Collateral Estoppel in Civil Cases Following Criminal Convictions

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Summary of Article

The author surveys the authorities dealing with the preclusive effect in a subsequent civil case of findings made in an earlier criminal case – both at the guilt determination and sentencing phases. The preclusive effect is determined under the concept of collateral estoppel. In United States v. Mendoza, 464 U.S. 154, 158 (1984), the Supreme Court summarized the doctrine of collateral estoppel as follow: "once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." Collateral estoppel is a judicially developed doctrine designed to promote judicial economy but not at the expense of fairness. Accordingly, in the leading case for the present discussion, the Second Circuit summarized the elements that are needed before it is applied SEC v. Monarch Funding Corporation, 192 F.3d 295, 304 (2d Cir. 1999):

> To strike an appropriate balance between the competing concerns for fairness on the one hand, and efficiency on the other, courts have imposed a number of prerequisites to assure that the precluded issue, whether or not correctly resolved, was at least carefully considered in the first proceeding. For the bar to apply: (1) the issues in both proceedings must be identical; (2) the issue in the prior proceeding must have been actually litigated and actually decided; (3) there must have been a full and fair opportunity for litigation in the prior proceeding; and (4) the issue previously litigated must have been necessary to support a valid and final judgment on the merits.

The law is settled that collateral estoppel applies in tax litigation and that findings in criminal tax proceedings may be preclusive in a subsequent civil tax proceeding. Thus, the courts easily apply the doctrine to give preclusive effect to a determination of guilt of tax evasion to the related civil fraud penalty for the year(s) involved. This tax evasion finding is made in the guilt determination phase of the criminal proceeding, and is made only if guilt is found beyond a reasonable doubt (which is why there is no preclusive effect to a finding of not guilty in a subsequent civil proceeding involving the same issue but with a lesser standard of proof). Findings are also made in the sentencing phase of the criminal proceeding, where the court must find facts relevant to sentencing by a preponderance of the evidence, the same standard that generally applies in civil cases. The preclusive effect of findings made in the sentencing phase are less settled because, in part, of the relatively recent vintage of the federal Sentencing Guidelines which require elaborate findings to determine the appropriate sentence. In the few tax cases in point, the courts seemed not to have appreciated the key role of findings in the

sentencing phase under the United States Sentencing Guidelines and thus without any real discussion of the issues denied the preclusive effect for such findings.

In this article, the author argues that findings in the sentencing phase should meet the requirements for collateral estoppel. In the leading case – Monarch Funding – the Second Circuit rejected an automatic rule against collateral estoppel for sentencing findings and held that, in appropriate cases, collateral estoppel could apply (although it did not find that case an appropriate case). The author discusses the key role of findings made in the sentencing phase in light of the factors discussed in Monarch Funding. Specifically, the author focuses on the sentencing phase tax loss number which is conceptually the same as the fraud penalty tax base for the year(s) involved. Both fraud and the amount attributable to fraud must be determined in the sentencing phase by a preponderance of the evidence, just as they are in a civil proceeding as to the issue of the civil fraud penalty. There is a premium on the parties and the court in the sentencing phase to get the tax loss number right so that the court can make the critical calculation upon which to impose sentence, and there are institutional pressures requiring relatively open opportunity to properly resolve all issues relating to the quantum attributable to fraud. Accordingly, the author asserts, the tax loss number from the criminal proceeding for the year in question should be preclusive under the doctrine of collateral estoppel.

There is a nuance to applying preclusive effect, however, and that is the threshold requirement in§ 6663(b) that the IRS first prove fraud by clear and convincing evidence. As noted above, if the taxpayer had been found guilty of evasion in the guilt determination phase, that finding would be preclusive on the threshold § 6663(b) fraud issue. But, if the guilt phase determination of fraud is not made (e.g., as in a tax perjury case under § 7206(1)), then the sentencing findings do not assist in resolving the threshold burden because sentencing findings are made by a preponderance of the evidence and not by clear and convincing evidence, a more exacting standard of proof. Accordingly, in those cases, the IRS must first establish anew by clear and convincing evidence that some amount of underpayment was attributable to fraud and, once it does that, then the tax loss number determined for sentencing would be preclusive as to the civil fraud penalty base.

The author further argues that administrative as well as judicial economy is promoted by giving preclusive effect to the tax loss number findings in the sentencing phase. The court, the IRS, the DOJ prosecutors and the defense counsel are keenly focused on the tax loss number and spend considerable resources in developing a good tax loss number. Accordingly, the author urges that it is in all parties interests to settle the fraud and amount attributable to fraud once and then let the chips fall where they may for both sentencing and civil purposes. For this reason, the DOJ should relax its policy that civil liability will not be considered in the criminal proceedings, so that the prosecutors and the taxpayers counsel could stipulate an appropriate amount for both sentencing and civil fraud penalty purposes.

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I. Introduction.

In Coomes v. Commissioner, T.C. Memo 2004-182, Judge Goeke held that an order of restitution of the tax evaded incident to taxpayer's criminal sentencing for a tax crime does not collaterally estop the IRS as to the amount of the tax liability. Judge Goeke's cryptic findings and analysis of this issue mask subtle issues in the interface of the collateral estoppel doctrine and the criminal process, particularly the role of sentencing under the United States Sentencing Guidelines.[1] The purpose of this article is to address some of those subtleties in relation to the civil tax preclusive effect of findings in the criminal process. I hope to introduce the reader to the issues and subtleties involved.

By way of disclaimer, I am working on a case that raises one of the issues discussed in this article. That issue is the civil tax preclusive effect of a sentencing court's determination of the tax loss number in imposing the sentence. Under the Sentencing Guidelines for tax crimes, the tax loss number is the critical factor calculating the sentence. The sentencing court must find the tax loss number by a preponderance of the evidence. In concept, the tax loss number is the same as fraud base for the civil fraud penalty.[2] In the audit, the taxpayer has taken the position that the sentencing court's determination of the tax loss number is preclusive as to the amount subject to the civil fraud penalty. The IRS has taken the position that it can recalibrate the civil

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[1] I discuss the Sentencing Guidelines in more detail below. The Sentencing Guidelines have recently been put in considerable disarray by the Supreme Court decision in Blakely v. Washington, ___ U.S. ___, 124 S.Ct. 2531 (2004). Blakely was a decision under a state sentencing scheme, but the analysis of the state scheme at least potentially casts doubt upon the federal Sentencing Guidelines. The potential scope of Blakely has created turmoil among the courts of appeals and district courts who must deal daily with now uncertain Sentencing Guidelines. Accordingly, the Supreme Court recently accepted certiorari in two federal sentencing guideline cases and recently held oral argument on an expedited basis in order to permit it to offer further guidance in the sentencing.. The Supreme Court's ultimate decisions in the two accepted cases could impact the discussion in this article, but rather than speculating about the outcome and its impact on the issues discussed here, I shall assume the validity of the federal sentencing guidelines in basically the shape they now exist. I do note in this regard that the issues discussed in this article do not relate to the issues that so concerned the Court in Blakely and will concern the court in the two accepted cases.

[2] § 6663.

fraud penalty base to a significantly higher number than the tax loss number found by the sentencing court. I will state why I think preclusion is mandated or, at least, prudential, but I do caution readers to consider this position from their own analytical perspective.[3]

Experienced tax crimes practitioners might prefer to skip the introductory materials. The discussion in this article that addresses other than well-plowed ground is the discussion of the findings in the sentencing phase of a criminal proceeding. That discussion, with some background of the sentencing phase and predicate activity leading to the sentencing phase, starts at p. 16.

II. The Coomes Decision.

In Coomes, the taxpayer, a nonlawyer, represented himself in the Tax Court. This may account for the cryptic nature of the opinion. The problem with such undeveloped cases, of course, is that statements made in the opinion may gather a momentum that they don't deserve.

Judge Goeke states the facts he believes to be relevant as follows:

> Respondent determined deficiencies in petitioner's 1993, 1994, 1995, 1996, 1997, and 1998 Federal income taxes and additions to tax as follows:

		Additions to Tax		
Year	Deficiency	Sec. 6651(f)	Sec. 6654 /1/	Totals[4]
1993	$12,253	$9,189.75	$513.41	$21,956
1994	6,698	5,023.50	347.56	12,069
1995	5,554	4,165.50	301.16	10,021
1996	3,256	2,442.00	173.32	5,871
1997	5,269	3,951.75	281.90	9,503
1998	4,431	3,323.25	202.76	7,957
Total[5]	$37,461	$28,096	$1,820	$67,377

* * * *

[3] Portions of this article are from my Tax Crimes book used in the Tax Fraud and Money Laundering I teach at the University of Houston Law School. The latest version of that book (which is now in the process of substantial revisions) may be downloaded from my firm's web site: www.tjtaxlaw.com. I will have a new edition of this book available on the web site by the end of December (or, at the latest, early January 2005) in time for teaching the class in Spring 2005.

[4] The opinion does not provide this total column; I have added it.

[5] The opinion does not provide this total row; I have added it.

> On August 7, 2003, in the U.S. District Court for the Southern District of Ohio, petitioner pleaded nolo contendere to four counts under section 7203 of willfully failing to file Federal income tax returns for 1994, 1995, 1996, and 1997. Petitioner was sentenced to four 2-year terms of probation to be served concurrently and ordered to pay a fine of $2,000 and restitution of $27,475.97 in respect of his income tax liabilities for 1994, 1995, 1996, and 1997.[6]

At this point, I digress to make three points regarding this cryptic discussion of the facts. First, the restitution ordered at sentencing relates only to 4 of the 6 years involved in the Tax Court case. As I shall note in discussing restitution, restitution can only include the tax loss for the years of conviction. Second, Judge Goeke does not discuss the tax loss number that the sentencing court was required to find at sentencing. Unlike restitution, the tax loss number can include tax loss attributable to nonconviction years under the sentencing concept of relevant conduct. Nevertheless, as I shall note, the tax losses attributable only to the conviction years should logically aggregate the same amount as the restitution. Third, I find it impossible to logic out from the bare facts Judge Goeke recounts how the restitution amount was calculated[7] but this is not critical to my discussion in this article.

From the foregoing recited facts, Judge Goeke stated the issue as follows:

> Petitioner appears to argue that the District Court's judgment in his prior criminal proceeding, which ordered him to pay restitution, disposed of his tax liabilities for 1994, 1995, 1996, and 1997. This raises the issue of whether the doctrine of collateral estoppel applies with respect to petitioner's tax liabilities for 1994, 1995, 1996, and 1997.

From the context, it appears that the taxpayer was arguing that the sentencing order was preclusive as to his tax liabilities, penalties and even interest. Judge Goeke does not specifically say that, but as I noted in footnote 7, the aggregate civil tax liabilities (exclusive of penalties and

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[6] A more detailed, but still cryptic, statement of the facts may be found in the unpublished appellate decision in the criminal case. United States v. Coomes (6th Cir. - No. 03-4102), unofficially published at 2004 TNT 155-7. The procedural development of the case (including how the civil tax case was resolved virtually contemporaneously with the final resolution of the criminal case) is interesting, but further discussion here would lose the focus of this article.

[7] For example, the aggregate amount of the tax deficiencies asserted in the Tax Court for those 4 years is $20,777, which is less than the $27,475.97 restitution ordered for the 4 years. Judge Goeke's opinion does not address how the restitution aggregate amount was calculated, so it is possible that it included interest (a proper component for restitution) if the base restitution amount were $20,777. And, as I shall note, in determining restitution, the base might not have been the same as the civil deficiency in the Tax Court – i.e., the criminal numbers might not have included certain amounts which were purely civil tax adjustments reflected in the notice of deficiency.

interest) for the years was less than the restitution order, so that the taxpayer sought to be bound by the restitution amount for those years, he would have been shooting himself in the foot.

Judge Goeke then resolves the issue as follows:

> The purposes of applying the doctrine of collateral estoppel (a.k.a. issue preclusion) are to prevent litigants from having to relitigate identical issues and to promote judicial economy. See Meier v. Commissioner, 91 T.C. 273, 283 (1988). Collateral estoppel applies "once an issue is actually and necessarily determined by a court of competent jurisdiction, [and] that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." Montana v. United States, 440 U.S. 147, 153 (1979). Building on the Supreme Court's decision, the Court of Appeals for the Sixth Circuit has identified four conditions for collateral estoppel to be enforced. Hickman v. Commissioner, 183 F.3d 535, 536 (6th Cir. 1999), affg. T.C. Memo. 1997-566. First, the issue in the subsequent litigation must be identical to that resolved in the prior litigation. Second, the issue must have been actually litigated and judicially determined in the prior action. Third, the issue in the prior litigation must have been necessary and essential to a judgment on the merits. Fourth, collateral estoppel can be invoked only against parties and their privies who were part of the prior litigation. Id.; see also Montana v. United States, supra at 153-155; M.J. Wood Associates, Inc. v. Commissioner, T.C. Memo. 1998-375.
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> Petitioner pleaded nolo contendere to charges under section 7203 for willfully failing to file Federal income tax returns and pay taxes. Not a single issue, including petitioner's tax liabilities and additions to tax for the years at issue, was actually litigated during petitioner's criminal proceeding as a result of his nolo plea. In the criminal proceeding a judicial determination did not occur with respect to petitioner's tax liability since it was not litigated nor was it an essential element of the Government's case. See Hickman v. Commissioner, supra at 538. Consequently, petitioner cannot invoke collateral estoppel to limit his tax liability to the amount of restitution ordered by the District Court.[8] See id.; see also Morse v. Commissioner, T.C. Memo. 2003-332.

Judge Goeke thus rejected the taxpayer's attempt to limit his liabilities (including principal and interest) based on the restitution amount because, in Judge Goeke's sweeping words, "Not a single issue" related to those liabilities had been determined in the criminal proceeding.

