

# TAX OBSTRUCTION CRIMES: IS MAKING THE IRS’S JOB HARDER ENOUGH?

*By John A. Townsend\**

I.	INTRODUCTION .....	262
II.	THE BACKGROUND .....	263
	A. <i>The Statutes Involved</i> .....	263
	B. <i>The Context: Tax Crimes Are All About Obstruction</i> .....	264
	C. <i>Obstruction Theories, Tax Crimes and Willfulness</i> .....	266
III.	THE TAX PRACTICE BACKGROUND .....	272
	A. <i>The Ethics of Audit Avoidance</i> .....	272
	B. <i>Examples from the Real World of Tax Practice</i> .....	278
IV.	OBSTRUCTION THEORIES .....	282
	A. <i>Introduction to Obstruction Theories</i> .....	282
	1. The Obstruction Statutes, Including § 7212.....	282
	2. Section 7212’s Provenance - the Obstruction Statutes.....	283
	3. Section 7212’s Relationship to the Conspiracy Statute .....	286
	4. Dangers Lurking in the Obstruction Statutes .....	288
	B. <i>Interpretation of the Obstruction Statutes</i> .....	289
	1. Introduction to Corruptly .....	289
	2. Corruption and Misleading Truth .....	291
	3. Obstruction and Covertness .....	297
	4. Corruptly is No Potted Plant .....	297
	C. <i>Section 7212</i> .....	306
	1. Introduction.....	306
	2. I Am Corruptly; Let Me Work.....	308
	a. Cases .....	308
	b. DOJ Position .....	318
V.	CONSPIRACY THEORIES .....	320

---

\* I express my gratitude for all those with whom I have discussed some aspect of this Article over its long period of gestation. They are too numerous to mention, but I do mention specifically those with whom I co-authored a LEXIS-NEXIS text on Tax Crimes – Larry Campagna, Steve Johnson and Scott Schumacher. Larry Campagna is also a colleague and co-adjunct professor at the University of Houston Law School where he and I teach a course on Tax Fraud and Money Laundering. I also express my appreciation to my partner, Larry Jones, with whom I have discussed many aspects of this Article.

A.	<i>Introduction to Conspiracy Theories</i> .....	320
1.	Dangers that Lurk in Conspiracy Charges .....	320
B.	<i>The Agreement, Scope and Pinkerton Liability</i> .....	323
1.	The Agreement .....	323
a.	Object Jargon - Semantical Games .....	323
b.	Scope of the Agreement; Pinkerton Liability.....	324
C.	<i>The Defraud / Klein Conspiracy</i> .....	328
1.	It Depends on What the Meaning of Defraud Is .....	328
2.	Government Option - Offense or Defraud Conspiracy or Both? .....	343
3.	Final Thoughts on the Defraud Conspiracy .....	351
VI.	ANY MORE EXPANSIVE CLAIM IS CONTEXTUALLY UNACCEPTABLE .....	352
A.	<i>Courts, Including the Supreme Court, Have Not Thought Audit Avoidance was Criminal</i> .....	352
B.	<i>The Willfullness Requirement</i> .....	353
VII.	MITIGATING THE EFFECT OF OVERBROAD CONSTRUCTIONS - LENITY AND RELATED CONCEPTS .....	356
VIII.	CONCLUSION .....	363

“We consider whether conspiring to make the government’s job harder is, without more, a federal crime.”

*United States v. Caldwell*, 989 F.2d 1056, 1058 (9th Cir. 1993) (Kozinski, J.)

## I. INTRODUCTION

This article addresses the question of “whether acting or conspiring with others to make the Internal Revenue Service’s (“IRS”) job harder is, without more, a federal crime.”<sup>1</sup> The issue is occasioned, as it was in *Caldwell*, by broad judicial statements and government claims as to the scope of the tax obstruction crimes.<sup>2</sup> If read literally, these variously worded interpretations would criminalize otherwise legal actions involving no deceit but with an intent to make the government’s job harder.<sup>3</sup> Judge Kozinski, for the Ninth Circuit, answered no to the question in the context of a tax defraud conspiracy.<sup>4</sup> As interpreted, the defraud conspiracy is one of a panoply of federal obstruction crimes. This Article focuses on the obstruction crimes that are likely to be encountered in a tax setting. Many of the lessons to be learned in the tax obstruction area are useful in other obstruction contexts as well as in the general area of so-called white collar crime.<sup>5</sup>

Taxpayers and tax practitioners often structure transactions and take return reporting positions with the intent to avoid an IRS audit, a practice sometimes called “audit avoidance.”<sup>6</sup> When doing so, most taxpayers and practitioners do not intentionally underreport or underpay tax liabilities, falsify the reporting on tax returns they sign or prepare or otherwise engage in conduct that is false or dishonest. These taxpayers and tax practitioners prefer to avoid waving the red flag in front of the IRS bull. They know that an IRS audit involves significant costs, disruption and angst, even if the IRS accepts the taxpayer’s positions or, worse, if the IRS decides to fight and the taxpayer prevails after litigation.

---

1. *United States v. Caldwell*, 989 F.2d 1056, 1058 (9th Cir. 1993).

2. *See id.* at 1056.

3. *See id.* at 1059.

4. *Id.* at 1059-61.

5. For a good introduction to white collar crimes, see STUART P. GREEN, LYING, CHEATING AND STEALING: A MORAL THEORY OF WHITE COLLAR CRIME (2007). Professor Green notes the ambiguities in the traditional definitions of white collar crime, including “the unexplained use of the terms ‘deceit,’ ‘concealment,’ ‘guile,’ and ‘violation of trust.’” *Id.* at 14-16. Some of these ambiguities are present in the traditional definitions of the obstruction crimes that are the focus of this Article and Professor Green’s book. For a good review of Professor Green’s book, see Peter J. Henning, *Review Essay: The DNA of White Collar Crime*, 11 NEW CRIM. L. REV. 323 (2008).

6. *See* discussion *infra* Part III.A as to the term “audit avoidance” in this context. Included within the meaning of the term “audit avoidance” is audit mitigation – meaning that, should an audit occur, the facts relevant to the tax issues are presented in the best light for the result the taxpayer desires.

The government sometimes asserts that otherwise legal conduct with the intent to impair, impede or influence an audit – audit avoidance – may be a criminal obstructive act. Where individual or multiple actors are involved in tax setting, the government may use the Omnibus Clause of the tax obstruction statute.<sup>7</sup> Where two or more actors are involved, the government may assert the “defraud conspiracy,” which in a tax context is called a *Klein* conspiracy.<sup>8</sup> The notion in each case is that otherwise legal acts with a motive to impair, impede, or influence an IRS audit are criminalized.

