appealed, arguing that his cause of action fell within the judicial exception to the prohibitions of both Acts which was recognized in *South Carolina v. Regan*, 465 U.S. 367, 373 (1984) (In that case, the Supreme Court stated that the Anti-Injunction Act may not bar relief "where…Congress has not provided the plaintiff with an alternative legal way to challenge the validity of a tax").

The Tenth Circuit affirmed the district court's dismissal for lack of subject matter jurisdiction, initially noting that Ambort's case did not fit within the confines of the *Regan* exception since his claims could have been resolved by way of existing alternative remedies, *i.e.*, the refund claim/refund suit procedure.

The Tenth Circuit also recognized that "federal courts have long rejected Ambort's rationale for lack of tax liability." *Id.* at 1140. It even pointed out that it had affirmed the dismissal of a refund claim Ambort had previously filed on the grounds that it failed to state a claim upon which relief could be granted. *See Benson v. United States*, Nos. 94-4182, 95-4061 (10th Cir. Nov. 13, 1995). In that case, the court specifically held that "Mr. Ambort, a United States citizen born in California and living in the United States, is subject to the tax laws," and then declared his assertion of status as a nonresident alien frivolous. *Id.*

In sum, the Tenth Circuit held that the consistent rejection of Ambort's frivolous arguments did not constitute a denial of access to the courts, and that his refusal to accept the administrative and judicial outcome of his refund claims did not bring his case within the *Regan* exception to either the Anti-Injunction Act or the Declaratory Injunction Act. The district court's determination that it had no subject matter jurisdiction over Ambort's claims was therefore affirmed.

## MONEY REMITTED TO THE IRS AND LATER REFUNDED TO THE U.S. MARSHALS SERVICE DID NOT SATISFY TAX LIABILITY

In ***McCorkle v. United States***, 2005 WL 428415 (U.S. Tax Ct. 2005), McCorkle was convicted of laundering and conspiring to launder telemarketing fraud proceeds from July 26, 1996 through July 2, 1997. McCorkle had on deposit $7 million in laundered proceeds in a Grand Cayman Island bank, of which he remitted $2 million to the IRS for "his 1996 tax year." McCorkle filed for an extension of time to file his 1996 income tax return and reported no tax due and owing with the extension. McCorkle made this payment in May 1997, shortly after Federal agents had seized his property and documents. As part of McCorkle's trial, the jury necessarily found McCorkle had remitted $2 million in laundered proceeds to the IRS, which was forfeitable pursuant to 18 U.S.C § 982. Accordingly, the court entered a forfeiture order requiring forfeiture of, among other things, the $2 million remittance.

Pursuant to the forfeiture order, the U.S. Marshall's Service sought to recover the $2 million remittance. IRS-Appeals complied and returned the $2 million in February 1999. Also in 1999, the IRS' examination of McCorkle's 1996 tax liability resulted in a tax deficiency of $905,315 and various additions to tax and penalties. McCorkle did not petition the Tax Court, thus on October 9, 2000, the IRS assessed the income tax deficiency, plus an estimated tax penalty of $48,186, a miscellaneous penalty of $656,353, a failure to file penalty of $656,353, and interest of $234,073. In April 2002, the IRS filed a notice of Federal tax lien (NFTL) showing an "Unpaid Balance of Assessment" for 1996 in the amount of $1,852,980.

In May 2002, McCorkle timely requested a hearing pursuant to 26 U.S.C. § 6320, arguing the $2 million satisfied his 1996 tax liability. The Appeals Office denied McCorkle any relief, sustaining the filing of the NFTL and finding the $2 million remittance had been subject to a criminal forfeiture proceeding and McCorkle was not entitled to rely on those funds to satisfy the 1996 tax liability. The Appeals Officer also determined McCorkle had admitted to his inability to pay, but McCorkle failed to request any collection alternatives or to provide any information from which collection alternatives could be considered.