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[8] Footnote 4 of opinion: This does not, however, change the fact that the District Court ordered petitioner to pay restitution. Given the factual circumstances of this case, we believe that the restitution ordered was to be paid to respondent. We therefore expect petitioner's tax liability to be offset by any payments of restitution petitioner made. See Toney v. Commissioner, T.C. Memo. 2003-333; Wallace v. Commissioner, T.C. Memo. 2000-49; cf. M.J. Wood Associates, Inc. v. Commissioner, T.C. Memo. 1998-375.

III. Collateral Estoppel – the Concept.

For present purposes, the collateral estoppel doctrine is aptly summarized by the Supreme Court in Montana v. United States, 440 U.S. 147, 153-154 (1979) (citations and footnote omitted):

> A fundamental precept of common-law adjudication, embodied in the related doctrines of collateral estoppel and res judicata, is that a "right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction . . . cannot be disputed in a subsequent suit between the same parties or their privies . . . ." [citation omitted] Under res judicata, a final judgment on the merits bars further claims by parties or their privies based on the same cause of action. Under collateral estoppel, once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation. Application of both doctrines is central to the purpose for which civil courts have been established, the conclusive resolution of disputes within their jurisdictions. To preclude parties from contesting matters that they have had a full and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions.[9]

The collateral estoppel doctrine is judicially developed,[10] so the courts determine the parameters of its application. Although there are different formulations of the elements necessary for the doctrine to apply, application in any case is policy based. The following is a good summary of the elements of collateral estoppel (citations and footnotes omitted):

> To strike an appropriate balance between the competing concerns for fairness on the one hand, and efficiency on the other, courts have imposed a number of prerequisites to assure that the precluded issue, whether or not correctly resolved, was at least carefully considered in the first proceeding. For the bar to apply: (1) the issues in both proceedings must be identical; (2) the issue in the prior proceeding must have been actually litigated and actually decided; (3) there must have been a full and fair opportunity for litigation in the prior

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[9] Judge Goeke cites portions of this quote from Montana in his opinion in Coomes. For a good discussion of the issues giving rise to collateral estoppel, see Restatement of the Law, Second, Judgments, § 27 (1982).

[10] United States v. Mendoza, 464 U.S. 154, 158 (1984).

proceeding; and (4) the issue previously litigated must have been necessary to support a valid and final judgment on the merits.[11]

IV. The Issues in the Civil Case Following Criminal Conviction.

A. Introduction

The issues in the civil case following criminal conviction are the amount of the tax deficiency and the penalties, if any that apply.[12]

B. Civil Tax Deficiency.

Where the taxpayer has previously filed a return, the tax deficiency is the amount of tax due less the amount reported to be due (if any).[13] I may refer to this as the underreported tax, and may use this term to describe the amount underreported when a return is filed or the amount due when no return is filed. Where the taxpayer has not filed a return, the deficiency is the amount due less the amount the taxpayer has paid (e.g., by withholding).[14]

There are elaborate civil procedures to determine the amount of a deficiency. These include audits resulting in a notice of deficiency and then litigation in the Tax Court or via refund or certain other types of litigation in the district courts (including the bankruptcy courts) or the United States Court of Federal Claims.[15] A taxpayer who disagrees with the IRS's determinations upon audit can obtain an independent review in one of the judicial forums.[16]

C. Civil Penalties.

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[11] SEC v. Monarch Funding Corporation, 192 F.3d 295, 304 (2d Cir. 1999); see also United States v. Ansueto, 304 F.3d 165, 172 (2d Cir. 2002). The Restatement states the elements more succinctly:

> When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim.

Restatement of the Law, Second, Judgments, § 27 (1982).

[12] Interest is a (more or less) mechanical calculation made after the Tax Court enters the decision document. Interest is thus not addressed in the main Tax Court proceeding. If the parties then disagree as to the interest calculations, they may resolve their differences in a subsequent Tax Court proceeding. § 7481(c).

[13] § 6211(a)(1).

[14] § 6211.

[15] I assume that the reader is aware of these procedures.

[16] Id.

1. Fraud Penalties.

In addition to the deficiency, the IRS may assert that the taxpayer owes penalties. The penalties most pertinent to the current discussion are fraud penalties –

- the civil fraud penalty which is 75% of the portion of the underpayment[17] attributable to fraud.[18]
- the fraudulent failure to file penalty which is up 75% (reached after 5 months of delinquency) of the net tax due on the date the return was required to be filed.[19]

Focusing first on the civil fraud penalty, the statute sets up a procedure for determining the base to which the penalty applies. First, the IRS must establish that some part of the underpayment is attributable to fraud.[20] The IRS must make a threshold showing of fraud as to some part of the underpayment by clear and convincing evidence[21] - a quantum of evidence more stringent than preponderance of the evidence (the normal civil proof standard) but less than beyond a reasonable doubt (the criminal proof standard). Once that threshold showing is made, the penalty base is the entire amount of underpayment but the penalty base is reduced by any amounts that "the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud."[22]

This statutory reduction of the fraud penalty base recognizes a concept long accepted in the tax law that some portion of the correct amount due and owing may be due to fraud while the balance is not. This concept, made explicit in the civil fraud penalty, plays out in both civil and criminal cases. In criminal tax cases, a key concept is the criminal figure – the tax liability for the year that was due to fraud. Tax liability amounts that are not due to fraud – which present

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17 The penalty applies to the "underpayment" as noted in the text. Underpayment and understatement are not necessarily the same, but usually are because the taxpayer usually pays with the return (through payments with the return, and withholding and estimated taxes deemed paid with the return) the amount reported due. Hence, usually, the underpayment and underreported amount will be the same.

18 § 6663(a).

19 § 6661(f) which increases the failure to file penalty from a maximum of 25% to a maximum of 75% when the failure to file is fraudulent is involved. The penalty base is the tax required to be shown on the return (§ 6651(a)) but that base is reduced by the tax that has been paid (e.g., by withholding or estimated taxes) by the due date of the return (§ 6651(b).

20 § 6663(b).

21 § 7454(a); see Rule 142(b), Tax Court Rules of Practice and Procedure (citing§ 7454(a)).

22 § 6663(b).

only civil tax issues – are not susceptible of resolution in a criminal case.[23] Following from this elementary concept, the criminal law dollar quantification of the fraud excludes amounts that are not attributable to fraud. Accordingly, when adopting the approach of quantifying the portion of the tax deficiency to which the civil fraud penalty applies, Congress rightly fell back to making the cut by excluding the portion not attributable to fraud. In concept the civil fraud penalty base is the same as the criminal figure in the criminal proceeding.[24]

The fraudulent failure to file penalty has no similar reduction of its base for nonfraud amounts. The penalty base is the entire amount underpaid and thus includes both: (1) amounts that the taxpayer had the requisite intent to defraud via failure to file (the criminal figures which we shall discuss below) and (2) any amounts that represent purely civil issue adjustments of the type we discussed above that would be excluded from criminal figure in a criminal case and from the parallel civil fraud penalty. In the normal case, therefore, the fraudulent failure to file penalty base will be at least the same as the equivalent civil fraud penalty base and could be more, conceptually even a lot more.

Both penalties are civil penalties that require a predicate finding of fraud. Fraud is, of course, a criminal concept imported for use in imposing the civil fraud penalty..

2. Accuracy Related Penalty.

The Code imposes a 20% accuracy related penalty.[25] The conduct penalized is negligence or disregard of rules and regulations, substantial understatement of income tax (a more or less objective penalty that can independent of taxpayer negligence or culpability), and substantial valuation or basis misstatement. The penalty is 40% for gross valuation or basis misstatements.

I shall not deal with the accuracy related penalty here because there is nothing in the criminal proceedings that deals with the conduct to which this penalty applies, so that the collateral estoppel doctrine could not apply to preclude the IRS from asserting the accuracy related penalty in a later civil tax proceeding. I think, however, that it is important to keep the accuracy related penalty in mind because, if collateral estoppel for findings in the criminal case were to bind the parties as to the civil fraud penalty base, the IRS can still assert the accuracy

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[23] The fountainhead decision is James v. United States, 366 U.S. 213 (1961) from which all else in the scope of the text in the statement follows. Accordingly, one of the drills for the defense practitioner in a criminal case is to show that the objects of the Government's or court's interest are civil tax issues that are not properly the basis for criminal prosecution and conviction.

[24] I will address this relationship in more detail below, but just wanted to summarize the relationship at this point.

[25] § 6662.

related penalty for deficiency amounts in excess of that civil fraud penalty base.[26] The real money at stake in the collateral estoppel issue is thus the difference between the 75% civil fraud penalty on the amount that the Government might be precluded from asserting on that excess and 20% (or 40% in case of a gross valuation or basis misstatement). In most cases that difference would be 55%, which depending upon the base amount to which the penalty applies would not be insubstantial. So, the Government would have a financial incentive to avoid being collateral estopped to a lower fraud amount determined in a criminal proceeding. But, by the same token, if the Government is not bound by the fraud amount determined in the criminal proceeding, then neither should the taxpayer be bound and, at least conceptually, the taxpayer may be able to establish a lower amount in the civil proceeding, thus avoiding the 75% penalty altogether on the reduction (at a cost of the 20% or, possibly 40% accuracy related penalty).

D. Statute of Limitations.

Because the taxpayer's civil tax liability has generally been put on hold pending resolution of the criminal tax investigation and case, it is often the case that the civil statute of limitations absent fraud will have expired.[27] The civil statute of limitations is normally 3 years, but is increased to 6 years if there is a substantial omission of income.[28] Two key exceptions apply. First, there is an unlimited statute if the taxpayer fails to file a return.[29] Mere failure to file is the event that extends the statute of limitations; there is no requirement that the failure to file be willful as is required for the crime of failure to file.[30] Second, there is an unlimited statute if the taxpayer filed a false or fraudulent return or willfully attempted to evade or defeat the tax.[31]

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[26] See IRM 35.2.3(11)(a) (in notices of deficiency, "If the case does not involve collateral estoppel, it may be prudent to consider raising the appropriate lesser penalties in the notice of deficiency as alternative determinations.")

[27] This was historically the rule. See TIGTA Final Audit Report -- Improvements Are Needed to Ensure Information Developed During Criminal Investigations Is Referred for Civil Action 1 (9/2/04), reproduced at 2004 TNT 210-4 ("Typically, civil actions such as making assessments and proceeding with collection activity are not conducted until the criminal aspects of an investigation have been formally closed.") However, in a recent publicly reported discussion, the Chief of CI is reported to have said: "Gone are the old rules about ceasing a civil audit once a matter has been referred for criminal activity" Sheryl Stratton, IRS, Justice Officials Discuss Booming Criminal Tax Business, 2004 TNT 214-3. Whether the IRS would actually finalize its civil investigation with the issuance of a notice of deficiency before the criminal case is tried may be a separate issue because the taxpayer could then institute a civil case with a collateral (or even principal) benefit of discovery of the Government's criminal case otherwise unavailable in the criminal proceeding. There would be a downside to the taxpayer, however, for the Government might attempt to exploit the civil case to end-run the taxpayer's Fifth Amendment privilege by the threat of dismissal or inability to prove his civil case without testifying. For these reasons, any civil case would likely be suspended pending the outcome of the criminal investigation and/or proceeding. See Pollack, Parallel Civil and Criminal Proceedings, 129 F.R.D. 201 (1990). But, provided that the Government issued its notice of deficiency timely (i.e., within the otherwise applicable 3 or 6 year civil statute of limitations), the

V. The Criminal Context - Fact Finding.

A. Introduction.

Collateral estoppel applies to facts found in the prior proceeding. The prior proceeding here is the criminal proceeding. The issues are (1) what facts, if any, were found in the criminal proceeding, and (2) should they be preclusive in a subsequent civil proceeding?

Criminal proceedings consist of two phases. First, there is the guilt determination phase which is a trial in which the fact finder determines whether the defendant is guilty or not guilty of the crime(s) charged. The guilt determination phase may be pre-empted by a guilty plea or, less frequently, dismissal of the indictment.[32] Second, if the defendant is found guilty, there is a sentencing phase. Under the Sentencing Guidelines, sentencing requires fact finding to determine facts relevant to an appropriate sentence. Sentence for this purpose includes as appropriate the physical incarceration, probation and the terms thereof, criminal fines, restitution and other matters as allowed by statute or the Sentencing Guidelines.

B. The Federal Tax Crimes.

1. Introduction.

Government will not then be a risk of losing the underlying tax revenue because of inability to prove fraud to obtain an unlimited statute of limitations.

[28] § 6501(a) and (e).

[29] § 6501(c)(3).

[30] § 7203.

[31] § 6501(c)(1) & (2).

[32] This phase may also be pre-empted by a nolo contendere plea that functions for further criminal proceedings (and many other purposes) as a guilty plea. I briefly discuss the nolo contendere plea below beginning on p. .

Federal tax crimes are specified in the Internal Revenue Code. There are a number of tax crimes as well general crimes related which often coexist with tax crimes.[33] For purposes of analysis, I focus here on the tax crimes most frequently encountered – tax evasion (§ 7201), tax perjury (§ 7206(1)), and failure to file income tax returns (§ 7203) and the so-called Klein conspiracy (Title 18 U.S.C. § 371).[34]

2. Tax Evasion.

Section 7201 describes the crime of tax evasion as a "willful[] attempt[] in any manner to evade or defeat any * * * or the payment thereof." This crime encompasses both what is called evasion of assessment (acts that prevent the proper assessment) and evasion of payment (acts that prevent the proper collection after assessment). For purposes of this analysis, I focus on evasion of assessment usually accomplished by the filing of a fraudulent tax return. The key factual elements of this crime in this setting are:

> First: That the defendant owed substantially more tax than he reported on his 19__ income tax return because he _______ [e.g., intentionally failed to report income];
>
> Second: That when the defendant filed that income tax return he knew that he owed substantially more taxes to the government than he reported on that return; and
>
> Third: That when the defendant filed his 19__ income tax return, he did so with the purpose of evading payment of taxes to the government.[35]

As respects liability for an amount of tax, all that is required for guilt is that the defendant owe substantially more tax than reported and that the underreporting of that substantial amount be willful.[36] There is no requirement that the substantial amount willfully underreported be quantified.

