Sentencing and Restitution Issues in Criminal Tax Fraud Cases

By Matthew T. Schelp and Matthew P. Diehr

Attorneys who frequently represent criminal defendants accused of fraud are likely familiar with the importance of restitution in the federal criminal system to deter and punish crime. Equally familiar to these practitioners is the application of the all-important United States Sentencing Guidelines (“the Guidelines”). This article will (1) outline the statutory framework for sentencing and restitution in federal courts, (2) discuss this framework with some specific application to tax fraud or tax-related concepts, and (3) offer useful advice for practitioners facing sentencing and restitution issues in criminal tax fraud cases.

I. Restitution

A. The General Statutory Scheme in Federal Courts

Restitution is a concept familiar to lawyers in a great variety of practices. In Missouri, for example, “[a] right to restitution is established under unjust enrichment” by means of a civil lawsuit where a party has mistakenly conferred a benefit on another party. Homecoming Financial Network, Inc. v. Brown, 343 S.W.2d 681, 685 (Mo. Ct. App. 2011). In the context of a federal criminal prosecution, the Mandatory Victims Restitution Act of 1996 is the starting point. 18 U.S.C. § 3663A (“the MVRA”). Somewhat of a misnomer, the MVRA is plainly not mandatory—§ 3663A(c)(3) provides mechanisms for the court to decline to impose restitution when the sheer number of victims makes restitution impracticable or where loss calculation involves “determining complex issues of fact [that] . . . would complicate or prolong the sentencing process.” In the latter instance under § 3663A(c)(3)(B), known as the “complexity exception,” the court must make an assessment that this laborious process would outweigh the benefit to any victim.

This underscores the real focal point of the MVRA—the victims. “Restitution is designed to make victims whole, not to punish perpetrators; it is essentially a civil remedy created by Congress and incorporated into criminal proceedings for reasons of economy and practicality.” United States v. Carruth, 418 F.3d 900, 904 (8th Cir. 2005). 18 U.S.C. § 3664(f)(1)(A) explicitly contemplates that restitution should be calculated as “the full amount of each victim’s losses as determined by the court.” The point is driven home by requiring restitution prior to any applicable fines, which are of course another consequence of criminal conduct. 18 U.S.C. § 3572(b); see also 18 U.S.C. § 3664(d)(4) (court “may require additional documentation or hear testimony” to aid its restitution determination); 18 U.S.C. § 3771(a)(4) (victims retain “the right to be reasonably heard at any public proceeding in the district court involving . . . sentencing”).

1. Practitioners may have represented defendants who have ostensibly failed to profit from their crimes—substitution of meager gain as the restitution rightfully required of a defendant has not met with much success in federal courts. In United States v. Zangari, 677 F.3d 86, 92-93 (2d Cir. 2012), the Second Circuit joined several sister courts, including the Eighth Circuit, in holding that “a sentencing court ordering restitution under the MVRA may not substitute a defendant’s ill-gotten gains for the victim’s actual loss.”

Matthew T. Schelp is a partner in Jensen Bartlett & Schelp, L.L.C. He is a graduate of the University of Missouri School of Law. He served four years in the United States Navy Judge Advocate General’s Corps. He also held the position of Securities Fraud Coordinator and the Deputy of Healthcare Fraud Coordinator for the United States Attorney’s Office of the Eastern District of Missouri. He prosecuted cases involving public corruption, bank fraud, healthcare fraud and tax fraud and has argued cases before the United States Court of Appeals for the Eighth Circuit and the Court of Appeals for the Armed Forces. He practices predominantly in the areas of complex civil and criminal litigation.

Matthew P. Diehr is an associate in Jensen Bartlett & Schelp, L.L.C. He is a graduate of Saint Louis University School of Law, cum laude, where he was a member of the Saint Louis University Law Journal. His undergraduate degree is from Tulane University in New Orleans. Matt works with clients in the firm which currently represents clients accused of wire fraud, mail fraud, securities fraud and tax fraud.
The MVRA’s complexity exception has been the subject of recent litigation in the Eighth Circuit with respect to when, exactly, a court ought to determine that “complex issues of fact related to the cause or amount of the victim’s losses would complicate or prolong the sentencing process to a degree that the need to provide restitution to any victim is outweighed by the burden on the sentencing process.” In United States v. Petters, 2010 WL 2291486 (D. Minn. June 3, 2010), the court took the unusual step of issuing a sua sponte ruling that the burden on the sentencing process outweighed the need for restitution, invoking the complexity exception. Id. at *5. Petters involved a five week jury trial of a multi-billion-dollar Ponzi scheme spanning over a decade and believed to be the largest prior to Bernie Madoff. Id. at *1-2.

