

# Criminal Tax Bulletin

Department of Treasury  
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## TITLE 26 AND TITLE 26 RELATED CASES

### **Failure To Account For Or Pay Over Trust Fund Taxes Sufficient For Conviction Under 26 U.S.C. § 7202**

In *United States v. Gilbert*, 266 F.3d 1180 (9<sup>th</sup> Cir. 2001), Gilbert was convicted of violating 26 U.S.C. § 7202 when he failed to pay over to the IRS withholding taxes he collected from the employees of his private security business. As the responsible person for the company, Gilbert was required to collect, account for and pay over to the IRS taxes withheld from his employees. Although Gilbert collected and accounted for the taxes, he failed to remit them to the Service.

On appeal, Gilbert contended, *inter alia*, the district court improperly construed § 7202 in finding he violated the statute by failing to pay over the withholding taxes. He argued § 7202 requires the failure to *both* account for and pay over withholding taxes. In contrast, the government argued § 7202 imposes a dual obligation to account for and pay over withholding taxes and, therefore, it is a violation to fail to account for *or* pay over the taxes.

Focusing on the plain meaning of § 7202, the Ninth Circuit noted Gilbert's reliance on the cases of *Wilson v. United States*, 250 F.2d 312 (9<sup>th</sup> Cir. 1958) and *United States v. Poll*, 521 F.2d 329 (9<sup>th</sup> Cir. 1975), to support the proposition that § 7202 punishes the failure to account for and pay over withholding taxes was misplaced. In those cases, the court was only concerned with how to define willfulness under the statute and any statements as to whether § 7202 required the failure of both elements were dicta. The court agreed with the Second Circuit's analysis in *United States v. Evangelista*, 122 F.3d 112, 121 (2<sup>d</sup> Cir. 1997), that

construing § 7202 as requiring the failure to both account for and pay over the taxes would "result in a greater penalty for one who simply failed to collect trust fund taxes than for one who collected them and . . . used them for his own selfish purposes . . . so long as he notified the IRS that he collected the tax." As the Second Circuit concluded, "that Congress intended to make such a distinction is simply inconceivable." *Id.* Finally, the court also agreed with the government's contention that *Slodov v. United States*, 436 U.S. 238 (1978) supported a finding that § 7202 punished the failure to account for or pay over withholding taxes. In *Slodov*, the Supreme Court interpreted § 7202's civil counterpart, 26 U.S.C. § 6672, focusing on language similar to that of § 7202, in that a person is liable if he "willfully fails to collect such tax, or truthfully account for or pay over such tax." Although not directly on point, the Ninth Circuit opined *Slodov* "expressly states the general purpose of § 6672 and § 7202 - - that a person has an obligation to both withhold and pay over the tax. As such, when an individual fails to perform one of the required duties, he is subject to conviction under § 7202."

### **Honest Services Doctrine and Mail Fraud**

In *United States v. Vinyard*, 266 F.3d 320 (4<sup>th</sup> Cir. 2001), Michael Vinyard started a sham brokerage with his brother, James, to defraud James' employer. James' employer paid the sham brokerage over \$12 million to research recycling efforts and to negotiate deals on a confidential basis. The brothers did not inform James' employer they created and operated the brokerage. They also misrepresented to outside contractors the brokerage's relationship with James' employer. James pleaded guilty and testified against Michael, who was convicted of mail fraud and money laundering and was sentenced to 70 months' imprisonment. The indictment charged Michael with depriving James' employer of the intangible right of honest services of its employee and of money and property. On appeal, Michael claimed the indictment was invalid because

he neither intended to cause economic harm, nor caused actual economic harm to his brother's employer and, therefore, could not have violated the deprivation of honest services provision under the mail fraud statutes.

In affirming Michael's conviction and sentence, the Fourth Circuit noted Congress codified the "honest services" doctrine in 1988, clarifying the term 'scheme or artifice to defraud' includes depriving another of the intangible right of honest services. Therefore, the elements of mail fraud involving the deprivation of honest services are identical to those of a normal mail fraud prosecution, of which Michael was convicted. The court adopted the reasonably foreseeable harm test, which focuses on an employee's intent to commit, rather than on an employer's response to fraudulent acts, but held the test does not require proof of actual economic loss, nor an intent to economically harm the employer. The employee need only intend to breach his fiduciary duty and reasonably foresee that the breach would create an identifiable economic risk for the employer. Since Michael deprived the employer of a chance to consider other brokers and search for the best possible price, the possibility of a less than optimal outcome was reasonably foreseeable to Michael at the time he and his brother defrauded the employer. Accordingly, the court affirmed the denial of Michael's motion for judgment of acquittal.