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[33] Federal tax crimes often involve conduct criminalized by other more general non tax-specific criminal provisions, such as conspiracy. 18 U.S.C. § 371, the general conspiracy statute which, in its second part, defines what is often referred to in a tax context as a Klein conspiracy. United States v. Klein, 247 F.2d 908 (2d Cir. 1957), cert. denied, 355 U.S. 924 (1958).

[34] The term "Klein conspiracy" comes from United States v. Klein, 247 F.2d 908 (2d Cir. 1957) and involves the "defraud" branch of the general conspiracy statute, 18 U.S.C. § 371. The term "has become a "has become the generic term for a conspiracy to frustrate the government (particularly the IRS) in its lawful information gathering functions." United States v. Alston, 77 F.3d 717, 717 n. 13 (3d Cir. 1996).

[35] These elements determined during the guilt phase are from the Fifth Circuit's Pattern Jury Instruction 2.96.

[36] I say that the amount must be substantial but recognize that there is disagreement among the circuits on whether a substantial amount is required. In United States v. Daniels, 387

3. Tax Perjury.

The crime of tax perjury is the act of "willfully" making and subscribing a false return or other document given to the IRS under penalties of perjury.[37] The elements of tax perjury are:

First: That the defendant signed an income tax return that contained a written declaration that it was made under penalties of perjury;

Second: That in this return the defendant falsely stated that _______ [state material matters asserted, e.g., the defendant received gross income of $_______ during 19__];

Third: That the defendant knew the statement was false;

Fourth: That the false statement was material; and

Fifth: That the defendant made the statement willfully, that is, with intent to violate a known legal duty.[38]

Unlike the crime of tax evasion, willful underreporting of a tax liability is not an element. A taxpayer may be guilty of this crime even if he fully paid or overpaid his tax liability.[39]

4. Failure to File.

The failure to file crime is simple – a duty to file and "willfully" failing to file.[40] The elements of the failure to file tax crime are:

One: The defendant _________ was required by law or regulation to file a tax return concerning his [her] income for the taxable year ended December 31, 19__;

F.3d 636 (7th Cir. 2004), the Seventh Circuit and stated "the government need not charge a substantial tax deficiency to indict or convict under 26 U.S.C. § 7201," but blunted the force of the holding by later noting that "In any event, defendants did not contest substantiality at trial, and at sentencing they conceded a tax loss of over $69,000 * * * [which is] substantial under any rubric." (387 F.3d at 641 n.3.) Other courts have found an implicit substantiality requirement. See cases discussed in Daniels and United States v. Helmsley, 941 F.2d 71, 83-84 (1991) ("We have also required a showing that the deficiency was substantial."). I think the difference is more apparent than real, for juries are unlikely to convict for insubstantial tax amounts and, as a result, DOJ tax is unlikely to pursue tax evasion counts for insubstantial amounts of tax (as well as the fact that insubstantial amounts will likely produce no jail time under the Sentencing Guidelines even if there is a conviction). So I stand by my statement in the text above, some purists may disagree.

[37] § 7206(1).

[38] Fifth Circuit's Pattern Jury Instruction 2.97.

[39] E.g., United States v. Johnson, 558 F.2d 744, 745 (5th Cir. 1977).

[40] § 7203.

Two: The defendant failed to file such a return at the time required by law; and

Three: In failing to file the tax return, the defendant acted willfully.[41]

There is no requirement that a tax liability be due; only that the taxpayer willfully failed to file a return that was due.

5. The Klein Conspiracy.

Title 18, Section 371 defines the Klein conspiracy as an agreement between 2 or more persons "to defraud the United States, or any agency thereof in any manner or for any purpose" with at least one overt act in furtherance of the conspiracy. The elements of the crime are:

> One: The conspiracy, agreement, or understanding to * * defraud the United States as described in the indictment, was formed, reached, or entered into by two or more persons;
>
> Two: At some time during the existence or life of the conspiracy, agreement, or understanding, one of its alleged members knowingly performed one of the overt acts charged in the indictment in order to further or advance the purpose of the agreement; and
>
> Three: At some time during the existence or life of the conspiracy, agreement, or understanding, defendant knew the purpose of the agreement, and then deliberately joined the conspiracy, agreement, or understanding.[42]

As with the tax specific crimes, there is no requirement of a tax due for conviction; the crime of conspiracy although requiring an object to defraud is independent of the crime or act that is the object. The act of agreement, so long as reflected in an overt act in furtherance of the agreement, is the act criminalized.[43] Still, in my experience, it would be hard (but not impossible) to imagine the Tax Division authorizing an independent conspiracy charge related solely to tax crime objects where no tax crime occurred.

C. The Guilt Determination Phase.

1. General.

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41 The Fifth Circuit has no pattern jury instruction for failure to file. I cite the above from the DOJ Tax Division's Criminal Tax Manual (DOJ Tax CTM) 120, 123.

42 There is no Fifth Circuit Klein conspiracy pattern jury instruction. This draft jury instruction was excerpted from DOJ Tax's Criminal Tax Manual.

43 United States v. Recio, 537 U.S. 270, 274 (2003) ("That agreement is a distinct evil, which may exist and be punished whether or not the substantive crime ensues.") (internal quotations omitted).

In the guilt determination phase, the trier renders a general finding or verdict of guilty to the charges. Although judges are sometimes the trier in criminal cases that do not plead, more usually the jury is the trier. For this reason, for purposes of further discussion I shall refer to the jury as the trier of guilt. The judge charges the jury as to the law and factual elements it must find for guilt; the jury then determines whether the required factual elements are present and returns a verdict of guilty or not guilty as to each charge (referred to in criminal parlance as count).[44] The jury does not specifically find separately the component elements, but in order to find guilt the jury, so the theory goes, will have determined that the facts of each element of the crime necessary to convict.[45] Because the jury is required to make the component findings in determining guilt, the Government may obtain preclusive effect for any facts the jury necessarily (presumably) determined in reaching the general jury verdict.[46]

2. Facts in the General Verdict for Tax Crimes.

a. Quantum of Tax Liability Not Found.

A guilty verdict for any of the crimes does not require a finding of the quantum of the tax liability for the year or years of conviction. Hence, nothing in the general criminal verdict could be preclusive as to the amount of the tax liability.

b. Fraud.

(1) General.

To summarize, the civil fraud penalty requires two key factual elements: First, the taxpayer must have committed fraud. Second, there must be a base – the amount the taxpayer intended to defraud – to which the penalty applies.

(2) Fraud Issue.

Only one of the tax crimes – § 7201 – requires a finding of fraud as to taxes willfully underpaid or underreported. Tax perjury and failure to file require no tax due and owing. The Klein conspiracy only requires a finding that the parties conspired to defraud – not that they did so. Hence, only the verdict of guilty as to tax evasion is preclusive that the taxpayer intended

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[44] As noted below, and as you should already know, finding of not guilty is not the same as innocent. Even more technically, the not guilty verdict is just a finding that the Government failed to prove guilt beyond a reasonable doubt.

[45] At least courts undertake the assumption (perhaps fiction in some cases) that the jury understand that it must find each factual element and did so in reaching the general verdict.

[46] United States v. Ansueto, 304 F.3d 165, 172 (2d Cir. 2002) ("We have long held that 'a criminal conviction, whether by jury verdict or guilty plea, constitutes estoppel in favor of the United States in a subsequent civil proceeding as to those matters determined by the judgment in the criminal case.'" (Citation omitted.))

fraud as to some amount, but does not determine and thus is not preclusive as to the amount.[47] A verdict of guilty as to the other tax crimes and the Klein conspiracy is not preclusive that the taxpayer intended fraud for civil tax purposes.

The principles from which these conclusions follow are developed in the Supreme Court's analysis in Helvering v. Mitchell, 303 U.S 391 (1938). The issues were (1) whether the taxpayer's acquittal of a charge of tax evasion was preclusive as to his nonliability for the civil fraud penalty and (2) whether civil fraud the penalty violated the constitutional prohibition of double jeopardy. Only the first issue concerns us here. The Court held that the acquittal was not preclusive. The Court reasoned that all that had been determined in the verdict of acquittal for tax evasion was that the Government had not proved beyond a reasonable doubt that the taxpayer was guilty of tax evasion. The verdict of acquittal "did not determine that Mitchell had not wilfully attempted to evade the tax." Since, the issue for civil fraud purposes is resolved by a lesser standard of proof (now clear and convincing under § 7454(a) in civil tax cases), the verdict of acquittal is not preclusive as to nonliability for the civil fraud penalty.[48]

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[47] Amos v. Commissioner, 43 T.C. 50 (1964). See IRM 35.4.21.5.

[48] See also Spear v. Commissioner, 91 T.C. 934 (1988); and IRM 35.4.21.5(3).

This analysis means that a verdict of guilt of tax evasion – because it does affirmatively find the presence of the key fraud element by a higher standard of proof – would be preclusive as to the key fraud element the civil fraud penalty.[49]

In Wright v. Commissioner, 84 T.C. 636 (1985) (reviewed), the taxpayer had been convicted of tax perjury (§ 7206(1)). The IRS argued that the conviction was preclusive as to the presence of the fraud element of the civil fraud penalty.[50] The Court rejected that argument,

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[49] See Gandy Nursery, Inc. v. United States, 318 F.3d 631, 638-639 (5th Cir. 2003) (holding that, for purposes of the civil fraud penalty, criminal conviction of fraud in reporting taxes in a net operating loss year constitutes collateral estoppel as to civil fraud in a carryforward year.)

[50] For the year in issue, the penalty base for the fraud penalty was the entire amount of the understatement whether attributable to fraud or not. § 6653(b) of the Internal Revenue Code of 1954. The rate was less (50% rather than the current 75%), but the base could be significantly higher (the entire tax deficiency rather than only the portion attributable to fraud).

reasoning based on solid Supreme Court authority that the wilfulness element of tax perjury simply required a finding that the taxpayer violated a known duty to file true, correct and complete returns, not that he intended to commit tax fraud in doing so. Hence, there had been no finding of fraud in the verdict of guilty for tax perjury. The Court concluded (p. 643):

> Thus, the crime [of tax perjury] is complete with the knowing, material falsification, and a conviction under section 7206(1) does not establish as a matter of law that the taxpayer violated the legal duty with an intent, or in an attempt, to evade taxes [the requirement for civil fraud].

From these cases and their progeny, we know that, except as to the presence of fraud in the case of a tax evasion conviction, a conviction of a tax or a related crime such as conspiracy will not be preclusive as to the presence of the fraud element for civil tax purposes (the fraud penalty and the unlimited statute of limitations for fraud).[51]

[51] E.g., IRM 25.1.6.3(3); 35.4.21.5(3).

(3) Quantum.

As apparent from the foregoing, none of the tax crimes requires as an element of the crime that the jury determine the amount of tax attributable to fraud. Accordingly, in the guilt determination phase, nothing is preclusive as to the base to which the civil fraud penalty applies. Similarly, as to the fraudulent failure to file civil penalty, there is no element of the failure to file criminal offense that requires the jury to determine the amount of tax due (the base for that penalty).

c. A Side Note on the Nolo Contendere Plea.

I noted that only the actual finding of guilt for the tax evasion will have a subsequent civil tax preclusive effect on the issue of fraud. In Coomes, the taxpayer was convicted of failure to file his tax returns, for which even a guilty verdict or plea of guilty would not be preclusive. However, Coomes avoided a judicial adjudication of guilt by entering a plea of nolo contendere.[52] Nolo contendere is Latin meaning I do not wish to contest. (Such pleas are often referred to in shorthand as simply nolo pleas, and I use that shorthand in the balance of this article.) Because of their equivocal nature, nolo pleas must be approved by the court.[53] Many courts will not approve them because they equivocate on responsibility. DOJ Tax has a policy of not accepting nolo pleas in tax cases because its criminal enforcement priorities are not well served by equivocations as to criminal liability.[54]

The nolo plea in Coomes was a nonevent as relevant to the discussion here. The historical analysis, however, is that nolo pleas in tax evasion cases is relevant to the issue of preclusion because there has been no contested and judicially resolved determination of fraud

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[52] FRCrP rule 11(a) permits a plea of nolo contendere.

[53] FRCP Rule 11(b).

[54] CTM 5.11[3]; see also USAM 6-4.320. The Department of Justice generally disfavors such nolo pleas. USAM 9-27.520 & 530.

that can be preclusive in the subsequent civil case.[55] This analysis was developed before the Sentencing Guidelines which now require that tax attributable to fraud be quantified in order to impose sentence.

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[55] Rule 11(b)(3) requires that a court make a judicial finding of a basis for a guilty plea, but has no similar requirement for a nolo plea. See also, IRM 9.5.13.4.2(6) ("A plea of nolo contendere subjects the defendant to the same punishment as a plea of guilty, but does not admit the charges. It cannot be used against him or her as an admission in any civil suit for the same act."); IRM 9.5.14.8.1(6) (same as to Tax Court); and IRM 9.6.3.6(6) (same); IRM 35.4.21.5 ("Collateral estoppel will not be asserted as to a judgment of conviction to evade tax based upon a "nolo contendere" plea.")

D. The Sentencing Phase.

1. The United States Sentencing Guidelines.

a. The Purpose of the Guidelines.