As thus articulated, the notion fails to recognize that some activity covered within that broad statement is not criminal. Judge Kozinski forcefully held that the notion is too broad, rejecting the government’s claim that “conspiring to make the government’s job harder is, without more, a federal crime.”<sup>9</sup> The government continues to repackage the notion, hoping it will find traction in some court somewhere. In the meantime, by continuing to make the claim through indictments by grand juries it controls,<sup>10</sup> the government has a powerful *in terrorem* tool to influence the behavior of taxpayer and tax practitioner communities.

The question in this Article, as in *Caldwell*, is whether the government’s claim of criminality for making the IRS’s job more difficult, without more, is wrong. I conclude that it is. Judge Kozinski’s question is the right question for the tax obstruction crimes, including the *Klein* conspiracy he addressed in *Caldwell*, and his answer is correct for the tax obstruction crimes.

## II. THE BACKGROUND

### A. *The Statutes Involved*

Section 7212’s so-called “Omnibus Clause” criminalizes action that “corruptly . . . obstructs or impedes, or endeavors to obstruct or impede, the due administration of” the Tax Code.<sup>11</sup> The intent to defraud the

---

7. I.R.C. § 7212 (2002 & Supp. 2008). In non-tax settings of obstruction (or conceivably even in tax settings), the government may use the general obstruction provisions of Title 18 that, for context, I discuss later in this text.

8. The *Klein* conspiracy is named after the leading “defraud conspiracy” case in a tax setting. 18 U.S.C. § 371 (2000 & Supp. 2008); *United States v. Klein*, 247 F.2d 908, 920 (2d Cir. 1957), *cert. denied* 355 U.S. 924 (1958).

9. Obstruction crimes, as suggested by Judge Kozinski’s “without more” qualifier, are usually done in the context of “other misconduct” – *i.e.*, other crimes. Henning, *supra* note 5, at 338. However, that situation is not addressed in this article, which focuses instead on whether audit avoidance “without more” – either a substantive offense (*e.g.*, tax evasion) or at least the affirmative lie – is an obstructive crime.

10. Of course, it is the grand jury that indicts, but to think that the grand jury acts as anything but an instrument of the prosecutor is naive.

11. I.R.C. § 7212.

government of tax revenue is not a textual element of the crime.<sup>12</sup> The defraud conspiracy is a conspiracy “to defraud the United States, or any agency thereof in any manner.”<sup>13</sup> Most readers of the defraud conspiracy statute would key on the word “defraud,” assuming it would not apply in a tax setting because pure audit avoidance does not include the intent to defraud the government out of tax.<sup>14</sup> Going beyond the normal meaning of the word “defraud,” courts frequently describe the defraud conspiracy as criminalizing conspiracies to impair, impede, or defeat the lawful functions of the IRS, one of which is conducting audits.<sup>15</sup>

These crimes are formulated with the overlapping theme of impairing or impeding the functioning of the IRS. Because these crimes are independent of any attempt to defraud the government out of tax due and owing, they are considered crimes of tax obstruction.<sup>16</sup>

### B. *The Context: Tax Crimes Are All About Obstruction*

Section 7212’s Omnibus Clause and the *Klein* conspiracy are only two potentially applicable criminal provisions in a broader web of provisions that address the citizen’s responsibility to the tax system.<sup>17</sup> The provisions in this broader web also sound in obstruction; attempts to impair or impede the functioning of the IRS in the ascertainment or collection of tax liabilities.

The “capstone” tax crime of evasion<sup>18</sup> requires an affirmative act to evade.<sup>19</sup> The affirmative act to evade is an obstructive act to impair the IRS’s function to determine tax liability<sup>20</sup> and to collect the tax. The other major tax crimes including tax perjury,<sup>21</sup> aiding or assisting in preparation of false returns or documents,<sup>22</sup> and failure to file,<sup>23</sup> criminalize conduct,

---

12. Although defrauding the government of tax revenue is not an element of the crime, it is usually a traveling companion with the crime. People usually do not obstruct tax administration except where they want to decrease their tax liabilities and payments. (This begs the question of what precisely obstruction is.) Even where tax protestors wrap their arguments in the American flag or some other perceived countries’ flag (e.g., the Republic of Texas), they are usually not acting from detached patriotic or similar fervor – they simply want to pay less tax than the law commands that they pay.

13. 18 U.S.C. § 371.

14. See GREEN, *supra* note 5, at 153.

15. See *United States v. Klein*, 247 F.2d 908, 915 (2d Cir. 1957).

16. See generally 18 U.S.C. §§ 1501-1521 (enumerating general obstruction crimes).

17. Of course, aliens also have responsibilities to our government, but this paper uses the traditional formulation.

18. See I.R.C. § 7201.

19. See *Spies v. United States*, 317 U.S. 492, 497, 63 S. Ct. 364, 367 (1943); see also *Boulware v. United States*, 128 S. Ct. 1168, 1173 (2008) (citing *Spies*, 317 U.S. at 497).

20. “Determine” in this context means quantifying the amount the taxpayer owes and assessing the tax. Assessment is a formal act whereby the government’s books show that the taxpayer owes a tax and sets in motion the taxpayer’s formal duty to pay and the IRS’s collection tools. See *Bull v. United States*, 295 U.S. 247, 259-60, 55 S. Ct. 695, 699-700 (1935).

21. See I.R.C. § 7206(1).

22. See *id.* § 7206(2).

the effect of which is to impair the normal and efficient functioning of the IRS in determining liability for tax and collecting tax. Although these crimes are obstructive in their underlying nature, they are specifically prescribed crimes with elements that make them narrower than mere obstruction of tax administration. This analysis refers to these crimes as the substantive tax crimes, although they also include obstructive conduct.

A key textual element of these substantive tax crimes requires the person to act “willfully,”<sup>24</sup> which is a term of art in the tax area to indicate a particularly high level of what criminal lawyers sometimes call *mens rea*. By contrast, the general obstructive tax crimes do not have a textual requirement that the person act “willfully.”<sup>25</sup> As I will develop, the government asserts that it may prove tax obstruction via these provisions without having to establish that the person acted willfully in the statutory meaning. I discuss this in more detail below, but at this point I raise the issue in order to establish a helpful distinction between tax obstruction crimes and substantive tax crimes. For purposes of this Article, I refer to the § 7212’s Omnibus Clause and the *Klein* conspiracy as the tax obstruction crimes and, when that term is used, I do not intend to include the substantive tax crimes (although they are also obstruction crimes).