## **OTHER CONSTITUTIONAL ISSUES**

### **Lack of Reaction Protected by Fifth Amendment**

In *United States v. Velarde-Gomez*, 269 F.3d 1023 (9<sup>th</sup> Cir. 2001), Velarde-Gomez was convicted of importing marijuana and possessing marijuana with the intent to distribute. While in custody following his arrest at a border crossing, but before being read his *Miranda* rights, Velarde-Gomez remained silent and made no reaction when the interrogating officer informed him that 63 pounds of marijuana had been discovered in the gas tank of the automobile he had been driving. At trial, the prosecutor suggested Velarde-Gomez's silence and complete lack of response was indicative of a professional drug courier, who is trained to maintain a calm composure. Velarde-Gomez appealed his convictions, asserting his Fifth Amendment privilege to remain silent was violated by the government's use at trial of his silence and lack of reaction.

In rejecting the government's argument that the evidence presented at trial was a comment on Velarde-Gomez's demeanor, rather than his silence, the Ninth Circuit followed the holding of its previous decision in *United States v. Whitehead*, 200 F.3d 634 (9<sup>th</sup> Cir. 2000) *cert. denied*, 531 U.S. 885 (2000). In *Whitehead* the court held the government could not comment on a defendant's post-arrest silence, even if the defendant had not yet been read *Miranda* rights. Similarly, the court ruled Velarde-Gomez's silence and lack of response were protected by the Fifth Amendment's privilege against self-incrimination because it found no meaningful distinction between the evidence presented by the government in this case and the defendant's silence held inadmissible in *Whitehead*. The court reasoned because the government's evidence was based solely on Velarde-Gomez's failure to speak, instead of a physical response or other action, it was not admissible demeanor evidence. The Ninth Circuit, therefore, reversed Velarde-Gomez's convictions and remanded the case for a new trial.

## **EVIDENCE**

### **Timely Disclosure of Brady Material**

In *United States v. Coppa*, 267 F.3d 132 (2<sup>nd</sup> Cir. 2001), Coppa and numerous co-defendants were indicted on various crimes related to a large-scale stock fraud and money-laundering scheme. Before the trial date was set, the defendants filed a motion to compel the government to immediately disclose all exculpatory and impeachment material in its possession. The district court granted the motion, basing its decision on its prior ruling in *United States v. Shvarts*, 90 F. Supp. 2d 219 (E.D.N.Y. 2000). In its petition for a writ of mandamus, the government claimed it had no constitutional obligation to disclose impeachment material relating to potential government witnesses immediately upon defendants' request. Moreover, the government asserted such disclosure was actually prohibited by the Jencks Act, 18 U.S.C.S. § 3500.

In granting a writ of mandamus, the Second Circuit noted, although a line of cases beginning with *Brady v. Maryland*, 373 U.S. 83 (1963), and *Giglio v. United States*, 405 U.S. 150 (1972), clearly establishes the government's constitutional duty to disclose evidence favorable to a defendant if it is material to the defendant's guilt or punishment, the prosecution generally is not required to disclose all exculpatory and impeachment material

immediately upon the defendant's request. Moreover, the Second Circuit held the issue of the materiality of the information required to be disclosed under *Brady* and *Giglio* turns on whether non-disclosure of the information would create a reasonable probability of altering the outcome of the trial. The government is only obligated to turn over *Brady* and *Giglio* material in time for its effective use at trial or a plea proceeding. The time of the effective use of a particular item of evidence depends on its materiality as defined in *United States v. Agurs*, 427 U.S. 97 (1976), and *United States v. Bagley*, 473 U.S. 667 (1985), as well as the particular facts and circumstances of the case. The Second Circuit, therefore, determined the district court erred in holding due process required the immediate disclosure of *Brady* material, and remanded the case.