In order to understand the Sentencing Guidelines, I think it helpful first to summarize sentencing practice prior to the Sentencing Guidelines. Then, as now, the statutes set the maximum sentence for a defined crime.[56] The sentencing court had considerable discretion to set a sentence anywhere at or below the aggregate maximum sentences for the counts of

[56] Statutes sometimes also set minimum sentences, but for our present discussion we shall ignore minimum sentences because they are not relevant to the types of crimes upon which we focus.

conviction.[57] There were no standards to guide the sentencing court as to factors to consider and the weight they should be given. This resulted in great disparity in sentencing for similar counts of conviction. In the tax area, defendants might draw no or lighter incarceration in certain districts than similarly situated defendants did in other districts. Indeed, the phenomenon even occurred with the same districts between different judges and even with the same judge for whom consistency was the hobgoblin of small minds. The decision was influenced considerably by the judge's personal attitudes and convictions about the sentencing process, and these attitudes and convictions varied among the judges (and even as to the same judge depending upon his or her most recent experiences) because there were no guides. This phenomenon was perceived as unfair.

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[57] Koon v. United States, 518 U.S. 81, 96 (1996) ("Before the Guidelines system, a federal criminal sentence within statutory limits was, for all practical purposes, not reviewable on appeal.")

Moreover, there was no standard for relating sentences for one type of crime to another type of crime. Thus, for example, although tax fraud and embezzlement might have a maximum five year sentence, some judges might perceive that stealing from a corporate employer as more serious than stealing from the Government by underpaying taxes and mete out sentencing accordingly. This too was perceived as unfair, because it too could vary from judge to judge (with some judges perhaps reversing the seriousness of the offenses in their sentencing practices) and because there was no suggestion that Congress intended the crimes as being of differing seriousness in terms of sentencing.

The Sentencing Reform Act of 1984[58] ("the Act") was enacted to address these and related issues. The Act grants the United States Sentencing Commission authority to establish Sentencing Guidelines broadly to rationalize the federal sentencing process. The Guidelines

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[58] Title II of the Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, 217(a), 98 Stat. 1837, 2017-34 (codified as amended at 18 U.S.C. 3551-3568 (1994), 28 U.S.C. 991-998 (1994)).

promulgated by the Sentencing Commissions offer judges guidance on the effect of typical factors deemed relevant to sentencing, but still permit judges in appropriate cases to go outside those guidelines (in a process called departure) when they can articulate an acceptable basis for doing so.[59]

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[59] As I noted in footnote one of this article, there is some current uncertainty as to the Guidelines that is beyond the scope of this article.

b. Sentencing Ranges and the Sentencing Table.

The Guidelines establish ranges for sentencing.[60] The judge has virtually unfettered discretion to sentence within the guideline range. The judge may "depart" from the range, but must specify in writing why the case presents atypical features not considered by the Commission in setting the Guideline range. A party dissatisfied with a departure from the range may appeal, and the appellate court will review the departure de novo.[61]

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[60] The ranges and factors considered in deriving the ranges are recalibrated by the United States Sentencing Commission from time to time. The adjustments may be minor fine-tuning to reflect actual experience with the Guidelines or more major changes as, for example, congressional mandated reconsideration of the Guidelines to make the indicated punishments fit the magnitude of the criminal conduct that has rocked the corporate community.

[61] The standard for review was recently changed from abuse of discretion per Koon v. United States, 518 U.S. 81, 100 (1996) to de novo review pursuing to Prosecutorial Remedies

The ranges – applicable in all except atypical cases where the safety valve is ability to depart from the ranges – eliminate the excesses in the wide disparities in sentencing and set standards roughly relating the gravity of crimes. The ranges are set forth in a Sentencing Table[62] which is a grid where the axes (or determinants) are the Offense Level and the Criminal History Category. Under the Table, the higher the Offense Level and the higher the Criminal History Category the greater the sentencing range. My experience is that, in most tax crimes cases, the defendant has no criminal history and hence sentencing is determined solely by the Offense Level unless the court decides to depart.

The first step in calculating the Offense Level is to determine the Base Offense Level. For financial crimes generally, the Base Offense Level is determined by the dollar amount

and Other Tools to end the Exploitation of Children Today Act of 2003 (often acronymed to the "PROTECT Act"), Pub. L. No. 108-21, 117 Stat. 650, 670 (2003).

[62] S.G. Ch. 5, Part A.

attributable to the fraud.[63] In tax cases, this is called the tax loss,[64] which I often refer to as the tax loss number (although the word number may be redundant). That tax loss will then be applied to a Tax Table which determines the Base Offense Level. For example, under current Sentencing Guidelines, a tax loss of $30,001 through $80,000 has a Base Offense Level of 16, whereas a tax loss of $80,001 through $200,000 has a Base Offense Level of 18. The Base Offense Level is then adjusted for factors the Commission felt appropriate to the sentencing process (e.g., acceptance of responsibility, which is a downward adjustment favorable to the

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[63] For financial crimes, the dollar amount the defendant fraudulently sought to obtain is often the amount. However, for nontax crimes, any resulting loss to the victims that are attributable to the fraud can be included in the amount. A good example of the latter is financial statement fraud related to a public company where, as in the case of Enron and Dynegy (posture children for this concept), the investors' losses attributable to fraud can

[64] E.g. S.G. § 2T1.1 (Base Offense Level determined by the tax loss from the Tax Table which put a number on ranges of tax loss, with higher numbers as the dollars of tax loss increase.

defendant, and role in the conduct adjustments which are upward adjustments unfavorable to the defendant). After the adjustments, the resulting number is the Offense Level to which the Sentencing Table grid explained above applies.

Making these calculations requires fact findings. The sentencing judge determines the facts by a preponderance of the evidence.[65] The judge then applies the Guidelines and applicable law to those facts as found.

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[65] The actual Guideline (§ 6A1.3) provides that the court should consider relevant information with "sufficient indicia of reliability to support its probable accuracy." The Comments indicate that "a preponderance of the evidence standard is appropriate to meet due process requirements and policy concerns in resolving disputes regarding application of the guidelines to the facts of a case." Hence, it is accepted that the preponderance of the evidence standard is the one applied in the sentencing process. I should note that, technically, where the parties do not disagree with the recommendation of Probation Office in the PSR as to any sentencing factor (such as the quantum of the tax loss number in tax cases), the sentencing court

The fact finding process, highly summarized, is as follows: (1) after conviction, the federal Probation Office investigates the facts that, based on its experience with the Sentencing Guidelines and the particular sentencing judge, it believes the sentencing judge is required to, should or even might desire to consider in imposing sentence and presents its findings and recommendations to the sentencing judge in a Presentence Report (PSR);[66] (2) the parties make any objections they deem appropriate;[67] and (3) at the sentencing hearing, the judge finds the facts pertinent to the sentencing decision by adopting the uncontested findings of the PSR or,

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does actually have to make the findings by a preponderance of the evidence. The process then operates like a stipulated fact which, for example, the Tax Court will typically adopt by reference with full future preclusive effect for the stipulated finding.

66 S.G. § 6A1.1.

67 In order to make appropriate objections, the parties (the Government and the defendant through his counsel) are provided copies of the PSR in sufficient time for it to make appropriate objections to the PSR. S.G. § 6A1.2.

where objection is made, by resolving the objections in a sentencing proceeding. In that proceeding, the party making the objection can introduce evidence and, as appropriate, the opponent may introduce contrary evidence. The judge then resolves the contested finding by a preponderance of the evidence. The Federal Rules of Evidence do not limit the judge from considering evidence that he finds otherwise relevant and probative as to the facts he is required to find.

Thus, during the sentencing phase there will be fact findings made by the court. Judicial fact findings, of course, are the stuff of which collateral estoppel is made. The issue now is to identify the fact findings required and made in the sentencing proceedings that might potentially be relevant to the later civil tax proceedings. Before identifying the findings that are specific to subsequent civil tax cases, I turn to a general discussion of the preclusive effect of sentencing findings.

2. Collateral Estoppel for Sentencing Findings - Generally.

In SEC v. Monarch Funding Corp.,[68] the SEC brought a civil action alleging securities fraud against an individual (one Bertoli), seeking civil remedies of disgorgement and injunction. This civil action was suspended pending the outcome of related federal criminal litigation in another district. The prosecutor in the criminal action coordinated with the SEC. In the criminal case, Bertoli and others were charged with RICO violations and predicate violations of Section 10(b) and Rule 10b-5. Bertoli was also charged with conspiracy to obstruct justice for various actions to interfere with the investigation. The other defendants pled in the criminal case, and Bertoli was tried and convicted only of the obstruction counts. In the initial sentencing, the sentencing judge applied the Sentencing Guideline's obstruction provisions which reference the underlying criminal conduct the investigation of which gave rise to the obstruction. The sentencing judge found by a preponderance of the evidence that the underlying conduct was securities fraud and applied those guidelines even though the individual was not convicted of securities fraud. On appeal, the Court of Appeals (Third Circuit) affirmed the conviction but

[68] 192 F.3d 295 (2d Cir. 1999).

reversed the sentencing based upon ex post facto considerations (i.e., the sentencing judge should have used an earlier version of the Sentencing Guidelines).

On remand for re-sentencing, the sentencing judge incorporated his earlier findings by reference and made new findings related to the acts of obstruction. The sentencing judge did this even though some of the findings in the initial sentencing were no longer relevant to the sentencing on remand. The sentencing judge then resentenced. The Third Circuit affirmed the resentencing on appeal.

Upon recommencement of the civil case, the SEC moved for summary judgment on the basis that the sentencing judge's initial sentencing findings made as required by the Sentencing Guidelines were preclusive as to the acts establishing civil liability under Section 10(b), Rule 10b-5, and Section 17(a)(1)-(3). The district court granted summary judgment on that basis, but apparently had not considered the sentencing judge's opinion on the resentencing. The Second Circuit remanded for consideration of the impact of the resentencing opinion. On remand, The SEC renewed its motion for summary judgment. Bertoli argued in response that sentencing findings should never be given preclusive effect or, alternatively, that, in the context before the court, they should not be given preclusive effect. The district court rejected the position that sentencing findings could have no preclusive effect and adopted, instead, a position that they could have preclusive effect if, upon close scrutiny of the sentencing proceeding, the "traditional safeguards" of the collateral estoppel doctrine were met. Viewing the extensive sentencing proceedings and findings, the court determined that it was appropriate to give the findings relevant to the civil case preclusive effect in the civil case. Although the initial sentencing which contained the key findings had been remanded (thus not allowing any direct preclusive effect to those findings), the district reasoned that the findings and conclusions the sentencing judge reached after remand for the re-sentencing only made sense in light of the earlier findings which were incorporated by reference upon resentencing. Thus, only an inference could be made that the findings in issue were even adopted in the resentencing, but that was enough for the judge upon reconsideration of the motion for summary judgment in the civil case. The district judge thus granted summary judgment for the SEC by giving preclusive effect to the initial sentencing findings.

On appeal, the Second Circuit started its opinion as follows: “The question before us on this appeal, one of first impression, is whether findings made in a criminal sentencing proceeding may preclude relitigation of an issue in a subsequent civil case.”[69] After reciting the facts it deemed relevant to its analysis, the Second Circuit held:

> We decline to adopt a per se rule against extending the doctrine of offensive collateral estoppel to sentencing findings. We agree with Bertoli, however, that applying the doctrine in this case was inappropriate.[70]

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[69] P. 298. The court later said (p. 304): “As the district court acknowledged, the application of collateral estoppel to sentencing findings presents a novel issue. While a few cases have brushed against the question, they have done so without much elaboration leaving the darkness unobscured.” (Citation is omitted.)

[70] P. 303.

The Court reviewed the policies and risks of collateral estoppel, concluding with the summary we quote above as to the predicate elements to be considered in applying the doctrine of collateral estoppel.[71] The Court identified two risks in favor of a rule prohibiting preclusive effect to sentencing findings:

First, the court noted that in a civil case (such as the instant one), there are procedural opportunities to bear on the issue resolution process that are not available in a sentencing proceeding. The court noted that, although the Sentencing Guidelines require that a defendant have adequate opportunity to present information about a sentencing factor,[72] there is no absolute right to a "full-blown evidentiary hearing."[73] The court also noted that, in making sentencing

[71] P. , supra.

[72] Citing S.G. 6A.1.3(a) of the Guidelines there in consideration.

[73] P. 305.

findings, the judge is not constrained by the Federal Rules of Evidence which apply in a civil proceeding.[74]

Second, the court reasoned, "the incentive to litigate a sentencing finding is frequently less intense, and certainly more fraught with risk, than it would be for a full-blown civil trial."[75] Specifically, the court identified the possibility that a defendant in a sentencing proceeding will forego challenging sensitive issues for reasons unrelated to the merits, including unwillingness to testify at trial to refute the Government's allegations.

Then, focusing on the judicial economy basis for collateral estoppel, the court expressed concern that giving per se preclusive effect to sentencing findings might increase the risks of

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[74] Id.

[75] Id.

sentencing and thus force the expenditure of judicial resources at that stage.[76] The Court expressed specific concern about the Government introducing evidence for findings beyond the scope of what might otherwise be required. In addition, with these concerns about the mushrooming of the sentencing phase proceedings, there is no assurance that corresponding judicial economies will be achieved in subsequent civil litigation with a rule giving presumptive preclusive effect to the sentencing findings. The court questioned: "If the economies achieved by applying collateral estoppel are not readily apparent, why risk the permanent encapsulation of a wrong result?"[77]

Having thus made a powerful statement of the arguments against any preclusive effect for sentencing findings, the Court then retreated and said that it was not prepared to hold that

[76] Id., pp. 305-6.