In Petters, the United States Probation Office had prepared its pre-sentence investigation report (“PSI”) with its list of victims and loss amounts, all while the government sought extensions to brief the issue due to its complexity. Id. The court noted internal inconsistencies in the PSI itself, compounded by the government’s alteration of victims and loss amounts in its subsequent proposed restitution order. Id. Time was an additional factor, as restitution orders are to be made within ninety days of sentencing. 18 U.S.C. § 3664(d)(5). The court’s patience, apparently, wore thin. Underwhelmed that this evidence met the government’s obligation that “[w]hen an MVRA victim is identified, the government must prove ‘the amount of the loss sustained by [the] victim as a result of the offense’ by a preponderance of the evidence,” the court found the factual record before it inadequate to render a sufficient restitution order, so it simply declined to order restitution. Id. at *2, citing United States v. Chalupnik, 514 F.3d 748, 754 (8th Cir. 2008) (quoting 18 U.S.C. § 3664(d)(5)).

In its decision to decline restitution under the complexity exception, the Minnesota district court took into consideration “that alternative avenues of recovery are available to victims.”2 Id. at *4. Another Minnesota district court had issued an analogous decision, awarding restitution to private victims but declining restitution for corporate victims, noting in dicta that “[t]he corporations’ better remedy is a pursuit of any rights they possess in a private lawsuit.” United States v. Kline, 199 F. Supp. 2d 922, 927 (D. Minn. 2002). This is notable because a clear circuit split exists with regard to whether the availability of alternative avenues of recovery is properly considered by courts as a factor weighing against restitution.3 The First, Fourth, and Ninth Circuits have expressed disapproval for considering the availability of alternative remedies as a factor weighing against restitution,4 while the Tenth Circuit has held expressly to the contrary.5 Petters did not specifically state that the existence of alternative avenues of recovery compelled its conclusion, but rather seemed to offer this fact to mitigate the appearance of harshness from this outcome. Petters, 2010 WL 2291486, at *4.

Whether the existence of “alternative avenues of recovery . . . available to victims” is properly considered by courts as a factor weighing against restitution may affect practitioners in a number of ways, whether representing a criminal defendant or perhaps a victim of such an offense. Because the Eighth Circuit has not taken a clear side in the circuit split, courts will continue to wrestle with whether such avenues of recovery are properly considered under the

2. The court noted that the government had previously expressed intent, absent a restitution order, to invoke its authority under Part 9 of Title 28 of the Code of Federal Regulations to remit forfeited assets to victims. Id. (“In other words, through the remission process victims will have the opportunity to seek restitution from the same funds from which Court-ordered restitution would be made.”).

3. The Eighth Circuit has, of course, approved district court decisions generally applying the complexity exception, but it has not expressly endorsed consideration of alternative avenues of recovery as a complicating factor weighing toward declining restitution. United States v. Martinez, 690 F.3d 1083, 1088-89 (8th Cir. 2012) (declining to issue restitution where Martinez’s victim “was going out of business regardless of Martinez’s fraud . . .”); United States v. Osland, 453 F.3d 1048, 1062-63 (8th Cir. 2006) (noting a court could decline to issue future lost income as restitution under the complexity exception, but ultimately upholding such an award).

4. United States v. Hyde, 497 F.3d 103, 108 (1st Cir. 2007) (rejecting the relevance of a bankruptcy award, discharge, or settlement to its restitution analysis); United States v. Alalade, 204 F.3d 536, 540 (4th Cir. 2000) (rejecting a defendant’s request to preemptively reduce his restitution obligations due to an anticipated remission proceeding); United States v. Cienfuegos, 462 F.3d 1160, 1162 (9th Cir. 2006) (“[U]nder the MVRA the availability of a civil suit can no longer be considered by the district court in deciding the amount of restitution.”).