### ***Brady* Violated When State Failed To Disclose Defense Witness's Statement**

In *Boss v. Pierce*, 263 F.3d 734 (7<sup>th</sup> Cir. 2001), the defendants, the Bosses, sought writs of *habeas corpus* overturning their state robbery and murder convictions. They argued that during their trial, prosecutors unconstitutionally withheld material evidence favorable to their defense, in violation of *Brady v. Maryland*, 373 U.S. 83 (1963). At trial, the state's key witness testified that one of the Bosses stole his bicycle and used it to knock down the victim. The witness then testified he saw both of the Bosses beat the victim and steal his money. The jury also heard from the girlfriend of one of the Bosses who testified he was not in the vicinity of the attack when it occurred. This testimony was corroborated by the witness's sister, Janice Hill. On the last day of trial, the state gave the Bosses an investigative report summarizing an interview with Hill conducted four days before the trial commenced. According to the report, Hill told state investigators the state's key witness had bragged that he had actually carried out the attack and had implicated the Bosses in order to avoid suspicion.

On appeal, the Seventh Circuit stated to establish a *Brady* violation "the defendant must demonstrate that (1) the prosecution suppressed evidence, (2) the evidence was favorable to the defense, and (3) the evidence was material to an issue at trial." Focusing on the suppression and materiality elements, as the state agreed the report was favorable to the defense, the court rejected the state's argument that through exercising "reasonable diligence," defense counsel could have uncovered the information Hill related to the investigator. The court opined "[w]e regard as untenable a broad rule that any information possessed by a defense witness must be considered available to the

defense for *Brady* purposes." As to materiality, the state contended the evidence was merely cumulative of other exculpatory testimony and thus, not material. Disagreeing, the Seventh Circuit found "independent corroboration of the defense's theory of the case by a neutral and disinterested witness is not cumulative of testimony by interested witnesses, and can undermine confidence in a verdict." Accordingly, the court directed the Bosses' writs of *habeas corpus* to be granted.

## **FORFEITURE**

### **Excessive Fines**

In *United States v. 22 Santa Barbara Drive (Garcia)*, 264 F.3d 860 (9<sup>th</sup> Cir. 2001), the Ninth Circuit held the forfeiture of illegal drug trafficking proceeds can never violate the Eighth Amendment's Excessive Fines Clause. The Ninth Circuit, following the Seventh, Eighth and Tenth Circuits, distinguished facilitating property from proceeds and held "[b]ecause criminal proceeds represent the paradigmatic example of 'guilty property,' the forfeiture of which has been traditionally regarded as non-punitive," the excessive fines clause does not apply to a forfeiture action brought under 21 U.S.C. § 881(a)(6), (which subjects to forfeiture proceeds traceable to drug transactions).

In this case, the government seized for forfeiture real property purchased with the proceeds of drug trafficking. Upon the sale of the property, the government was awarded the same percentage of the sale proceeds as was the percentage of drug proceeds used to purchase the real property. Because the value of the real property had substantially increased in value, claimant owners argued the amount awarded was excessive within the meaning of the Eighth Amendment. The Ninth Circuit disagreed.

The Ninth Circuit distinguished forfeitures brought under 18 U.S.C. §§ 881(a)(4) and (a)(7), which are considered punitive and within the ambit of the Eighth Amendment because they constitute payment as punishment for some offense, from forfeitures brought under § 881(a)(6), which involve the forfeiture of the actual drug proceeds. Not having ruled directly on this issue, the Ninth Circuit looked to other circuits for guidance. It found the Seventh, Eighth and Tenth Circuits have held the forfeiture of proceeds cannot be considered punishment and thus, subject to the excessive fines clause, because it simply parts the owner from the fruits of the criminal activity. Accordingly, the Ninth Circuit joined those circuits in holding the forfeiture

of proceeds can never be an excessive fine.

## **MONEY LAUNDERING**

### **Venue Proper Where Money Laundering Transaction Took Place**

In *United States v. Mikell*, No. 97-CR-81493 (E.D. MI Sept. 24, 2001), the United States District Court Judge for the Eastern District of Michigan, Southern Division handed down its decision on various motions the parties submitted in the case. Defendants Mikell and Grisel each filed a “Motion for Judgment of Acquittal or in the Alternative for Arrest of Judgment (Venue),” arguing the government failed to prove by a preponderance of the evidence that venue with respect to the money laundering counts was proper in the trial district. Mikell and Grisel were convicted of money laundering in violation of 18 U.S.C. § 1956(a)(1)(A)(i) based on a scheme to defraud a creditor, with a security interest in the product produced by Mikell and Grisel’s company, out of the debt it was due.