[77] P. 306.

sentencing findings in all cases have no preclusive effect in subsequent civil litigation.[78] The Court held (citation other than Parklane omitted and page cites omitted):

> Generally speaking, the same concerns of unfairness and inefficiency were considered by the Parklane Court [Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979).] and were rejected as justifications for a total ban on the use of offensive collateral estoppel. Instead, the Court held that the "the preferable approach" is to entrust the task of minimizing such dangers to the discretion of our district courts. And although such dangers may be more pronounced in the sentencing context, we are confident that our trial judges will be able to limit their impact on a case-by-case basis. So long as the threat to fairness and/or efficiency has been minimized, we see no need to entirely foreclose application of the doctrine. Indeed, precluding relitigation of findings made during sentencing may promote an institutional goal of particular importance to the criminal process, namely,

[78] Id.

> "preserving the integrity of the judicial system by eliminating inconsistent results." For these reasons, we reject the per se rule urged by Bertoli and the amici.[79]

Having rejected a per se rule either way, the Court then rejected the SEC's argument for presumptive preclusion from sentencing findings:

> On the other hand, we cannot accept the SEC's position that collateral estoppel should presumptively extend to sentencing findings on the same basis as in other contexts. To the contrary, we conclude that precluding relitigation on the basis of such findings should be presumed improper. While we do not foreclose application of the doctrine in all sentencing cases, we caution that it should be applied only in those circumstances where it is clearly fair and efficient to do so. And the burden should be on the plaintiff in the civil case to prove these elements.

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[79] Id.

In other words, the Court in Monarch Funding imposed upon district courts the requirement to undertake fact specific inquiries to insure that the sentencing findings for which a party seeks preclusive effect are justified given the policy bases of the collateral estoppel doctrine. The Court of Appeals then made that inquiry and determined that, in that case preclusive effect of the sentencing findings was not appropriate. The court noted that given the nature of the remand, the finding of securities fraud in the original sentencing was not a "legal necessity" for the sentence rendered on remand.

The Court also noted that, given the extensive sentencing proceedings and the cooperation between the prosecutor and the SEC,

> we cannot say that the criminal action was not complicated by efforts to have express findings made on tangential issues at sentencing in order to give the SEC a chance to invoke collateral estoppel in the subsequent civil action. More importantly, however, collateral estoppel did not do much to simplify the civil

action. Even discounting the added complexities associated with the novelty of the issue, the district court's "close scrutiny" and "searching examination" in this case required considerable effort - in all probability more effort than would have been required for a summary adjudication under Federal Rule of Civil Procedure 56(c), or even for a trial. In light of such efforts, it made little sense to bar Bertoli from litigating his securities fraud liability ab initio.

We raise this point to make clear that in determining whether to apply collateral estoppel to sentencing findings in the future, district courts should start by making a threshold assessment of whether it will be efficient to do so. Given the potential unfairness associated with extending collateral estoppel to sentencing findings generally, if the court reasonably determines that the doctrine will not promote efficiency, it should feel free to deny preclusion for that reason alone.[80]

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[80] Pp. 309-310 (case citation omitted).

The Second Circuit continues to apply its Monarch Funding holding.[81] Indeed, it has held that the holding applies not only to the Government's attempted use of sentencing findings, but also applies to the defendant's attempted use of such findings.[82] It is and should be a two way street as to preclusion or no preclusion.

Other courts have not directly addressed the issue of the preclusive effect of sentencing findings (although some tax cases approach the issue as I shall discuss below). Monarch Funding is the best exposition of the issues to be considered in determining the preclusive effect of sentencing findings. Monarch Funding requires a fact specific inquiry to determine whether the sentencing findings meet the precepts of fairness for the application of collateral estoppel.

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[81] State of New York v. Julius Nasso Concrete Corp., 202 F.3d 82, 87 (2d Cir. 2000); and United States v. Ansueto, 304 F.3d 165, 172 (2d Cir. 2002).

[82] United States v. Ansueto, 304 F.3d 165, 172 (2d Cir. 2002).

3. Sentencing Facts Potentially Relevant to Civil Tax Liability.

a. Introduction.

I start by excluding those facts that are clearly not determined in the sentencing phase. The amounts of the taxpayer's correct tax liability for the year and of any tax deficiency are not determined at sentencing. This is because of the phenomenon noted above that the correct tax liability and deficiency may include amounts not attributable to fraud and thus not relevant to any aspect of the criminal case. Hence, there is nothing in the sentencing proceeding that could be preclusive as the correct tax liability or the deficiency.

b. Quantum of Tax Attributable to Fraud.

(1) Tax Loss Number.

(a) The Role of the Tax Loss Number.

The principal factor in sentencing for tax crimes is the tax loss attributable to fraud. As noted above, this is referred to as the tax loss number which sets the baseline – referred to as the Base Offense Level – from which the Guidelines sentencing ranges are determined and departures, if made, are determined. The Guidelines Application Notes state that the tax loss number is the "criminal figures."[83] The term "criminal figures" is the terminology used in criminal tax cases to distinguish the amount from the "civil figures." To illustrate, assume that a

[83] S.G. 2T.1.1, Application Note 1. The equation between the criminal figures and the civil tax fraud penalty is recognized in the following caution to IRS personnel: "The basic principle involved is that in criminal cases referred to the Department of Justice for prosecution the Chief Counsel, or his delegate, should not, without a basic change in the facts or law, recommend criminal prosecution on the one hand while on the other hand admit or concede there is no civil fraud or fraud delinquency penalty." IRM 35.8.12.11(4). The DOJ CTM has the same concept somewhat differently worded: "Tax loss is what is commonly called the 'criminal deficiency" DOJ CTM 5.03[1][a].

taxpayer has an actual underpayment of $100,000, but that one-quarter of it ($25,000) relates to civil tax adjustments as to which the taxpayer did not have an intent to defraud. The taxpayer did have an intent to defraud with respect to the other three-quarters ($75,000). In this case, the civil figure would be $100,000 and the criminal figure would be $75,000. The tax loss number for sentencing purposes would be $75,000.

In order to sentence, the Court is required to determine by a preponderance of the evidence that tax loss number.[84] That is the amount that relates to the taxpayer's fraud. That is the same conduct and the same base that is subject to the civil fraud penalty. That finding is a

[84] In the rare case where there is no tax loss number (e.g., a tax perjury conviction with no fraud as to underpaid tax or a failure to file case where no tax was due), the Guidelines provide a minimum calculation of the Base Offense Level. S.G. § 2T1.1(a)(2). Still that determination would be a fact finding of no tax loss number and would be subject to the analysis above for its preclusive effect in a subsequent civil proceeding.

direct and required finding of the amount of tax related to fraud. This is the stuff of which collateral estoppel is made, unless the Monarch Funding inquiry precludes its application.

(b) The Processes to Getting a Fair Tax Loss Number.

The importance of this ultimate sentencing finding of the tax loss number is evidenced throughout the criminal investigation and prosecution and has a major impact upon the actions of investigator, prosecutor and defense.[85] One of the critical roles of the IRS's Criminal Investigation ("CI") is to prepare a Sentencing Guidelines calculation, the principal component of which is, of course, the tax loss number, and include that with the Special Agent's Report

[85] Indeed, given the central role of the tax loss numbers, anyone tempted to play the tax fraud game become aware of the Sentencing Guidelines calculations (which can only be made with the baseline established by the tax loss number), in order to a proper risk-reward analysis based on the amount of the tax fraud he or she is considering.

("SAR").[86] In preparing that number, the Special Agent will have access to the resources of the IRS's civil agents and investigative tools and will work to separate the nonfraud items from the fraud items (for only the latter are considered in the criminal investigation and prosecution process and are, of course, equivalent to the tax loss numbers). My experience teaches that one of the critical responsibilities of the attorney representing a taxpayer in a CI investigation is to engage a forensic accountant to make these determinations independently and as quickly as possible.. The calculations permit the attorney to quantify the downside risk for the taxpayer. The work behind the calculations will give the attorney a detailed knowledge of the case and perhaps some opportunities to eliminate items not attributable to fraud. Finally, in the same regard, the calculations will permit the attorney to work with the Special Agent, if possible, to get the tax loss number down. Of course, if there are defenses to criminal culpability (i.e., taxpayer's actions were not "willful"), then that defense must be pursued vigorously also, but where that defense is problematic, focus on the tax loss number is critical.

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[86] IRM 9.5.8.

I have had varying levels of success, but, if the case appears to be likely to go the whole route, working the numbers must be explored to see if some tentative agreement can be reached with the Special Agent as to the tax loss number. I do note in respect to working with the Special Agent on these matters that most Special Agents play their cards close to the vest, so expecting a full and open dialog on these or any other issues is generally not realistic; however, the practitioner can offer up potentially exculpatory information or leads (including leads as to items that should be excluded from the tax loss number calculation).[87] The reason I think trying to get the number down at this stage is so critical is that, at least theoretically, if the agent includes a larger number in his SAR than ultimately agreed to with the prosecutor in the

[87] The use of leads is a venerable practice in the criminal tax arena. See Holland v. United States, 348 U.S. 121 (1954). This is just another setting in which leads can be useful. Many defense counsel may not want to play the lead card at this stage because it shows part of their hand, which they may prefer to withhold until a later stage.

sentencing phase, it could present a risk that the Probation Office or Judge might be tempted by the information in the SAR go above the parties' agreement.[88]

Prior to referring a case to DOJ tax, the taxpayer's attorney may request a meeting with CI to provide information that might dissuade CI from recommending to DOJ Tax that the taxpayer be prosecuted. CI will usually provide the a conference. At that conference the IRS usually provides very little information other than the "criminal figures."[89] The reason the IRS

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[88] Of course, there may be strategic reasons for the taxpayer to play it close to the vest at this stage also.

[89] IRM 31.4.2.15(1)(b). This IRM provision predates the reorganization of CI pursuant to the Webster Commission report. Webster Commission, Review of the Internal Revenue Service's Criminal Investigation Division (April 1999) from William H. Webster and the Criminal Investigation Division Review Task Force (often referred to as the "Webster Report"). Procedurally, those conferences occur slightly differently than discussed in the IRM, but substantively are the same, including disclosure of the criminal figures.

provides the criminal figures, however, is because of their central role in the process. (As noted above, the Sentencing Guidelines equate the criminal figures to the tax loss number.) Our experience is that, in providing the criminal figures, the IRS cautions that the numbers may be adjusted. Our experience is that the numbers are, in fact, usually adjusted in the process (particularly in the fine tuning before sentencing as we will discuss below).

CI's recommendation to process the case is forwarded to DOJ Tax via a Criminal Reference Letter ("CRL") which encloses the SAR and provides an independent critical analysis, including specifically an analysis of the sentencing calculations.[90]

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[90] IRM 31.4.7. The following is paragraph from an example CRL (Exhibit 31.4.7-1)

> We agree with the information set forth on S.A.R. pp. 19 and 20 relative to the sentencing guidelines. Jane Doe's tax liabilities for 1986 through 1989, exclusive of interest and penalties, total $31,465.00, and John Smith's tax liabilities for 1986 and 1987, exclusive of interest and penalties, total $17,942.00.

DOJ Tax's Criminal Enforcement Section ("CES") then receives and considers CI's recommendation.[91] CES may reconsider and adjust the criminal figures. Taxpayer's counsel

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> Sentencing Guidelines § 2T1.1, Note 2 (The tax loss does not include interest or penalties.) Based on the Tax Table contained in § 2T4.1, this gives rise to an offense level of 10 for Mrs. Jane Doe and an offense level of 9 for Mr. Smith. There are no adjustments to these offense levels, and the criminal history category is I. An offense level of 10, with criminal history category of I, would result in a sentence between 6 and 12 months imprisonment. An offense level of 9, with criminal history category of I, would result in a sentence between 4 and 10 months imprisonment.

The tax liabilities referred to here are the criminal figures. The actual civil tax liability is irrelevant to the criminal investigation and prosecution process.

[91] CTM 6-4.113, 6-4.114.

will usually be afforded a conference with CES prior to its final action.[92] In that conference or perhaps by separate letter, CES will advise of the criminal figures and often very little else.[93]

If CES authorizes prosecution, it will forward the case to the United States Attorney's office for indictment and prosecution.[94] The case is then assigned to an Assistant United States

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[92] CTM 6.4-214.

[93] See Id. which states that "The Division's practice regarding "discovery" is to advise conferees of the proposed charges, method of proof, and income and tax figures recommended by IRS." These are the criminal figures, and the practitioner is generally already aware of these if he or she took advantage of the conference opportunity before CI referred the case to CES. Our experience is that, if for any reason the CES attorney believes the IRS figures should be adjusted, he or she will so advise and quantify the adjustment.

[94] Some cases are sent to the U.S. Attorney for further investigation by the grand jury. In such cases where the parameters of the prosecution authorization are not set in the

Attorney ("AUSA") in the district to do such work as necessary to obtain the indictment and the conviction.[95] The Special Agent(s) involved in the IRS criminal investigation will be assigned to assist the AUSA and will typically be assigned to assist the grand jury pursuant to Rule 6(e), Federal Rules of Criminal Procedure. Sometimes the civil agent(s) who assisted the Special Agents in the investigation will assist also, either as a resource that can be called up and sometimes as an assistant to the grand jury. My experience is that, because of CES's selectivity in picking its criminal cases (will approve prosecution only if conviction is virtually a slam dunk), most of the interface between the prosecution team and the defense team other than procedural wrangling will be over the factors that will ultimately enter the sentencing

transfer of the case to the U.S. Attorney, the U.S. Attorney must seek further approval from CES for indictment.

[95] Sometimes, depending upon the U.S. Attorney's priorities and resource allocation, a CES attorney may be involved in this process and indeed may do virtually all of the work. At least in the Southern District of Texas, significant CES attorney involvement is not common because we have several AUSA's with significant civil and criminal tax experience.

calculations if (statistically, when) the taxpayer is convicted (either by the jury or by plea). Focusing on the tax loss number (the critical component of those calculations), there will be significant discussion and fine-tuning of the numbers, as appropriate.