The larger issue is determining the type of conduct in a tax setting that is sufficiently obstructive, as defined in the tax obstruction crimes, to cause one to be found guilty of a felony. The specific question is the same one Judge Kozinski asked in the *Klein* conspiracy context, which is paraphrased as follows: Is otherwise legal conduct criminal solely because the actor intended the conduct to make the IRS’s job more difficult?<sup>26</sup> That question is not relevant for the substantive tax crimes which textually require a recognizably improper act (in common parlance, lying, cheating, stealing)<sup>27</sup> in addition to an improper intent: in the case of evasion, willfulness, an affirmative act of evasion, and a tax due; in the case of tax perjury, willfulness and a lie; in the case of aiding and assisting, willfulness and a

---

23. See *id.* § 7203.

24. See, e.g., *id.* §§ 7201, 7203, 7206(1)-(2).

25. See *id.* § 7212; see also *United States v. Klein*, 247 F.2d 908, 918-19 (2d Cir. 1957).

26. See *Klein*, 247 F.2d at 910.

27. This formulation is basically the same as the title and theme of Professor Green’s book, *LYING, CHEATING AND STEALING*, which explores this underpinning of white collar crime, including tax crimes (substantive and obstructive). See generally, GREEN, *supra* note 5. This theme is also present in the Enron prosecution where complex accounting issues were the backdrop, but the prosecutor distilled the criminal case to a simple theme: “This is a simple case. It is not about accounting. It is about lies and choices.” John C. Hueston, *Behind the Scenes of the Enron Trial: Creating Decisive Moments*, 44 AM. CRIM. L. REV. 197, 207 (2007). My experience is that the same applies for tax crimes, substantive or obstructive, where complex tax issues are the setting; in order to convict, the prosecutor has to distill the case to a jury who understands lying, cheating, or stealing and the choices entailed. The truth or falsity of the foregoing statement is the subject of this Article: Can a person be convicted for tax obstruction where he or she did not lie, cheat, or steal?

false document or lie; and in the case of failure to file, willfulness and the act of failing to file.<sup>28</sup>

### C. Obstruction Theories, Tax Crimes and Willfulness

The government has asserted variations of this claim in several cases, but most prominently and recently in *United States v. Stein*.<sup>29</sup> The superseding indictment charged nineteen individuals involved in KPMG's tax shelter operations either as KPMG tax professionals or outside parties (attorneys or principals of financial firms).<sup>30</sup> I am co-counsel for one of these nineteen indicted KPMG professionals.<sup>31</sup> The indictment is an amalgam of claims and allegations of facts, one of which is a *Klein* conspiracy charge ("Count One").<sup>32</sup> The claim is stated broadly and, in the style of criminal proceedings, with redundant language: the defendants "unlawfully, willfully and knowingly would and did defraud the United States of America and the IRS by impeding, impairing, defeating and obstructing the lawful governmental functions of the IRS in the ascertainment, evaluation, assessment, and collection of income taxes."<sup>33</sup> The specific claim discussed here – that otherwise legal conduct to avoid an audit can be a *Klein* conspiracy – is not articulated in the indictment.<sup>34</sup> In its other submissions, the government makes clear that it believes it can convict for the *Klein* conspiracy even if (i) the jury cannot find that the defendants intended to violate any tax law (i.e., the jury cannot conclude that the shelters were illegal in its criminal sense) and (ii) the jury can only find that the defendants took otherwise legal audit avoidance action with a motive to affect if and how the IRS conducts an audit.<sup>35</sup>

---

28. See I.R.C. § 7212.

29. S.D. N.Y. - 05 Cr. 888 (LAK). Thirteen defendants were subsequently dismissed for prosecutorial abuse on grounds unrelated to the topic of this Article. *United States v. Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007), *aff'd* 541 F.3d 130 (2d Cir. 2008).

30. Superseding Indictment, S1 05 Cr. 888 (LAK) (S.D.N.Y. 2005).

31. See *Stein*, 495 F. Supp. 2d at 392. Therefore, I am not a disinterested observer of the subject matter of this article.

32. Superseding Indictment, S1 05 Cr. 888 (LAK) at 1. These redundancies, a prelude to the government case in chief, perhaps seek advantage of the political truism that "If you say a thing often enough, it has a good chance of becoming a fact." JONATHAN ALTER, *THE DEFINING MOMENT: FDR'S HUNDRED DAYS AND THE TRIUMPH OF HOPE* 36 (Simon & Schuster, 2007) (quoting Louis Howe, campaign manager for Franklin D. Roosevelt).

33. Superseding Indictment, S1 05 Cr. 888 (LAK) at 73. It is worth noting at this point that, even though the defraud conspiracy statutory text imposes no willfulness element and the courts have not imposed a willfulness element in its tax meaning, the government articulates the allegation that the defendants acted "unlawfully, willfully and knowingly." *Id.* In conspiracy parlance, it is possible to read this facially redundant language as merely saying that the defendants entered the agreement with cognition. However, other portions of the text of Count One could possibly be read to require that the defendants knew that the object of the conspiracy was otherwise unlawful.

34. See, e.g., *id.*

35. Government's Memorandum in Opposition to Defendants' Pretrial Motions at 33, *United States v. Stein*, No. S1 05 Cr. 888 (LAK) (S.D.N.Y. 2005). Aside from the *Klein* Conspiracy charge, the government's charges in the superseding indictment are tax crimes requiring willfulness. See

Count One of *Stein* alleges a single conspiracy that has as its objects the violation of § 7201 (an offense conspiracy) and a *Klein* conspiracy.<sup>36</sup> In multiple additional counts, the indictment alleges specific tax offenses (tax evasion, § 7201, being the most prominent).<sup>37</sup> Under the so-called *Pinkerton*<sup>38</sup> doctrine making co-conspirators liable for crimes within the scope of the conspiracy, the government seeks to make all defendants guilty for the specific tax offenses even though they are not principals (either directly or under liability for aiding and abetting).<sup>39</sup>

To convict of either a substantive tax offense (e.g., § 7201 in *Stein*) or a conspiracy to commit a substantive tax offense, the government must prove that the defendants acted “willfully.”<sup>40</sup> Willfulness in the criminal context is a word with several meanings.<sup>41</sup> Willfulness has a specific