The district court judge agreed and ordered Mikell and Grisel’s convictions on the money laundering counts “arrested” for improper venue pursuant to Federal Rules of Criminal Procedure 34. The district court noted the Constitution mandated “[t]he Trials of all Crimes . . . shall be held in the State where the said Crimes shall have been committed.” Further, the district court found the underlying criminal activities were not relevant, even if the money laundering was a continuing offense. The Supreme Court interpreted the money laundering statute as not proscribing “the anterior criminal conduct that yielded the funds allegedly laundered,” and reasoned “the existence of criminally generated proceeds was a ‘circumstance element’ of the offense, not the essential conduct element as required for venue analysis.” *United States v. Rodriguez-Moreno*, 526 U.S. 275, 280 n.4 (1999).

Moreover, the fact that Mikell and Grisel’s underlying criminal conduct, as well as the conspiracy to commit the criminal activity took place in the Eastern District of Michigan was of no consequence. What was required was that the actual money laundering transaction take place in the Eastern District of Michigan. Because this was not the case, the district court ruled venue was not proper in the Eastern District of Michigan since the financial transactions in question occurred elsewhere.

## **SENTENCING**

### **Money Laundering Abuse of Trust Enhancement**

In *United States v. Young*, 266 F.3d 468 (6<sup>th</sup> Cir. 2001), Young pleaded guilty to embezzlement and money laundering charges. Young was the city manager for Newaygo, Michigan, and was responsible for the development and implementation of the city’s budget. He was also responsible for the city’s community and economic development. During his employment, Young opened bank accounts for two sham businesses and created and submitted fraudulent business invoices for payment by the city for services never rendered. The invoices were sent to the city treasurer, then forwarded to Young for approval. Checks for these invoices were deposited by Young into the bank accounts he opened. As a result of Young’s actions, the city could not pay its bills and suffered budget cuts. At sentencing, the district court applied a two level abuse of trust enhancement to each of the embezzlement and money laundering counts, then grouped the counts because both offenses involved the same victim. Young appealed the sentence, asserting the district court improperly enhanced the money laundering offense level for abuse of trust and impermissibly double counted the embezzlement conduct by applying that enhancement to both the embezzlement and money laundering offense levels.

The Sixth Circuit affirmed the sentence, finding the abuse of trust enhancement was properly applied to the money laundering count and the embezzlement counts were correctly grouped with the money laundering count. The court also held using the embezzlement conduct as relevant conduct in applying the abuse of trust enhancement to the money laundering offense was not impermissible double counting. The court noted Young, as city manager, had authority to approve payments and was individually entrusted with ensuring the validity of invoices. Young abused his position of trust by concealing the diversion of municipal funds into the business accounts he opened, which contributed significantly to facilitating the money laundering offense. The enhancement, therefore, was proper. Furthermore, after grouping the counts, the district court correctly ignored the embezzlement guideline calculation, which included one of the two abuse of trust enhancements, and based the sentence on the money laundering offense level calculation.

**Participation Must Be Irreplaceable For  
Downward Departure For  
Family Obligations**

In *United States v. Pereira*, No. 01-1303, 2001 U.S. App. LEXIS 25896 (1<sup>st</sup> Cir. Dec. 3, 2001), Pereira pled guilty to four counts of subscribing false tax returns and 21 counts of using the mails for commercial bribery. The charges stem from a cash kickback scheme arranged between Pereira, a purchasing agent, and the owner of one of his former employer’s vendors. Pereira’s plea agreement set his total offense level at 16, requiring 21 to 27 months’ imprisonment. Asserting the necessity for him to care for his elderly, invalid parents constituted an exceptional family circumstance, Pereira filed a sentencing memorandum seeking a downward departure. The district court departed downward to a level 10 after determining the departure was warranted because of Pereira’s extraordinary family obligations. On appeal, the First Circuit reversed the downward departure, ruling the district court had erred in granting Pereira a downward departure.

In reaching its verdict, the First Circuit opined that demanding family responsibilities do not by themselves constitute grounds for a downward departure. The court noted Pereira had a wife, two siblings, and friends living nearby who could assist in caring for Pereira’s parents. Moreover, the court found nothing extraordinary or exceptional about Pereira’s family circumstances. Observing that Pereira’s parents could depend on a network of family, friends, and alternative care facilities, the court refused to characterize Pereira’s involvement in this parents’ care as irreplaceable. The First Circuit concluded for a district court to grant a downward departure based on family obligations, the court must first properly determine the defendant to be irreplaceable. Because the district court did not properly find Pereira to be irreplaceable, the First Circuit ruled the court abused its discretion in granting Pereira a downward departure.

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