Bargaining over the tax loss number occurs at the pre-trial phase in determining whether the defendant will plead guilty (which occurs in most tax cases).[96] Most plea agreements will include an agreement as to the tax loss number (as well as other sentencing factors) the parties will recommend to the Probation Office for inclusion in the PSR. In reaching that agreement, the prosecutor (whether an AUSA or a DOJ Tax attorney) must faithfully and honestly determine the factors upon which sentencing is based and not enter agreements that are not appropriate.[97] My

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96 Indeed, in one case where I was attempting to spar with the AUSA over my client's criminal culpability, he just brushed me off advising that we were better off working with him and his team (including the Special Agent and the civil agent) on the tax loss numbers.

97 DOJ commands its prosecutors to promote and preserve the integrity the Sentencing Guidelines by faithfully and honestly determining the factors that influence

experience is that, while prosecutors will listen to defense arguments for a lower tax loss number, they will ultimately only agree to a tax loss number that is appropriate. If the parties are unable to reach a plea agreement, the tax loss number discussion will continue after (and if) a guilty verdict is obtained, although it might well be that, in the plea discussions, the parties had already reached a tentative agreement as to the tax loss number and the plea discussions broke down over some other issue.

After guilt is determined either by plea or by verdict, the Probation Office investigates all of the factors that bear upon sentencing and prepares an extensive report ("PSR") in which it

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Sentencing. See DOJ memorandum dated January 20, 2003 titled "Principles of Federal Prosecution of Business Organizations" (usually referred to as the Thompson Memorandum after its nominal author) and the underlying United States' Attorneys Manual 9-27. Thus, prosecutors are not to manipulate any of the myriad of ways that could end-run the Guidelines and certainly are not supposed to participate in or even stand silent as to the factual components such as the tax loss number that are not appropriate.

details those factors and makes Sentencing Guideline calculations, and recommendations to the Judge as to appropriate sentencing. In the process of preparing that report, the Probation Office will consider any agreements by the parties as to the tax loss number and other sentencing considerations. The Probation Office is not bound by such agreements between the parties, but usually accepts them. The Probation Office will usually – invariably in my personal experience – accept the parties' agreement as to the tax loss number.[98]

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[98] One of the possible dangers that occasionally worries practitioners is the possibility that, if higher numbers are calculated in the SAR than in numbers agreed by the AUSA and defense, the Probation Office could go behind the numbers and recommend higher numbers. In this regard, the Probation Office will have the SAR. That is a theoretical risk that should not be ignored; hence, as I noted above, if possible and strategically appropriate, I try to drive the number down before the SAR is written. Nevertheless, the risk that the Probation Office would undertake an independent calculation is very low. The Probation Office would not simply accept uncritically numbers from the SAR in the face of a post-SAR agreement between the AUSA and the defense. And, given the dynamics of how the parties reach an agreement as to

If the PSR includes a recommendation as to any sentencing factor that is other than the parties agreed to or there is no agreement of the parties, either party may object and the court is then required to resolve the objection by a preponderance of the evidence.[99] Otherwise, as to PSR findings and recommendations that are unobjected, the Court will adopt the findings and recommendations of the PSR, although it could make independent determinations on the preponderance of the evidence standard.[100]

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the tax loss number and the integrity that prosecutors bring to the process, their agreement as to the tax loss number should be defensible if the Probation Office were to inquire. Of course, if the parties agreed to a number that was not appropriate in an attempt to manipulate the application of the Guidelines and the Probation Office sniffs that out, the Probation Office should so advise the court.

[99] F.R.Cr.P. 32(i)(3).

[100] Id.

Since collateral estoppel deals with findings made and issues resolved by a court in a prior case, I should just briefly address the process just described. Most tax crimes sentencing determinations are made by the court accepting the findings and recommendations of the PSR rather than by having to hear evidence and make a determination by a preponderance of the evidence. In effect agreed or unobjected findings in the PSR reflect the parties' agreement that, if called upon specifically to resolve the matter in a hearing, the sentencing court would make those findings by the required preponderance of the evidence. They are like stipulations in any case which are routinely found by a court in deciding cases based on the stipulation rather than independent resolution of the fact.[101] Findings based on stipulations are made and resolved in the prior proceeding, and for collateral estoppel purposes are not any the less binding simply because stipulated or otherwise agreed to by the parties.

I have dealt extensively with the criminal tax process and how, at each material phase, the tax loss number is a critical component that is considered and fine-tuned. All of the key

[101] E.g., the Tax Court routinely adopts the stipulations of the parties.

players are skilled at determining the amount of tax involved that is attributable to the taxpayer's fraud. And, all of the parties involved know that the benchmark for showing the tax loss is by a preponderance of the evidence. Any agreements the parties reach as to the tax loss number are made in expectation that the court would reach the same result upon considering all of the evidence. And the court explicitly makes the required findings if it has to consider the evidence upon objection. The point of all this is, of course, that this process is uniquely driven to develop the facts and determine the quantified amount of tax attributable to the taxpayer's fraud – a concept that the prosecutors, the Probation Office and the sentencing judge (as well, hopefully, as the defendant's attorney) know well. Simply stated, the process is designed to derive a good number attributable to the taxpayer's fraud.

With regard to the Monarch Funding inquiry, the findings on the tax loss number are critical to the whole sentencing process and are indeed the principal determinant in the sentencing process in tax cases. The Government and the taxpayer occupy the same roles as they would in any subsequent civil proceeding – the Government seeking to set the highest number[102] and the taxpayer seeking to set the lowest number. There is no reason to believe that the process I have described would not result in a fair number for the tax liability that is attributable the taxpayer's fraud. Indeed, the Sentencing Guidelines' design and purpose is to insure integrity in the process. In this context it assumes that the taxpayer's sentencing calculations will be based upon real and provable factors and thus specifically assumes that the sentencing court will make its calculations based on the tax loss attributable to fraud. Any result which denigrates the integrity of the process to get accurate tax loss numbers to the sentencing court would be

[102] OK, the Government – our Government – should be seeking in both proceedings to set the fair number, but practically speaking in both proceedings the two parties – the Government and the taxpayer – will have at least theoretically opposing positions with the taxpayer trying to drive the number down as low as possible.

counterproductive to the process.[103] Thus, I would argue that the Monarch Funding inquiry will in most cases support preclusive effect in the civil proceeding for the tax loss numbers.

How that preclusive effect applies presents a nuance. In order for the civil fraud penalty to apply, the IRS has an initial burden of establishing fraud as to some amount by clear and convincing evidence. Since, in sentencing, the sentencing court determines the presence and amount of fraud (i.e., the tax loss number) only by a preponderance of the evidence, that finding would not be preclusive as to the IRS's initial burden in applying the civil fraud penalty.[104]

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[103] How can the Government responsibly assert that it sought and obtained a lesser tax loss number in the sentencing process than was proper (an argument that is implicit if it seeks in the later civil proceeding to increase the base for the fraud penalty)? That would be an admission of the precise type of manipulation of the sentencing process that the Sentencing Guidelines were intended to avoid. This is a strong policy argument for denying the Government the opportunity to play those games in sentencing.

[104] Cf. Helvering v. Mitchell, supra.

Accordingly, the IRS must first shoulder the burden of establishing fraud by clear and convincing evidence and, once it has done that, the quantum of the penalty should then be set by the sentencing court's findings as to the tax loss number.

The one tax case that I have found that appears to address the issue holds contrary without critical analysis. In Maciel v. Commissioner, T.C. Memo. 2004-28, prior to the Tax Court case, the taxpayer had pled guilty to tax perjury for 1991 and 1992. In his written guilty plea, as summarized and quoted in part by the Tax Court, the taxpayer admitted that:

> "willfully" made and signed his 1991 and 1992 individual tax returns that he "did not believe" [were] "true and correct" [and] "willfully omitted true and correct information concerning" [his] "income, knowing then that" he "had additional reportable income" of $78,454 and $75,587 for 1991, and 1992, and that there

> was additional tax due and owing on this additional income of $19,299 and $10,377 for 1991 and 1992, respectively.[105]

Further, as noted by the Court:

> Petitioner admits that he is estopped to deny that he willfully omitted $78,454 and $75,587 of income for 1991 and 1992, respectively, but contends that he is not estopped to deny the fraud penalty for those years. Petitioner concedes that his conviction is relevant evidence on the issue of fraud.

The Court then discussed the doctrine of collateral estoppel and held, on the basis of its decision in Wright, that a tax perjury conviction is not per se preclusive as to fraud. The Court then turned to the sentencing proceedings upon which the taxpayer relied. Those proceedings which are quoted in footnote 57 are (emphasis supplied):

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[105] The LEXIS Pagination is p. 64.

n57 Judge Fogel [the sentencing judge] stated:

But I **don't** think the conduct looked at in its totality suggests that the reason * * * [petitioner] diverted the money was to avoid paying money to the Internal Revenue Service. I think that's the finding that the Court would have to make. So I think we're looking at the lower of the two [sentencing] calculations.

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The Court has considered the entire 1990, 1991, 1992, but that there is no intent to evade that's established convincingly by the record. So I would find this is a [sentencing] guideline level 6 which gives the Court an opportunity or gives the Court the discretion, rather, to impose anywhere from zero to six months incarceration.

Although the quote is cryptic and is not put in context in terms of the Sentencing Guidelines, I think it is evident what the sentencing court did – it found for purposes of determining the Base Offense Level that no tax loss number was involved (i.e., "no intent to evade"). The relevant portion of the Sentencing Guidelines, § 2T1.1 (not quoted by the Tax Court) is:

> (a) Base Offense Level:
> > (1) Level from §2T4.1 (Tax Table) corresponding to the tax loss; or
> > (2) 6, if there is no tax loss.

The sentencing judge thus found that there was **no tax loss** because the taxpayer's conduct, while constituting tax perjury, had not been with the intent to evade his tax liability. (Remember that the tax perjury crime can be committed without any tax fraud, so that there is no tax loss for sentencing purposes, and there is no fraud for civil tax purposes.) How the sentencing judge reached that finding is not apparent from the Tax Court's opinion,[106] but that he did reach the finding seems clear at least from the only portion of the record cited in the Tax Court's opinion. Further, it is apparent in the context of the quote from the sentencing hearing and the Sentencing Guidelines that the finding was necessary for the sentencing – i.e., probation without any incarceration.[107] Nevertheless, with no Monarch Funding type inquiry or other analysis of the Sentencing Guidelines nor indication of appreciation for the process, the Tax Court just denied preclusive effect for the finding.

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[106] Although I can't personally see how a conclusion of "no intent to evade" can be made in view of the taxpayer's stipulation of willfully unreported income, there is no apparent indication that the Government successfully appealed that conclusion.

[107] See Tax Court opinion LEXIS p. 24.

A bankruptcy court held in In re Minkoff[108] that the tax loss number in the criminal case was not preclusive as to the civil tax liability. As noted above, that holding that the tax loss number determination is not preclusive as to the taxpayer's civil tax liability is absolutely solid. The issue discussed here is rather whether it is preclusive as to the fraud elements (presence of fraud and amount of tax attributable to fraud). Minkoff does not address that issue.

The IRS's only pronouncement on the issue – a redacted field service advice (FSA)[109] – suffers the same infirmity. There, two individuals – X and Y – owned two companies – Co. A and Co. B – and received income from each which they failed to report on their returns. They were indicted for tax perjury – i.e., failing to report the income from each company on their returns. At sentencing, the court said that, since the jury rendered a general verdict, it could not determine whether the jury felt that the individuals had willfully misreported with respect to both

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108 unofficially reported at 2000 TNT 12-15.

109 FSA 200221002, unofficially reported at 2002 TNT 102-75.

companies or only one of them.[110] As reported by the FSA, the sentencing court "held them criminally responsible only for willfully failing to report income from Co. A." Although not fleshed out in the FSA, I take that to mean that, at sentencing, under the relevant preponderance of the evidence, the sentencing court determined a tax loss number which, because it found no fraud involved, excluded the income from Co. B. Finally, although the FSA is not explicit, it seems that the individuals in the civil proceeding were arguing that the sentencing finding

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[110] The FSA discussion of the court's sentencing discussion appears to be inarticulate in terms of the sentencing. The FSA thus says that, for the reason noted in the text, the sentencing court could not determine "whether the jury believed X and Y were guilty of fraud with respect to both Co. A and Co. B, or guilty with respect to only one of the two companies." The charges of conviction were for tax perjury which simply requires willful misstatements under perjury; it does not require fraud as to underpayment or underporting of income that results in underpayment (as we have noted). In the context, all the jury determined in a guilty verdict was that the individuals were guilty of willful misstatements under oath, not that they were guilty of fraud.

excluding Co. B is preclusive so that the tax on that income cannot be included in the civil fraud penalty tax base. The IRS concluded on these facts that the sentencing findings were not preclusive.

The IRS analysis is, I think, weak. The IRS first focuses its discussion by setting forth an understanding of the differences between the criminal case and the civil case. It misstates those differences (probably because the author misunderstood them). First, consider the following:

> Fifth, the higher "standard of proof imposed on the Government in criminal proceedings commonly results in the use of taxable income figures for purposes of a criminal prosecution that are different from those used for civil purposes in determining the taxpayer's corrected federal income tax liability." Schwener v. Commissioner, T.C. Memo. 1987-594 (citing One Lot Emerald Cut Stones and One Ring v. United States, 409 U.S. 232, 235 (1972), and Helvering v. Mitchell, 303 U.S. 391, 402-03 (1938)).