---

Superseding Indictment, S1 05 Cr. 888 (LAK) at 45-46. Recognizing at least the possibility that it would not be able to prove willfulness, the government saw the defraud conspiracy as its ultimate fallback where, it believed, its burden was less. See, e.g., Government’s Memorandum in Opposition to Defendants’ Pretrial Motions at 33, *United States v. Stein*, No. S1 05 Cr. 888 (LAK) (S.D.N.Y. 2005) at 31-32. The memorandum states:

The defendants broadly claim that the Government must prove a violation of a known legal duty for all charged counts. This is not so with respect to the conspiracy count. As demonstrated below, the defendants may be convicted of the conspiracy to defraud the United States even if acquitted of the evasion counts, or even if the Court were somehow to dismiss the evasion counts and the evasion object of the conspiracy in response to the defendants’ motions. A conspiracy to defraud the United States does not include “*Cheek*” willfulness as an element.

The government requested the court to instruct the jury that it can convict for the defraud conspiracy “even if the taxpayer’s ultimate legal position [on the merits of the tax shelters] is correct,” so that the jury is unable to find a tax offense (evasion) or an offense conspiracy to commit a tax offense. Government’s Request to Charge at 16, *United States v. Stein*, 584 F. Supp. 2d 660 (S.D.N.Y. 2008) (No. S1 05 Cr. 888 (LAK)). The government reasoned that “[o]ne cannot use deception or dishonest means to impede, impair, defeat or obstruct the IRS, even to protect a legitimate tax position.” *Id.* Inconsistently, and incorrectly, the government also urged that a false statement or false document is not required; rather, it urges that legal action intended to avoid an audit suffices. See *infra* note 346 and accompanying text (discussing Item 5 in *Klein*, which the government thinks supports this proposition).

36. See Superseding Indictment, S1 05 Cr. 888 (LAK) at 1, 45-50.

37. See, e.g., *id.* at 45-46.

38. *Pinkerton v. United States*, 328 U.S. 640, 646-47, 66 S. Ct. 1180, 1183-84 (1946). For further discussion of *Pinkerton*, see *infra* Part V.B.1.b. A very interesting question is whether, if the jury rejects the offense conspiracy but accepts the defraud conspiracy count, the government could piggyback *Pinkerton* liability for the substantive offenses from just the defraud conspiracy. This has to do with scope of the conspiracy. If the jury finds that the scope of the *Klein* conspiracy does not include substantive tax offenses, then the substantive offense claims could not be subject to *Pinkerton* based solely on the defraud conspiracy.

39. See, e.g., 18 U.S.C. § 2 (2000 & Supp. 2008) (establishing, in addition to *Pinkerton* liability, “principal” liability for (i) persons who commit the offense, (ii) persons who aid or abet a person who commits the offense or (iii) persons who willfully commit a criminal act through another person (who may be innocent)).

40. See, e.g., I.R.C. §§ 7201, 7206(1)-(2) (2002 & Supp. 2008) (demonstrating that substantive criminal tax offense statutes generally require that the defendant act “willfully”). The willfulness requirement also applies to a conspiracy to commit the offense, where the offense includes a willfulness requirement. *Ingram v. United States*, 360 U.S. 672, 678, 64 S. Ct. 268, 277 (1959).

41. *United States v. Kay*, 513 F.3d 432, 447-48 (5th Cir. 2007) (en banc), *reh’g denied* 513 F.3d 461 (5th Cir. 2008) (involving the Foreign Corrupt Practices Act containing elements that the acts be



meaning in the tax context; however, to understand its importance in the criminal law, it is helpful to survey the landscape of the criminal use of the term.<sup>42</sup> The Fifth Circuit recently reviewed the variant criminal meanings of willfulness as follows:<sup>43</sup> (1) that the defendant intentionally did the acts that the law defines as criminal, whether or not he knew that the acts violated the law;<sup>44</sup> (2) that the defendant knew generally that the acts were unlawful;<sup>45</sup> and (3) that the defendant knew the terms of the statute and that he was violating the statute. The latter is the interpretation for the willfulness element of substantive tax crimes, for, as the Supreme Court noted in *Cheek*, the tax law's complexity and potential for ensnaring the innocent require "the government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty."<sup>46</sup>

In its third meaning – i.e., in the *Cheek* meaning applicable to substantive tax crimes generally – the requirement of willfulness has both objective and subjective components.<sup>47</sup> Objectively, as a matter of law, the law's command must be knowable – the law's command is sufficiently certain that it is capable of being known by a citizen.<sup>48</sup> Subjectively, the

---

done "willfully" and "corruptly."). These "willfully" and "corruptly" requirements are probably redundant at least in part. See *id.* at 451-52.

42. *Id.*

43. *Id.*

44. This is the common concept in Anglo-American jurisprudence that animates the saying that ignorance of the law is no excuse. See, e.g., *Ratzlaf v. United States*, 510 U.S. 135, 149, 114 S. Ct. 655, 663 (1994) (noting the "venerable principle that ignorance of law is no defense," but holding that, in that case, a willfulness textual element overrides the principle).

45. See *Bryan v. United States*, 524 U.S. 184, 191-92, 118 S. Ct. 1939, 1944-45 (1998).

46. *Cheek v. United States*, 498 U.S. 192, 201, 111 S. Ct. 604, 610 (1991) (summarizing and synthesizing this rule from prior Supreme Court cases). The Supreme Court summarized:

Those cases construed the willfulness requirement in the criminal provisions of the Internal Revenue Code to require proof of knowledge of the law. This was because in our complex tax system, uncertainty often arises even among taxpayers who earnestly wish to follow the law, and it is not the purpose of the law to penalize frank difference of opinion or innocent errors made despite the exercise of reasonable care.

*Id.* at 205 (internal quotations omitted). See also *Bryan*, 524 U.S. at 194 (stating that "[i]n certain cases involving willful violations of the tax laws, we have concluded that the jury must find that the defendant was aware of the specific provision of the tax code that he was charged with violating."). Do not read the *Bryan* decision's language too literally to require that the defendant know the code section he or she is violating; all that is needed is that the defendant know the law's requirements. *United States v. Patridge*, 507 F.3d 1092, 1094 (7th Cir. 2007), *cert. denied* 128 S. Ct. 1721 (2008) ("An act is willful for the purpose of tax law, the Court concluded, when the taxpayer knows what the Code requires yet sets out to foil the system. Knowledge of the law's demands does not depend on knowing the citation any more than ability to watch a program on TV depends on knowing the frequency on which the signal is broadcast.").