5. United States v. Gallant, 537 F.3d 1202, 1254 (10th Cir. 2008) (“While the availability of other relief is deemed irrelevant to the amount of a restitution award, it is not necessarily irrelevant to the availability of such an award under § 3663A.”) (emphasis in original) (distinguishing availability of relief from a court’s determination of proper amount under 18 U.S.C. § 3664(f)(1)(B), which prohibits sentencing courts from reducing a victim’s restitution based on insurance coverage or other prospective compensation). District courts within the Second, Third, and Sixth—and, of course, Eighth—Circuits have considered availability of alternative remedies relevant to their restitution analysis. See United States v. Schwartz, 2006 WL 1662899, at *6-7 (D. Conn. May 25, 2006); United States v. Collardeau, 2005 WL 1106475, at *8 (D. N.J. Apr. 28, 2005); United States v. Warshak, No. 1:06-cr-00111, U.S. Dist. LEXIS 85888, at *2-3 (S.D. Ohio Aug. 27, 2008).
statutory language of the complexity exception to preserve scarce judicial resources or whether instead such a consideration unfairly passes the buck to victims in contravention to the MVRA’s victim-oriented approach. Practitioners should take note that in complex federal criminal matters—tax or otherwise—such questions regarding availability of alternative avenues of recovery may arise.

B. Restitution Considerations Unique to Tax Fraud Matters

The most common offenses for failure to comply with the United States tax code are the felony offense for attempting to evade or defeat any tax, 26 U.S.C. § 7201, and the misdemeanor offense for willfully failing to file a tax return, 26 U.S.C. § 7203. For individuals, the fines that attach to these offenses are $100,000 and $25,000, respectively. But as criminal defense lawyers know, clients may also find themselves caught elsewhere in the web of criminal statutes that may touch on tax-related offenses. These offenses do not necessarily implicate the MVRA—§3663A(c)(1)(A)(ii) mandates restitution for “offense[s] against property under this title [Title 18].”6 Because the power to award restitution is statutory in nature, “[f]ederal courts may order restitution only when explicitly empowered to do so by statute.” United States v. Yielding, 657 F.3d 688, 718 (8th Cir. 2011), citing United States v. Balentine, 569 F.3d 801, 802 (8th Cir. 2009). Not finding any such authority to issue restitution in Title 26, a court may not issue restitution as a separate part of a sentence for pure tax offenses such as attempting to evade tax or willfully failing to file a tax return. United States v. Nolen, 523 F.3d 331, 332 (5th Cir. 2008) (district court reversed where defendant “was convicted solely of Title 26 offenses but was ordered to pay restitution as a separate and independent part of his sentence, not as a condition of supervised release”).

Courts have held that the general conspiracy statute, 18 U.S.C. § 371, prohibiting “any offense against the United States, or to defraud the United States” also applies to tax fraud. Specifically, § 371 is interpreted broadly enough to proscribe conspiracies “for the purpose of impairing, obstructing, or defeating the lawful functions of any department of government.” United States v. Fletcher, 322 F.3d 508, 513 (8th Cir. 2003), citing Haas v. Henkel, 216 U.S. 462, 479 (1910). Commonly known as Klein conspiracies, the government may allege a conspiracy to defraud the IRS in the function of assessing and collecting taxes. Fletcher, 322 F.3d at 513; see United States v. Klein, 247 F.2d 908 (2d Cir. 1957).7

Because Klein conspiracies are prosecuted as Title 18 offenses, the MVRA is implicated. Because the victim of a Klein conspiracy is the United States—and it is clear “the IRS is an eligible victim under the MVRA”—concerns with regard to number of victims are unlikely to exist. United States v. Senty-Haugen, 449 F.3d 862, 865 (8th Cir. 2006). As practitioners know, the complexity of a defendant’s scheme to defraud is limited only by human creativity, but can it be so complex—for instance, in the accounting treatment required—that a court should decline to issue restitution under the complexity exception?