McCorkle appealed the determination to the Tax Court, arguing the rights of the United States had not ripened until: 1) he was convicted; 2) the jury rendered a special verdict of forfeiture; and 3) the District Court entered the forfeiture order. McCorkle also argued the IRS was a "bona

fide purchaser for value reasonably without cause to believe the $2 million remittance was subject to forfeiture," thus the IRS could have defended against the forfeiture order and since it failed to do so, McCorkle argued the IRS should be estopped from trying to collect the 1996 tax liability. As there were no real disputes to the underlying facts, the parties each moved for summary judgment.

In granting summary judgment for the IRS, the court pointed to 21 U.S.C. § 853(c)'s "relation-back doctrine," which provides that the title of the United States to forfeited property "relates back" to the time of commission of the illegal act underlying forfeiture. Therefore, the court stated, the date the district court ordered the forfeiture was not the date on which the rights of the United States arose, and until the order was entered, the United States had no right to seize the forfeited property. However, the court continued, upon entry of the order, the forfeiture related back to the date of the criminal act giving rise to the forfeiture, such date being prior to McCorkle's remittance of $2 million to the IRS. Accordingly, the court rejected McCorkle's understanding of when title to forfeited property would vest in the United States.

The court also determined the Appeal Officer had no duty to defend against the forfeiture order and was duty bound to comply. Further, the court found McCorkle's estoppel defense had critical defects and the IRS's failure to petition the District Court did not bar the IRS from collecting McCorkle's 1996 tax liability.

## FEDERAL TORTS CLAIM ACT

### Sovereign Immunity Barred Tax Preparer's Suit Against the IRS

In ***Harris v. United States***, 2005 WL 518977 (S.D.Tex. 2005), Harris, a return preparer, brought an action against the United States and the IRS seeking damages and injunctive relief for alleged misconduct on the part of the IRS. Harris alleged the IRS engaged in a campaign of harassment against him and his clients in a bad faith effort to damage his business, which included telling clients he was under criminal investigation and forbidden from preparing tax returns, withheld refunds, improperly subpoenaing clients, as well as other specific allegations. Harris claimed this alleged conduct was defamatory, caused him "extreme emotional stress and financial hardship," and ultimately forced him to file for bankruptcy. In response, the government moved to dismiss for lack of subject matter jurisdiction, or alternatively, for summary judgment.

The district court granted the government's motion to dismiss finding Harris had failed to establish a waiver of sovereign immunity, and, alternatively, had failed to exhaust administrative remedies. The court concluded Harris' action fell under the Federal Tort Claims Act (FTCA), which subjects the government to liability for injury or loss of property "caused by the negligent or wrongful act or omission of any employee of the government while acting within the scope of his office or employment …." The court found, however, that "[Harris'] allegations stemmed entirely from the alleged conduct of the IRS officials related to the assessment and/or collection of revenue and therefore, fell outside the FTCA's waiver of sovereign immunity." This is because 28 U.S.C. § 2680(c) excepts from the FTCA, "[a]ny claim arising in respect of the assessment or collection of any tax…." Further, the court found the language of § 2680(c) "is broad enough to encompass any activities of an IRS agent even remotely related to his or her official duties." Accordingly, the court concluded § 2680(c) excepted Harris' tort claims.

Alternatively, the court found Harris' failure to exhaust administrative remedies still required dismissal. "Presentment of a claim to the appropriate agency and denial of that claim by the agency in writing, sent by registered or certified mail, are prerequisites to a tort suit brought against the United States." As the uncontroverted evidence was that Harris had not filed the requisite administrative claim, the court concluded that even if Harris' claims were permitted under the FTCA, the claims would still merit dismissal.

Finally, the court held the Anti-Injunction Act (AJA), 26 U.S.C. § 7421(a), which generally prohibits any suit "for purposes of restraining the assessment or collection of any tax," barred the kind of injunctive relief [Harris] sought. Harris' "broad plea for injunctive relief preventing the IRS 'from invading his privacy,' if granted, would certainly interfere with IRS activities intended to culminate in the assessment of collection of taxes, such as audits," the court stated. Accordingly, as no statutory exception applied, the AJA also barred Harris' request for injunctive relief.

CRIMINAL TAX BULLETIN

March/April 2005

TABLE OF CASES