The IRS simply confuses the guilt finding phase and the sentencing phase. It is true, as I note earlier in this article, that the law is clear that a finding of not guilty as to tax evasion is not preclusive as to the presence of civil fraud because of the differing burdens of proof and what the criminal finding of not guilty means. But, at the sentencing phase and in the ensuing civil case, the determination of the amount attributable to fraud is by a preponderance of the evidence. Moreover, the IRS again makes the wrong comparison between what is determined at the sentencing phase (only the amount attributable to fraud) and the "corrected federal income tax liability." The comparison properly is between the tax loss number and the civil fraud penalty base which, as I noted earlier, are the same. So the IRS just misses the point on both scores. Note in this regard that all of the authority the IRS cites for this analysis predates the Sentencing Guidelines which introduce the critical role of the tax loss number.

Similarly, the FSA notes that the Guidelines recognize that there may be some uncertainty or imprecision on the tax loss number determination. However, that is not a distinction between determinations of fraud amounts in sentencing and determination of fraud amounts in civil case – both are by a preponderance of the evidence, a standard that does not require and almost never attains certainty or precision in civil or criminal proceedings.

From this base of confusion, the IRS then attempts to apply the traditional elements for collateral estoppel (applying the Tax Court's iteration of those elements as articulated in Peck v. Commissioner, 90 T.C. 162, 166-67 (1988) (note that these are just different ways of breaking down the test noted above from Montana):

1. First, is the issue the same in both actions? The IRS says no. The IRS reasons that the tax perjury conviction did not require a finding of the tax loss and thus the issue in the subsequent proceeding as to the base for the civil fraud penalty is not the same issue. We hope the reader can easily see that the IRS makes the wrong comparison. The comparison is the tax loss number in the sentencing phase of the criminal case and the civil fraud penalty tax base. Both are the same issue.

2. Was there a final judgment in the earlier case? The IRS answers that question yes because, of course, it has to. Even sophistry will not avoid that conclusion.

3. Were the parties in the prior case the same as in the current case? Yes.

4. Did the parties actually litigate the issue in the first case? The IRS answers "No, as to the sentencing hearing." The IRS articulates the reasons for this answer as follows: First, the IRS sets up the same strawman confusing the jury determination of guilt of tax perjury with the tax fraud base determination. We have already addressed that irrelevant issue. Second, turning to the appropriate phase of the criminal case (the sentencing phase), the IRS reasons that "The sentencing hearing determined the criminal tax loss, not the civil tax liability [which was] was neither actually, nor necessarily, litigated in the criminal case nor at the sentencing hearing." The IRS is, of course, right, but the statement is irrelevant. The issue the IRS should be considering is not preclusion as to the taxpayer's civil tax liability but preclusion as to the calculation of the civil fraud penalty base. Third, the IRS reasons that the sentencing proceeding did not determine the tax loss number with certainty or precision. I have already addressed that misguided notion above. For these articulated reasons, the IRS then concludes: "Therefore, the

Government is not barred from asserting a fraud penalty based on the conclusions from the sentencing hearing because the parties did not actually litigate the issue at the sentencing hearing." The conclusion is faulty, of course, because the premises are faulty.

5. Are the controlling facts and applicable legal rules the same in both cases? The IRS answers No. First, the IRS reasons that the rules of evidence are relaxed in the sentencing phase but apply without relaxation in the civil case. But, there is no rule that collateral estoppel applies if the first proceedings arguably involved more relaxed rules. And, in truth, the more relaxed rules in the sentencing phase as a practical matter assist the Government, if anyone, in asserting a larger amount of tax attributable to fraud. So the Government is certainly not prejudiced in the quantum of the fraud determination by more relaxed rules. Second, the IRS reasons that the burden of proof is difference – again confusing the jury guilt phase determination with the subsequent civil case.

In concluding its analysis, the IRS relies upon Monarch Funding, correctly noting, however, that "The court did not foreclose the application of collateral estoppel to sentencing hearing where it is clearly fair and efficient to do so." That is the whole point.[111] A more sophisticated inquiry is required than the IRS offers.

I submit that, on this issue, Maciel was wrongly decided and that Minkoff and the IRS FSA miss the point. In terms of the Monarch Funding inquiry, I submit that the tax loss number plays such a central role in sentencing for tax and tax related crimes that it would be false economy to denigrate its role to an ad hoc determination for a limited purpose. Focusing on the elements for application of collateral estoppel (quoted above),(1) the issues as to fraud and the quantum of tax attributable to fraud are identical in both proceedings; (2) the issue in the prior proceeding is actually litigated and decided in making the first step in the sentencing calculation; (3) there is a full and fair opportunity for the parties to litigate the tax loss number; and (4) the resolution of the tax loss number is necessary in order to sentence.

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[111] The IRS also refers to a pre-Monarch Funding case, United States v. Barnette, 10 F.3d 1553, 1560-62 (10th Cir. 1994), that did not involve the tax loss determination and did not apply the Monarch Funding analysis to see if it is fair and efficient to apply collateral estoppel.

In United States v. Roselli, 366 F.3d 58 (1st Cir. 2004),[112] the taxpayer, a return preparer, pleaded guilty to one count of conspiracy to aid and assist in the filing of materially false tax returns in violation of 26 U.S.C. § 7206(2).[113] The Government asserted at sentencing that the tax loss number was slightly in excess of $100,000, indicating a Base Offense Level of 14 and, after other adjustments, a final offense level of 13 which, under the Guidelines requires incarceration and based on which the Government recommended 1 year incarceration. The defendant asserted that the offense level was not readily ascertainable and in all events, to the extent calculable significantly less (in the range of $8,000 to $10,000) than the Government asserted. The defendant asserted a recalculated final offense level of 10, but agreed to recommend the same sentence as the Government sought (1 year but subject to serving it via home detention and subject to the court not making a tax loss finding). The defendant's attorney

[112] Unofficially reported at 2004 TNT 89-28.

[113] Earlier in the pleading the court says the guilty plea was to tax fraud. Later in the opinion when the court was more specific, it indicates that the guilty plea was to conspiracy.

explained to the court that his request that no tax loss number be found was based on the potentially preclusive effect it might have in deportation proceedings.[114] At sentencing, the district court declined to find a finite tax loss number because, whatever the number would have been between the parties' contentions, it would not affect his sentencing. The Court departed downward based on the defendant's unique family situation. The Government appealed both the failure to make tax loss number findings and the downward departure. The Court of Appeals held that, where the finding of a tax loss number would not affect the sentencing, the district court is not required to find it. The Court reasoned:

> Although the record indicates that the court was aware of the potential collateral effects that a tax loss finding might have in a subsequent deportation proceeding,

[114] The preclusive effect would relate to the ground for deportation based on the definition of an aggravated felony which includes any offense that "involves fraud or deceit in which the loss to the victim or victims exceeds $10,000." 8 U.S.C. § 1227(a)(2)(A)(iii); and 8 U.S.C. § 1101(a)(43)(M)(I).

> it explicitly stated that a tax loss finding would not affect its sentencing decision and would waste judicial resources with unnecessary and burdensome fact-finding. We reject the Government's challenge to the authenticity of the court's explanation. Moreover, the court was not required to spend its resources sorting through disputed facts merely because a tax loss finding might prove beneficial to the government in a subsequent deportation proceeding.[115]

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[115] 366 F.3d, at p. 64. The Court then proceeded to an analysis that only persons with a Guidelines fetish would appreciate regarding the necessity of making the predicate tax loss finding so that the remaining offense level calculations could be made before the Court determined a departure (i.e., it could not make a determination as to the extent of the departure). That analysis is interesting but not relevant to the point we develop here as to the potential preclusive effect if the district court had made a tax loss number finding.

In sum, although whether a tax loss finding would have any preclusive effect in a subsequent deportation proceeding, it is clear that the parties and both the sentencing court and the court of appeals perceived that as a possibility.

I note also two recent decisions where the taxpayer had been previously convicted of tax perjury. McGowan v. Commissioner, T.C. Memo 2004-146; and Kemp v. Commissioner, T.C. Memo. 2004-153. In each of these cases, the Court held that the Government had not met its threshold burden of proving fraud by clear and convincing evidence, despite the tax perjury conviction.[116] I don't know whether either the taxpayers or the Government mounted a fall back

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[116] I presume that, as to the threshold showing of fraud by clear and convincing evidence, if the sentencing court had determined that there was no tax loss number (thus permitting the minimum Base Offense Level), the taxpayer could have raised the argument that the Government's failure to prove some fraud at sentencing by a preponderance of the evidence was preclusive as to the fact that no fraud existed. I thus think it is likely that a tax loss number

argument that the sentencing tax loss determinations were preclusive as to the base to which the civil fraud penalty applied if the Government had met that threshold burden. However, as I noted above, the sentencing findings made by a preponderance of the evidence would not be preclusive as to the Government's burden to show fraud by clear and convincing evidence, although if the Government had met that burden the issue then might have been presented as to whether the sentencing finding was preclusive.[117]

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was determined, hence making critical the issue of whether the Government had in the civil case shown fraud by clear and convincing evidence.

[117] As I also noted, if the sentencing finding was that there was no tax loss number (i.e., no fraud), then it should preclude the Government from the right to even try to make the threshold showing of fraud by clear and convincing evidence.

In sum, I think strong arguments can be made for preclusive effect for the tax loss number in the sentencing proceeding on the civil fraud penalty determination.[118] I recognize that, in a Monarch Funding inquiry, arguments to the contrary may be mounted. I think that two arguments have surface appeal:

First, so the argument would go, although the tax loss number plays a central role in sentencing and the parties' have the types of opposing roles as to the tax loss number that offer some assurance that will be fairly determined, the actual determination of the finite tax loss number – whether by agreement with the Probation Office in the PSR or in a hearing to resolve

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[118] For related general reading, see Wystan M. Ackerman, Precluding Defendants from Relitigating Sentencing Findings in Subsequent Civil Suits, 101 Colum. L. Rev. 128 (2001); and Brian Levine, Preclusion Confusion: A Call for Per Se Rules Preventing the Application of Collateral Estoppel to Findings Made in Nontraditional Litigation, 1999 Ann. Surv. Am. L. 435 (1999).

the tax loss – may be in broad strokes because the of ranges in the Tax Table. I noted above,[119] for example, that any tax loss number from $30,001 through $80,000 will have the same Base Offense Level (16). Accordingly, although generally a taxpayer has a keen interest in keeping the tax loss number and Government has a keen interest in keeping it up,[120] if the dispute is really between a tax loss number of $30,001 and $79,999, the concern is that the parties might have no real interest in fine tuning the number "to get it right." Having gone through this process, however, I believe that the opposing sides continue to have the same opposing interests – the taxpayer to get the number down and the Government to get it up[121] – because the amount – even if not affecting the Base Offense Level -- will still play into the sentencing judge's mind in making any discretionary calls for or against the defendant. Accordingly, if I were the defendant's attorney in negotiating in this example, I would be asserting everything I could to get

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[119] See discussion at p. .

[120] This is a technical tax crimes expression with no other entendre intended.

[121] Id.

it below $30,001 (which would have a direct sentencing effect) and, if not below $30,001, then as close to $30,001 as possible in the expectation that the judge will be kinder and gentler with a tax loss number of say $31,000 than he or would with a tax loss number of say $79,000. The Sentencing Guidelines may appear to treat those tax loss numbers as the same, but any experienced practitioner – either defense counsel or prosecutor – will tell you that they are not the same.

Second, so this argument would go, the subsequent civil proceeding will offer broader discovery opportunities which will permit better calibration of the amount attributable to fraud. Of course, the IRS has conducted an extensive investigation of the issue prior to the referral to CES, and has discovery mechanisms in the IRS summons that are as powerful as discovery in litigation, certainly in Tax Court litigation where depositions are disfavored. And, to the extent that the IRS criminal investigation discovery is not sufficient, the Government can use the even more powerful grand jury subpoena where necessary to develop all facets of its criminal case. Civil discovery just doesn't get much better than that. It is, of course, conventional wisdom that there is limited discovery in criminal cases, which means given the investigative tools just mentioned, that the only practical limitation on the Government is that it can't force the defendant himself to testify. The defendant is the party that suffers most from the criminal discovery limitations. And, even more importantly, those discovery limitations are, as a practical matter, only relevant to the guilt determination of criminal proceedings. The tax loss number, our focus here, is a number that is relevant only to the sentencing phase where there is great pressure on the defendant to be forthcoming on the sentencing factors.

As with most federal crimes, most tax prosecutions are resolved by guilty plea. The principal incentive for a taxpayer to plead is the Guidelines benefit of acceptance of responsibility.[122] Acceptance of responsibility requires that the defendant truthfully admit the

[122] S.G. § 3E1.1. A guilty plea will not insure this favorable adjustment, but barring most unusual circumstances, it will. See Application Note 3 Conversely, foregoing the plea to go to trial, will not necessarily preclude the adjustment, but barring most unusual circumstances it will. Application Note 2.

conviction conduct.[123] This is a powerful incentive for the defendant to be forthcoming to any prosecutor or Probation Officer inquiries as to proper the tax loss number, so that for defendants who plead guilty the concept of limited discovery as to the conviction conduct is practically meaningless. Thus, I submit that, in a guilty plea disposition, the Government has more or at least equally effective real discovery opportunities in a criminal case as it would have in a civil case in which a defendant must meet the rules but without any further incentive to be affirmatively cooperative.[124]

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123 Id., at Application Note 1(a).

124 Note that even the civil discovery rules are limited in the Tax Court – the venue for most tax litigation – where depositions are disfavored. Depositions for discovery generally require consent of the parties. Rule 74, Tax Court Rules of Practice and Procedure; see also Rule 75 regarding certain limited depositions of nonparties shortly prior to trial. At least in the criminal case, the defendant must cooperate with the Government and the Parole Officer to develop the correct sentencing factors, the principal one being the tax loss number. Cooperation requires oral interviews and other types of cooperation if reasonably requested.