47. See *supra* note 46 and accompanying text.

48. See, e.g., *United States v. Pirro*, 212 F.3d 86, 91 (2000) ("Because only willful conduct is criminal under § 7206 and because willfulness requires a voluntary intentional violation of a known duty, the duty involved must be knowable.") (internal quotations omitted); see also *James v. United States*, 366 U.S. 213, 224, 82 S. Ct. 1052, 1058 (1961) (describing what a "knowable" legal duty is); *United States v. Critzer*, 498 F.2d 1160, 1162-63 (4th Cir. 1974); *Garber v. United States*, 607 F.2d 92, 97-98 (5th Cir. 1979) (en banc); *United States v. Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983), *cert.*

defendant must have actually known the rule and have intended to violate it.<sup>49</sup>

The objective component invokes the court's function to determine whether the law is sufficiently certain that it sets an appropriate standard to guide and judge conduct where the law requires that the defendant know that he or she is violating the law. If it does not, then even if the defendant clearly intended to violate some law that he mistakenly thought was certain, he cannot be tried for it.<sup>50</sup> I focus here on the subjective component – the intention to violate the knowable law. *Cheek* commands that the defendant intend to violate the knowable law.<sup>51</sup> Unlike the substantive tax crimes, the conspiracy statute does not specifically require that an offense conspirator have acted willfully. Certainly, for there to be a conspiracy, the conspirator must have entered an agreement and must have done so with all the intentionality normally connoted by the term “willfully.” But there is no explicit requirement that the object or means to carry out the object of the agreement violate any knowable or known legal duty. Nevertheless, the Supreme Court has determined that the offense conspiracy incorporates a willfulness element if the offense that is the object of the conspiracy has a willfulness element.<sup>52</sup> Substantive tax crimes have a willfulness element, so the tax offense conspirators must agree to join together to violate a known legal duty.

Like the offense conspiracy, the statutory text does not require that a defraud conspirator act willfully. However, unlike the offense conspiracy, the defraud conspiracy has no reference to an underlying offense statute – such as the tax crimes – that imports the willfulness requirement. The government's position therefore is that willfulness – intent to violate a known legal duty – is not an element of the *Klein* conspiracy.<sup>53</sup> The only intent required is that the conspirator agree with another or others to

---

*denied*, 466 U.S. 980 (1984); *United States v. Mallas*, 762 F.2d 361, 363 (4th Cir. 1985); *United States v. Harris*, 942 F.2d 1125, 1131 (7th Cir. 1991). Uncertainty of the law's requirements, often the by-product of tax law complexity and ambiguity, can defeat willfulness as a matter of law. *See, e.g., Harris*, 942 F.2d at 1131. The civil penalty regime of the tax law includes concepts for analysis in dealing with uncertainty in the law. The tax world deals daily with concepts such as frivolous, non-frivolous but not reasonable, reasonable basis, substantial authority, more likely than not, should, will or what have you. *See infra* note 75. By analogy to the willfulness requirement of the criminal tax laws, only the frivolous position would seem to support an environment where, as a matter of law, the taxpayer or the practitioner could be willful. This knowability standard is closely related to the rule of lenity, discussed below. *See infra* Part VII.

49. *See Cheek*, 498 U.S. at 201; *Bryan*, 524 U.S. at 193-94.

50. This point is established by the majority, concurring, and dissenting opinions in *James v. United States*, 366 U.S. 213, 221-22, 224-25, 246 (1961), a tax evasion case. After trial, the jury found the defendant guilty, which necessarily meant that the jury found he intended to violate the tax law. *Id.* The Supreme Court said that the law was sufficiently uncertain that a defendant could not be held to the standard even if he may have intended to violate the law. *Id.*

51. *Cheek*, 498 U.S. at 201.

52. *See Ingram v. United States*, 360 U.S. 672, 678, 64 S. Ct. 268, 277 (1959).

53. *See United States v. Klein*, 247 F.2d 908, 918-19 (2d Cir. 1957).

defraud the IRS, regardless of whether the conspirator knew the agreement or its ends or means was illegal in any way. (But, doesn't the concept of defraud connote intent and knowledge of illegality? Logically, yes; but perhaps no; stay with me.) The absence of this "willfulness" element for the defraud conspiracy is critical to the government's claim for the *Klein* conspiracy that no illegality is required and that a legal act with an intent to affect tax administration is enough.<sup>54</sup>

The quintessential example where this claim can be made is in tax shelter cases such as *Stein*.<sup>55</sup> Tax shelter opportunities often involve complex extrapolations and implementations<sup>56</sup> of perceived uncertainties in the Internal Revenue Code and applicable precedent.<sup>57</sup> These complexities may prevent the legal duty from being knowable or known. In such cases, the government is at high risk of failing to meet the willfulness requirement to convict for the offense itself or for the offense conspiracy. The government imagines the defraud conspiracy as the escape from that bothersome level of proof.

With this background, consider the following example:<sup>58</sup> Shelter promoters design a tax shelter. The shelter is aggressive but is based on

54. *Id.*

55. *United States v. Stein*, 584 F. Supp. 2d 660 (S.D.N.Y. 2008).

56. Implementations include structures – often involving one or more specially created entities designed to exploit the perceived legal loopholes offered for the respective entity by the Code. This does not mean to imply anything sinister from such complex structures that might not exist except for the perceived tax benefit. The Eleventh Circuit recently stated the truism that complex tax structures are the consequence – good or bad – of the Code:

It is no surprise that a knowledgeable tax attorney would use numerous legal entities to accomplish different objectives. This does not make them illegitimate. Unfortunately such "maneuvering" is apparently encouraged by our present tax laws and code.

*Ballard v. Comm'r*, 522 F.3d 1229, 1254 (11th Cir. 2008). The Ballard opinion recounts the twists and turns of that case up to the Supreme Court and back again to the Tax Court where the issue was fraud, albeit civil fraud. Civil fraud is the same as tax evasion (*e.g.*, *Helvering v. Mitchell*, 303 U.S. 391, 399, 405, 58 S. Ct. 630, 633, 636 (1938)). This observation is particularly apropos where audit avoidance sometimes leverages the benefits of entity structures.