The prosecution of one-time Minnesotan business magnate Jeffrey Wirth is instructive. Wirth made just such an argument to the court—that the “calculation of restitution amount is also too complex” such that the court should decline to issue restitution under the complexity exception. United States v. Wirth, 2012 WL 4328378, at *1 (D. Minn. 2012). The court held that the government had proven a tax loss of $6,457,500.00 by a preponderance of the evidence, briefly reviewing the evidence presented to recreate Wirth’s finances and establish his tax liability. Id. at *2-3. The court was compelled by the fact that the government “underscored the tax loss restitution, giving Mr. Wirth the benefit of the doubt on occasions where the Government suspected fraud, but lacked sufficient witnesses confirming use of business funds.” Id. at *3. Accordingly, Wirth’s fraud, and it was sizable, was deemed not too complex for the court to issue restitution. In rejecting Mr. Wirth’s argument for the court to apply the complexity exception, the court also noted the irony inherent in a defendant’s complexity exception argument in a Klein conspiracy—the same fraudulent accounting treatment used to conceal one’s own fraud renders the scheme too complex for a court to levy restitution. Id.

The intersection between accomplice law and the MVRA has created another interesting body of law with respect to restitution. In United States v. Yielding, 657 F.3d at 718, the defendant was convicted of aiding and abetting a violation of the anti-kickback statute, in contravention to 42 U.S.C. §§ 1320a-7b(b)(2) and 18 U.S.C. § 2, and also aiding and abetting the falsification of a document, in violation of 18 U.S.C. §§ 1519 and 2. Yielding, 657 F.3d at 697. The court ordered the defendant to pay nearly $1,000,000 in restitution. Id. at 699. The Eighth Circuit overturned this order because of the fundamental precept that an aider and abettor is treated as having committed the underlying crime—in this instance, a violation of Title 42, not a Title 18

6. Restitution is also mandatory for certain other select offenses not pertinent to this article.

7. 18 U.S.C. § 286 is another statute federal prosecutors may charge to bring tax fraud within the ambit of the MVRA. This statute states: “Whoever enters into any agreement, combination, or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined under this title or imprisoned not more than ten years, or both.” Of course, the mail fraud statute may also be implicated. 18 U.S.C. § 1341.
crime against property.8 Id. at 718. (“a fundamental theory of American criminal law is that there is no offense of aiding and abetting or accomplice liability as such . . .”). 18 U.S.C. § 2 “does not establish a separate offense, but rather imputes the actions of the principal to the aider and abettor as a matter of law.” Id., citing United States v. Stands, 105 F.3d 1565, 1577 (8th Cir. 1997). For this reason, the court rejected the government’s argument that aiding the violation of the anti-kickback statute amounted to a violation against property under Title 18—or any of the MVRA’s other enumerated offenses mandating restitution—and it vacated the restitution order. Id. At least one court in the Eighth Circuit has noted that the same rationale applies for accomplices to tax fraud. United States v. Jewell, 2009 WL 1010877, at *12 (E.D. Ark. Apr. 25, 2009) (“A principal convicted of tax evasion in violation of 26 U.S.C. § 7201 would not be subject to the Mandatory Victims Restitution Act . . . so the same must be true for a person who aids and abets tax evasion because he is ‘punishable as a principal.’”), citing United States v. Elias, 269 F.3d 1003, 1021 (9th Cir. 2001). The same is not true of a conspiracy to commit tax fraud—a Klein conspiracy—because, of course, conspiracy “is a separate crime from the predicate conduct.” Jewell, 2009 WL 1010877, at *12.

Practitioners should also note that although a court does not have the statutory authority to issue restitution as a sentence unless a defendant has committed one of the MVRA’s contemplated offenses, the court does have the ability to order restitution as a condition of probation or supervised release. See Yielding, 657 F.3d at 719; 18 U.S.C. §§ 3583(d), 3563(b)(2), and 3556. This distinction is more than nuance—the court must specifically find its restitution order is conditioned upon probation or supervised release to be upheld. Id.; see also Nolen, 523 F.3d at 332. Practitioners who frequently represent defendants accused of tax-related crimes or criminal fraud are aware of the significance restitution has to defendants. Particularly when faced with an indictment that charges offenses codified in both Title 18 and Title 26, practitioners may find the interplay between the MVRA, Klein conspiracies, and accomplice law useful in addressing restitution issues.