This phenomenon of real pressure to cooperate is also true, practically, for relevant conduct. Relevant conduct is criminal conduct outside of but related to the count(s) of conviction; the concept permits the relevant unconvicted conduct to be counted in the Base Offense Level, thus increasing the risk of higher guidelines ranges.[125] The tax loss number may thus include nonconviction years sucked in through the relevant conduct concept. But, in a nod

[125] S.G. § 3B1.3. Relevant conduct has been called the cornerstone of the Sentencing Guidelines. William W. Wilkins, Jr. and John R. Steer, Relevant Conduct: The Cornerstone of the Federal Sentencing Guidelines, 41 S.C.L. Rev. 495 (1990) (the authors are two of the persons principally involved in drafting the original guidelines and early revisions): Kate Stith & Jose A. Cabranes, The Federal Sentencing Guidelines Ten Years Later: Judging Under the Federal Sentencing Guidelines, 91 Nw. U.L. Rev. 1247, 1273 (1997) ("Perhaps the most extraordinary conceptual invention of the Commission"); Frank O. Bowman, III, Fear of Law: Thoughts on Fear of Judging and the State of the Federal Sentencing Guidelines, 44 St. Louis L.J. 299, 307 (2000) (relevant conduct is a "unique and controversial aspect of the Guidelines").

to at least unfairness with the concept,[126] the Guidelines do not require the defendant to be affirmatively forthcoming as to relevant conduct. As to relevant conduct, the defendant must simply avoid "falsely denying" any relevant conduct.[127] Thus, as to such relevant conduct, the

[126] I won't debate here the fairness of the concept, but do note that even acquitted conduct may be included in relevant conduct for reasons much the same as the denial of collateral estoppel for civil fraud after the defendant has been acquitted of tax evasion – i.e., the burden of proof is a lesser burden and all that acquittal means is that the Government did not prove guilt beyond a reasonable doubt. United States v. Watts, 117 U.S. 633, 635 (1997). As the dissenting opinion in Watts articulates, the notion that acquitted conduct can be used to increase a sentence is troublesome.

[127] S.G. 3E1.1, Application Note 1(a). The Note explains:

> Note that a defendant is not required to volunteer, or affirmatively admit, relevant conduct beyond the offense of conviction in order to obtain a reduction under subsection (a) . A defendant may remain silent in respect to relevant conduct

Defendant has a technical right to not cooperate, without necessarily blowing acceptance of responsibility (albeit putting a bad taste in the mouths of the prosecutor, the Probation Officer and potentially the court). The Probation Officer and the Court can then take whatever evidence of the relevant conduct is there and find it persuasive (under the preponderance standard), particularly where the defendant cannot take the risk of contesting that evidence at the risk of blowing his positive adjustment for acceptance of responsibility. This puts powerful pressure on the defendant to do what is necessary to reach an agreement on the tax loss number – including cooperating as to any relevant conduct the Government chooses to make an issue.[128] Quite

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> beyond the offense of conviction without affecting his ability to obtain a reduction under this subsection. However, a defendant who falsely denies, or frivolously contests, relevant conduct that the court determines to be true has acted in a manner inconsistent with acceptance of responsibility;

[128] Because the Government may choose not to make relevant conduct an issue for many reasons (e.g., not investigated by CI, etc.), where relevant conduct is not addressed in the proceeding, I would not give preclusive collateral estoppel effect to the absence of inclusion of

frankly, I can't imagine any responsible criminal defense attorney attempting a strategy of relying on this distinction between conduct of conviction and relevant conduct because, if perceived (and it would be perceived), it will create more harm than good.

Finally, in this regard, I think that the Government's systemic interests are better served by finally resolving the fraud issues at sentencing. My experience is that, because of the enormous resources the Government pours into investigating and prosecuting tax crimes (including major efforts by both one or more Special Agents and one or more civil agents) which are focused in major part upon determining a good fraud number, systemically it would be best to resolve the fraud issue once and only once. The parties, their counsel and their respective tax teams (agents for the Government and independent accountants for the defense) will be focusing intently on that issue in resolving the sentencing issues. Having then to pick up the issues again years later when the IRS thereafter picks up the suspended civil audit is a waste of limited

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relevant conduct as a finding that there was no relevant conduct fraud in the years of nonconviction.

resources all around. The systemic benefits exist even if there is a risk that the IRS will leave some quantum of tax fraud on the table that it might assert in a later civil proceeding.[129]

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[129] I can articulate another reason based on esoteric burden of proof principles that collateral estoppel might not apply. In the sentencing phase, the Government must establish the tax loss number by a preponderance of the evidence. At the subsequent civil proceeding, once the Government meets the burden of establishing fraud by clear and convincing evidence (either by collateral estoppel after a tax evasion conviction or actual evidence after other types of tax convictions), the taxpayer bears the burden of persuasion. This means that, in theory, an amount as to which the sentencing court was in equipoise gets left out of the tax loss number whereas an amount as to which the court in the civil case is in equipoise gets left in the base subject to the civil fraud penalty. However, although this is a theoretical possibility, I doubt that it is a practical one for cases only rarely turn upon a trier state of equipoise. Cigaran v. Heston, 159 F.3d 355, 357 (8th Cir. 1998) ("The shifting of an evidentiary burden of preponderance is of practical consequence only in the rare event of an evidentiary tie . . . ."); see also Polack v. Commissioner, 366 F.3d 608, 613 (8th Cir. 2003) (citing the Cigaran case). I don't think

For this reason, and wholly apart from the legal application of collateral estoppel, I would urge DOJ Tax to lift its general policy not to resolve civil tax matters, including the fraud

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theoretical possibility overweighs the systemic benefits of applying collateral estoppel. I should note that, in an earlier edition of my Tax Crimes book, I toyed with the notion that because of this equipoise possibility, the tax loss number determined at sentencing would merely set the floor for the civil fraud penalty base. My current thinking, as noted, is that the theoretical but highly unlikely possibility of equipoise as to some material amount, should not deprive the system of the benefits of collateral estoppel on this issue. As a side note, I have a great anecdote from my experience as an appellate attorney with DOJ Tax where the Fifth Circuit said, in effect, it was not interested in exactly this type of esoteric equipoise argument. Although the Fifth Circuit did not state its reason for rejecting the argument (or even mention the argument, the Government's primary argument at that stage), the oral argument showed clearly that it was not interested in equipoise purity of analysis, perhaps because its experience (similar to Cigaran and Polack) is that real world decisions, only rarely, turn upon equipoise, and thus equipoise purity should not drive the real world, even though it is obviously useful for analysis purposes.

penalty, in the criminal case.[130] In the limited case of the amount attributable to tax fraud, I urge that the tax loss number applied by the sentencing court to calculate the guidelines ranges be accepted in the subsequent civil proceedings. Systemically, it simply makes no sense to revisit that issue with the attendant expenditure of very limited resources by all involved – the taxpayer, the taxpayer's attorney, the new Government attorney in the civil proceeding, and the IRS agents (both civil and criminal), when parties with the tools, skills and incentives to get the issue resolved right have already addressed the issue. Even without court holdings of preclusive effect, the Government could authorize resolving this issue in the plea agreement (the contractual mode of resolving most criminal tax cases),[131] thereby permitting the Government to

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[130] DOJ CTM 5.14[1] ("It is the Department's view that, in a criminal tax case, collection of the related civil liabilities, including fraud penalties, is a matter entirely separate from the criminal aspects of the case.")

[131] The plea agreement is a contract. Santobello v. New York, 404 U.S. 257 (1971); United States v. Isaac, 141 F.3d 477, 481 (3d Cir. 1998), ("This court has reasoned from Santobello to the general proposition that "although a plea agreement occurs in a criminal

contractually deal with the civil clear and convincing burden and the amount burden to avoid results such as those encountered in the McGowan and Kemp cases discussed above where the Government was unable to meet that threshold burden.

I think that the answer must be different for the fraudulent failure to file penalty because the base for the fraudulent failure to file penalty is not the same as the tax loss number determination for sentencing purposes. As noted above, the tax loss number is the criminal figure which excludes purely civil adjustments.[132] I illustrate with a variation of the earlier

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context, it remains contractual in nature and is to be analyzed under contract-law principles. United States v. Moscahlaidis, 868 F.2d 1357, 1361 (3d Cir. 1989).")

[132] In a failure to file case, the tax loss number is defined as "the amount of tax that the taxpayer owed and did not pay." S.G. § 2T1.1(c) Note (2); see also DOJ CTM 5.03[1][b] (referring to the same language and concept in an earlier version of the Guidelines). But, in making these calculations only "criminal figures" are used, so that any purely civil adjustments are excluded.

example. Assume that the taxpayer has $100,000 of tax due that should have been reported on the return with none prepaid, that of that amount $25,000 were purely civil adjustments, and he clearly intended fraud for $75,000. The tax loss number for sentencing purposes will be $75,000. The tax base for the fraudulent failure to file civil penalty, however, is $100,000. Hence the two fact issues are not the same, and no preclusive effect can be given.

If, however, in a failure to file criminal case, the sentencing court were to determine that there is no tax loss in the sentencing proceeding,[133] then that would mean no fraud and, logically, would be preclusive on the threshold fraud determination required for the fraudulent failure to file civil penalty.[134] As indicated above, if the IRS did not prove fraud by a mere preponderance

[133] This finding in the sentencing phase would not be inconsistent with a jury verdict for failure to file under § 7203, because a taxpayer can be guilty of that crime without have a net unpaid tax due.

[134] Note that the failure to file crime does not require that the criminal figures (or tax loss number) be greater than zero. All it requires is a willful failure to file whether or not a tax is

of the evidence at sentencing when it had the full opportunity and incentive to do so, the doctrine of collateral estoppel should prevent it from doing so in the subsequent civil proceeding.

(2) Restitution.

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due. Hence, a finding in the sentencing phase of no tax loss number (so that the minimum Base Offense Level is used for sentencing) should logically be preclusive as to the absence of fraud for purposes of the conduct that could draw the civil fraudulent failure to file penalty.

The Sentencing Guidelines and related statutes permit or require a court to order restitution to an "identifiable victim" of a crime.[135] Restitution is permitted only for the victim's loss arising from the offense of conviction,[136] and the Court must make specific findings as to the loss.[137]

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[135] The general restitution statute, 18 U.S.C. § 3663, permits a sentencing court to order restitution to a "victim." The Sentencing Guidelines, § 5E1.1., interpret the requirement to allow restitution to an "identifiable victim."

[136] Hughey v. United States, 495 U.S. 411 (1990). Quantifying the amount for restitution in a tax case thus does not permit the amount attributable to tax fraud in unconvicted years to be included as it may be through the relevant conduct concept in determining the tax loss number setting the Base Offense Level for sentencing purposes.

[137] United States v. Lewis, 235 F.3d 215, 219 (4th Cir. 2000), reversing restitution imposed in a tax case because the sentencing court did not make the required specific findings.

In the case of a tax crime, restitution would be paid to the Government[138] and would be the payment of the tax liability that the taxpayer sought to evade. Generally, however, restitution is not available for tax offenses.[139] But, where the gravamen of the crime is a tax offense, but, as is often the case, one or more Title 18 offenses (such as the Klein conspiracy) are charged and convicted, the sentencing court may order restitution.[140] Moreover, even where the restitution statute does not otherwise apply to the counts of conviction, a sentencing court may "impose a

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[138] As quoted above, Judge Goeke so noted in Coomes.

[139] The general restitution statute, 18 U.S.C. § 3663, permits restitution only for Title 18 offenses and certain other specifically enumerated offenses, none of which are the tax crimes described in the Internal Revenue Code. See United States v Minneman ,143 F.3d 274, 284 (7th Cir. 1998) reh, en banc, den., and cert den 526 U.S. 1006 (1999) (citing United States v. Gottesman, 122 F.3d 150, 151 (2d Cir. 1997); United States v. Stout, 32 F.3d 901, 905 (5th Cir. 1994).).

[140] See 18 U.S.C. § 3663.

term of probation or supervised release with a condition requiring restitution for the full amount of the victim's loss."[141]

Where the sentencing court orders restitution in a tax case, it makes findings that the IRS (Government) has been defrauded and the amount it has been defrauded. (Restitution where ordered in full thus should be the same base number as the tax loss number for the years of conviction; the restitution amount would not include tax losses from nonconviction years which may be included in the tax loss number under the concept of relevant conduct.) Note that this is not the amount of the civil tax deficiency; it is just the portion of any deficiency that is due to fraud and should be the same as the tax loss number (perhaps including also interest) for the years of conviction. For reasons noted above, I believe that collateral estoppel principles should make that finding preclusive as to civil fraud penalty base for the restitution years.

[141] S.G. 5E1.1(a)(2).

Note, in this regard, however, that the fraudulent failure to file has a different tax base than the civil fraud penalty. The tax base for the fraudulent failure to file penalty is the tax due less the tax paid by the due date of the return. The fraudulent failure to file penalty applies to whatever the proper civil tax base is. As noted above, the sentencing court does not determine the civil tax base in ordering restitution but instead orders restitution for the amounts as to which there was fraud.

So, it appears that Judge Goeke got it right in Coomes because he was dealing with the fraudulent failure to file penalty.

4. A Two-Way Street.

Finally, I note that these concepts of collateral estoppel are a two way street. The Government should be able to assert preclusive effect for the sentencing finding determinations to the same extent and for the same purposes that a taxpayer should be able to assert them.

VI. Conclusion.

The federal courts to date have not come to grips with the subtle issues presented as to the potential application of collateral estoppel doctrine to findings made in the sentencing process. I have tried to develop the issues in this article and state my views as to how they should be resolved. Hopefully, further discussion will be forthcoming and clearer guidance offered by the courts.