Indeed, the Supreme Court recently reiterated the foundational principle that structuring to fit the constructs of the Code is appropriate. *Boulware v. United States*, 128 S. Ct. 1168, 1176 n.7 (2008) (noting "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted" (citation omitted)). However, taxation is determined by what occurred, with the clear implication that, if the taxpayer uses a form or structure authorized by the Code, the form or structure and its concomitant tax consequences govern. *Id.* (citations omitted). As Professor Isenbergh notes, in an area so imbued with formal structures, the form often creates the substance in terms of controlling the tax result, so that invoking general notions of substance over form is often meaningless. Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 879 (1982).

57. Tax lawyers are familiar with leading cases that illustrate the opportunity for wiggle room. See, *e.g.*, *Comm'r v. Brown*, 380 U.S. 563, 85 S. Ct. 1162 (1965); *Frank Lyon Co. v. United States*, 435 U.S. 561, 98 S. Ct. 1291 (1978); see also Charles I. Kingson, *How Tax Thinks*, 27 SUFFOLK U. L. REV. 1031, 1034-35 (2004).

58. The background for these assumptions is in the *Stein* case. 584 F. Supp. 2d at 661-63. These are simplified assumptions for analysis and may or may not be a fair representation of the *Stein* case.

nonfraudulent – nonwillful, if you will – extrapolations from authoritative tax interpretations either in cases or IRS pronouncements that appear to offer some room to maneuver.<sup>59</sup> The shelter promoters believe that the tax benefits claimed for the shelter will more than likely be sustained if audited or litigated, and they so opine.<sup>60</sup>

The participants (promoters and taxpayers) do not know that the shelter is illegal. They know the shelter is aggressive. They believe that the IRS will challenge the shelter if it hits the IRS audit radar screen, for the shelter does exploit a perceived loophole, and it is not uncommon for taxpayers and the IRS to disagree on tax positions, resulting in lengthy and expensive disputes even if the taxpayer ultimately prevails.<sup>61</sup> The shelter investors desire to avoid those disputes, if possible, so the promoters know that successful marketing must include some level of audit avoidance.

They take actions, including return reporting positions, which they believe lower the audit profile – stated otherwise, they do not raise a “red flag” that the IRS should audit the return. These actions are otherwise

---

59. This phenomenon is present in the *Stein* shelters which exploit the government’s victory in *Helmer v. Comm’r*, 34 T.C.M. (CCH) 727 (1975). At the government’s insistence, the Tax Court in *Helmer* held that contingent liabilities are not liabilities for the partnership basis adjustment rules. *Id.* In tax logic, that holding allowed the creation of artificial outside basis in partnerships (including entities taxed as partnerships) by contributing contingent debt to a partnership along with assets having a tax basis approximating the economic burden of the contingent debt. This created the opportunity to arbitrage the partnership basis rules for tax shelters, and soon the opportunities were exploited in various iterations of artificial basis producing artificial tax loss. As is not uncommon in tax cases, the government later realized that its interpretive victory in *Helmer* created unintended tax advantages, but did not move promptly to kill the monster that it had created. Only years later did the government use its *Chevron* rule-making authority to change the rules to close down the loophole it had created. However, some courts have held that, prior to the government’s changing the rules, the interpretation of *Helmer* in the various shelters that exploited it was correct, with the shelters using it failing only because of the economic substance doctrine. See *Klamath Strategic Investment Fund, L.L.C. v. United States*, 440 F. Supp. 2d 608, 625-26 (E.D. Tex. 2006); *Jade Trading, L.L.C. v. United States*, 80 Fed. Cl. 11, 58 (2007). But see *Kornman & Assocs. v. United States*, 527 F.3d 443, 461 (5th Cir. 2008); *Cemco Investors, L.L.C. v. United States*, 515 F.3d 749, 752 (2008), *cert. denied*, 129 S. Ct. 131 (2008). Even if the *Kornman* approach on the issue ultimately prevails, the mere fact that some courts have found *Helmer* to apply to these transactions suggests that, prior to the regulations’ change, it could not be known in a criminal knowability sense that *Helmer* could not apply to achieve the tax shelter benefits.

60. Excluded are those cases where the shelter promoters do not believe that the position will prevail, and thus state a lie if they render an opinion that it is more likely than not. Since the focus is on their actions at the time, it makes no difference whether, years later and after extensive litigation, the tax benefits are not sustained.

61. A classic example is *Frank Lyon Co. v. United States*, 435 U.S. 561, 98 S. Ct. 1291 (1978), a long, hard, and expensive fight ultimately won by the taxpayer. One of the themes addressed in this article is, in such circumstances where at the inception the law is ambiguous, whether any reasonable taxpayer would invite that type of fight with the IRS even if the taxpayer believed he ultimately would prevail. The taxpayer would probably agree with Abraham Lincoln who enjoyed recalling the story of the man who was tarred and feathered and ridden out of town on a rail while saying, “Except for the honor, I would just as soon skip it.” EMANUEL HERTZ, *LINCOLN TALKS: A BIOGRAPHY IN ANECDOTE* 258-59 (Random House 1987). Most people – epitomized by Mr. Lyon and his corporation – would rather bypass the protracted audits and litigation, however necessary they may be to the administration of the system.

legal. These actions involve no deceit, no false documents, no false returns, no lies, no backdating; all they involve is an attempt to exploit what are perceived as the IRS's audit deficiencies. Any structures or extra steps they put in place are all contemplated by law – e.g., they may use corporations, trusts, partnerships or other artificial entities to exploit the tax position and to offer the best tax profile. On these assumed facts, the government could not meet either the objective or subjective components of the willfulness requirement, so a charge for a tax offense itself or for an offense conspiracy would fail.

Finding no other way to give vent to its angst, the government turns to the tax obstruction provisions – the *Klein* conspiracy and § 7212. The government can prove beyond a reasonable doubt only that the defendants agreed among themselves to take those otherwise legal actions with the intent to lower the audit profile. According to Judge Kozinski's standard, are the described actions which make the IRS's job harder alone sufficient to establish a crime?<sup>62</sup>

Judge Kozinski said no for the *Klein* conspiracy charge before the court.<sup>63</sup> Judge Kozinski did not answer the question whether § 7212 criminalizes the same audit avoidance activity he rejected for the *Klein* conspiracy.<sup>64</sup> I urge below that § 7212<sup>65</sup> does not criminalize such audit avoidance activity. If Judge Kozinski is right that audit avoidance activity alone cannot be the basis for the *Klein* conspiracy and if § 7212 nevertheless criminalizes that activity, then the government could simply present the same conduct by multiple actors as an offense conspiracy to violate § 7212 or charge § 7212 directly and make an end-run around the *Caldwell* holding.<sup>66</sup> I conclude, however, that, properly interpreted, § 7212<sup>67</sup> does not permit conviction for audit avoidance activity.