II. Sentencing

A. The United States Sentencing Guidelines

18 U.S.C. § 3553(a) sets forth a variety of factors a district court shall consider in imposing a sentence, including:

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.

Section 3553 (b) states that district courts shall not impose a sentence outside the Guidelines unless it finds “there exists an aggravating or mitigating circumstance of a kind, or to a degree, not adequately taken into consideration by the Sentencing Commission in formulating the guidelines that should result in a sentence different from that described.” However, as practitioners are aware, United States v. Booker, 543 U.S. 220, 245 (2005) “make[s] the Guidelines effectively advisory.” Nonetheless, the Guidelines retain immense importance for practitioners advising clients regarding their options during plea bargaining and at trial. See, e.g. Rita v. United States, 551 U.S. 338, 347 (2007) (“a court of appeals may apply a presumption of reasonableness to a district court sentence that reflects a proper application of the Sentencing Guidelines . . .”). Rather than attempt a comprehensive analysis of the Guidelines in fraud matters that may touch on tax-related offenses, the authors instead present below a brief bullet-point discussion of three common Title 26 offenses with a few reference points for practitioners.

B. Sentencing Guidelines Applicable to Tax Fraud Matters

26 U.S.C. § 7201—tax evasion (“Any person who willfully attempts in any manner to evade or defeat any tax . . . or the payment thereof . . .”).

- A defendant convicted under § 7201 is sentenced under § 2T1.1 of the Guidelines. Guideline A.
- A defendant’s base offense level is six, to be increased by the tax table in 2T4.1 in proportion to loss. Guideline § 2T1.1(a)(1), (2).
- A defendant’s offense level increases by two for failing to identify a criminal source of income exceeding $10,000. Guideline § 2T1.1(b)(1).
- A defendant’s offense level increases by two if the offense involved sophisticated means (typically to conceal). Guideline § 2T1.1(b)(2).
- A defendant who commits perjury is subject to a two level increase. Guideline § 3C1.1. This may include a defendant who falsely avows ignorance of his tax liability. United States v. Frase, 496 Fed. Appx. 163, 166 (3d Cir. 2012).
- 26 U.S.C. § 7202—failure to pay

8. The government did not argue that 18 U.S.C. § 1519, an obstruction of justice statute, constituted an “offense against property under [Title 18].”
over payroll taxes (“Any person required under this title to collect, account for, and pay over any tax . . . who willfully fails to collect or truthfully account for and pay over such tax . . . .”).

• A defendant convicted under § 7202 is sentenced under § 2T1.6 of the Guidelines. Guideline app. A.

• A defendant’s base offense level is determined by the amount of tax not collected or accounted for and paid over, from tax table § 2T4.1. Guideline § 2T1.6(a).

• A defendant whose offense involves “embezzlement by withholding tax from an employee’s earnings and willfully failing to account to the employee for it” invokes the greater offense level of § 2T1.6 or 2B1.1. Guideline § 2T1.6(b)(1)

26 U.S.C. § 7203—failure to file (“Any person required under this title to pay any estimated tax or tax, or required . . . to make a return, keep any records, or supply any information, who willfully fails to pay . . . .”).

• A defendant convicted under § 7203 is sentenced under § 2T1.1 of the Guidelines. However, a defendant convicted under this provision for a violation of 26 U.S.C. § 6050I, related to cash receipts in a trade or business, is rather sentenced under § 2S1.3. Guideline app. A.

• A defendant’s offense level increases by two if he “abuses a position of trust or employs a special skill in a manner that . . . facilitates the commission or concealment of the offense.” Guideline § 3B1.3.

III. Conclusion

Representing defendants accused of federal tax crimes can be a complicated endeavor, and an intricate knowledge of the statutory framework for sentencing and restitution is crucial. The interplay between well-established legal theory, such as the common law origins of restitution, conspiracy law, and accomplice law, can occasionally lead to surprising results when put in practice in the context of criminal tax fraud matters. As the Guidelines indicate, recognizing the nuances of a client’s alleged offense and the manner in which it is charged are extremely important for effective advocacy. Hopefully, this article serves as a useful starting point for practitioners facing complicated issues with regard to sentencing and restitution issues in criminal tax fraud cases.