### III. THE TAX PRACTICE BACKGROUND

#### A. *The Ethics of Audit Avoidance*

I deal below in more detail with the criminal law context for the government's claims. I think it helpful first to deal with audit avoidance in the practice of tax law. I said above that audit avoidance is routine in tax practice. In this section, I document that statement.

---

62. *United States v. Caldwell*, 989 F.2d 1056, 1058 (9th Cir. 1993) (“We consider whether conspiring to make the government’s job harder is, without more, a federal crime.”)

63. *Id.* at 1059; *see United States v. Klein*, 247 F.2d 908 (2d Cir. 1957).

64. *Caldwell*, 989 F.2d at 1058.

65. I.R.C. § 7212 (2002 & Supp. 2008).

66. *See Caldwell*, 989 F.2d at 1058; I.R.C. § 7212.

67. I.R.C. § 7212.

The issue of audit avoidance in tax practice was the subject of a remarkable series of articles in the companion publications of *Tax Notes* and *Tax Notes Today*, perhaps the most widely read tax publications.<sup>68</sup> These articles, published in 2001, are by David Richardson, tax professor at the University of Florida, and the late Frederick G. Corneel, a tax practitioner in Boston who, prior to his death, was recognized widely as a leading commentator on ethics for tax professionals, particularly lawyers.<sup>69</sup> Richardson fired the first salvo by setting up Corneel's defense of audit avoidance in a particular setting.

Frederic G. Corneel, who received the American Bar Association ("ABA") Tax Section's Distinguished Service Award at the Section's May 2000 meeting, is the author of *Guidelines to Tax Practice*, and *Guidelines to Tax Practice Second*.<sup>70</sup> In *Guidelines to Tax Practice Second*, Mr. Corneel includes "audit avoidance planning" within a tax lawyer's professional responsibility; he describes such planning as assisting "the client in structuring a transaction and reporting it on the return in a way least likely to be subject to audit."<sup>71</sup> He cautions, however, that lawyers should not "participate in transactions entirely lacking in economic substance and intended solely to conceal or mislead [the Service]."<sup>72</sup>

One such audit avoidance plan was described by Mr. Corneel at meetings of the Standards of Tax Practice Committee of the ABA Tax Section held in January 1996 and January 2000.<sup>73</sup> His comments, both of which were made during questions from the floor and after a panel presentation, were as follows.

[W]e know that a gift tax return is much more likely to be audited if it says 10,000 shares of family stock than if it says \$50,000 cash. And so if you have family stock which has not appreciated a lot and you want to transfer it to a member of the family one of the things you can do is you can give \$50,000 to the transferee and have him buy the

---

68. David M. Richardson, *Audit Avoidance via Intent Modification - Is Fred Corneel onto Something . . . or Not?*, 92 TAX NOTES 277 (2001) [hereinafter Richardson, *Audit Avoidance*]; Frederic G. Corneel, *Audit Avoidance: A Response to David Richardson*, 92 TAX NOTES 681 (2001); David M. Richardson, *Further Thoughts on Audit Avoidance Techniques*, 92 TAX NOTES 681 (2001); see also David M. Richardson, *Statement of Standards of Tax Practice: Letter to a Former Student*, 87 TAX NOTES 1143 (2000) (a related article).

69. Professor Richardson, Corneel's protagonist in this friendly discussion, called Corneel "a prominent practitioner and icon of professionalism." David M. Richardson, *Statement of Standards of Tax Practice: Letter to a Former Student*, 87 TAX NOTES 1143, 1144 (2000) (although the reference in the article does not name Corneel specifically, the subsequent articles makes it absolutely clear to whom Professor Richardson was referring).

70. Frederic G. Corneel, *Guidelines to Tax Practice*, 31 TAX LAW. 551 (1978); Frederic G. Corneel, *Guidelines to Tax Practice Second*, 43 TAX LAW. 297 (1990).

71. Corneel, *Guidelines to Tax Practice Second*, *supra* note 70.

72. *Id.*

73. Richardson, *Audit Avoidance*, *supra* note 68.

stock and report that on Schedule D and you can report the gift as a gift of cash and in that way reduce substantially the risk of an audit. Well whether I discuss that possibility with the client or not depends very much upon my view of where the client wants to come out. And I insist that if they do not want to go the safe way to reduce the chance of audit that they better get two appraisals and that the appraisals be in the range of what's reasonable and so on. And I would never make that suggestion to somebody where I'm clear he's going to be trying to skate on thin ice. And I don't think that the line between civil fraud and negligence, and so on, is so easily drawn and so I think that if we give advice that looks in the direction of avoiding audit, maybe that doesn't quite tie in with what you are discussing but it does have to do with the likelihood of audit, then I think we have to be more sure than we would be otherwise that the client's position is sustainable. [January 1996, New Orleans].<sup>74</sup>

The second scenario is as follows:

It strikes me [that the issue being discussed by the panel] is related to advising clients on how best to avoid an audit. My sense is there is nothing at all improper in giving advice on how to avoid an audit as long as you are satisfied that the basic position is a sound position or is at least a reasonable basis.<sup>75</sup> People may be told that if they make a gift of stock of a closely held corporation that it is likely to raise an issue when it comes to an audit of the return - may trigger an audit of the return. If, on the other hand, they were to make a sale against a note and then at some later time, the child comes into the money with which to pay the note or the note is cancelled and that is disclosed - the audit may be avoided. I think that advice is alright if you make very sure that you have an appraisal, a sound appraisal that supports the sale. So it seems to me here that an audit is not a desirable thing and it is perfectly alright to tell people what the risk is and so on, but you must not do

---

74. *Id.* at \*2.

75. Tax practitioners will recognize that the "reasonable basis" standard for assisting in audit avoidance with respect to the transaction is very low indeed, with only a twenty to twenty-five percent likelihood of success. Charles P. Rettig, *Practitioner Penalties: Potential Pitfalls in the Tax Trenches*, 123 Tax Notes 207 (Apr. 13, 2009); and Burgess J.W. Raby and William L. Raby, *Painting the Accounting Practitioner Into a Tax Practice Corner*, 2005 TAX NOTES TODAY 178-4.

that in connection with a transaction that itself is improper.  
[January 2000, San Diego].<sup>76</sup>

Richardson uses Corneel's comments as a point of departure for an expanded drama whose cast includes various players in a hypothetical scenario.<sup>77</sup> The following is my own adaptation of Richardson's drama:

A taxpayer desires that his daughter own 10% of his wholly-owned company. He believes the company is worth \$10,000,000 because he recently received an offer in that amount from a third party willing to close the deal. He rejected the offer, but is confident that the valuation is right. He understands that the valuation could change over a short period, but at least for the time being it is a good value. So he expects to give the \$1,000,000 in value in the company through the 10% stock interest. He is concerned about gift taxes because he and his wife have previously used their lifetime exemptions. So, he seeks help from his tax lawyer. The lawyer advises him first that the stock that he proposes to give is not worth \$1,000,000 for gift tax purposes because a 10% stock interest is not worth 10% of the company; it might be worth 10% to a family member because of family control, but it is not worth that to a hypothetical unrelated third party in whose hands it would be a minority interest subject to the control of an unrelated party. The hypothesized unrelated third party would require heavy discounts for minority interest and lack of marketability. The lawyer is unwilling to opine what an appropriate aggregate discount would be. The lawyer suggests that these discounts might reduce the "value" of the stock to the hypothetical buyer by as much as 40-45%. A professional opinion by a competent appraiser is advisable, but that is a likely range that the valuation might come out. (Tax lawyers recognize that this advice and planning is tax alchemy – the father can give his daughter something that is worth \$1,000,000 and treat it for gift tax purposes as a gift of something significantly less.) Let's assume for a moment that the proper discounts aggregate in the 35-40% range, so the client picks the lower, 35% value, because he does not want surprises and, in all events, his family is getting a magical break with that much discount. He remembers the old saw that pigs get slaughtered. The lawyer cautions, however, that because

---

76. Richardson, *Audit Avoidance*, *supra* note 68, at \*2-3.

77. *Id.*



of disclosures on a gift tax return, a gift tax return reporting a gift of closely held stock that has been highly discounted – even at a conservative high discount – is at a higher audit risk of audit than if just cash is given. The IRS often challenges valuation discounts and, even when such discounts are appropriate, the taxpayer may have to go to court to win and the costs and hassle of doing so may be unpleasant. The lawyer offers two alternatives – (i) give the daughter cash of \$650,000 and let her buy the stock or (ii) sell the stock to the daughter for her note of \$650,000 and thereafter “consider” making a gift to the daughter. The gift that need then be reported on a gift tax return is cash or a note (at the face value of the note), which will raise no audit red flags for the IRS. Practitioners will recognize that the bona fides of this planning requires that the two steps in either scenario not be interdependent,<sup>78</sup> but obviously from the client’s perspective it achieves the goal of getting 10% of the stock to the daughter without having to lay out cash other than the gift tax at the discounted value and lowers the audit profile. This genre of tax planning is done often with, of course, the detailed facts adding substantial color to the propriety or impropriety of “separating” the steps. But, assume for a moment that, with the lawyer’s guidance, the taxpayer is willing to separate the two steps for a period of time sufficient to, in the lawyer’s judgment, give a reasonable shot at sustaining the result and, in all events, avoiding civil or criminal penalties.

Richardson’s drama and my adaptation of it go substantially beyond Corneel’s sparse setting.<sup>79</sup> Richardson gives voice to the various players in the drama – lawyer, client, client’s wife and daughter (who happens to be a law student with a love-hate relationship with the way tax law is practiced).<sup>80</sup> The client, client’s wife and daughter marvel at the alchemy of the large discount and the audit avoidance planning.<sup>81</sup> Richardson then concludes his contrived drama by stating that there was too much connection between the two steps in either the cash gift or note gift

---

78. E.g., if the immediate cash gift is used, there should be some material time that elapses between the date of the gift and the purchase of the stock with there being some real risk that the value of the stock may change in the interim, or, alternatively, if the note option is chosen, the daughter will have to be treated as a creditor to the father (e.g., pay interest, etc.) for at least a material amount of time before the father forgives the debt. In each case, the devil of uncertainty is in the concept of material. *See id.*

79. *See* Richardson, *Audit Avoidance*, *supra* note 68, at \*2-3.

80. *Id.*

81. *Id.*

scenario to permit the two steps to be separately recognized for return reporting purposes.<sup>82</sup> With that connection, the transaction in his drama does not meet the minimum standard in Corneel's Guidelines.<sup>83</sup> Professor Richardson also expressed a broader concern that the staple tools such as these in the tax lawyer's bag of tricks may result in client intent modification where intent is the controlling consideration.<sup>84</sup> However, besides imagining that there might be some disagreement with Corneel on the contrived facts (upon which Corneel had never opined), Professor Richardson expresses no disagreement as to the propriety of audit avoidance planning and reporting provided the facts support it.<sup>85</sup> He only states that, in the drama he presented, the facts were not sufficiently separated to support audit avoidance.<sup>86</sup> In other words, Professor Richardson would have found willfulness to support a substantive tax crime.<sup>87</sup>

Corneel responded,<sup>88</sup> as he should have, noting that Richardson had changed the facts to create an imagined disagreement with Corneel.<sup>89</sup> But, like Richardson, Corneel did not retreat from the propriety of audit avoidance planning and reporting.<sup>90</sup>

In the Third Edition of his *Guidelines for Tax Practice*, edited and published posthumously in 2003, Corneel's editor omitted any express

---

82. *Id.* For an extreme example in which the court recognized a momentary break in the pre-wired links in the pre-ordained events, see *Compaq Computer Corp. v. Comm'r*, 277 F.3d 778, 785-86 (5th Cir. 2001); Lee A. Sheppard, *Getting Around the Substitute Payment Withholding Rules*, 2007 TAX NOTES TODAY 186-5 (Compaq held the shares "for only a few minutes"); Michael S. Knoll, *Compaq Redux: Implicit Taxes and the Question of Pre-Tax Profit*, 26 VA. TAX REV. 821, 826 (2007) ("Compaq held the shares for only about one hour"). Depending on the situation, most planners desiring to avoid the IRS collapsing the links in the chain would take significantly more time between the links; how much more becomes the key question for planners in a deal that, even with the break(s) in the links, will be completed as planned. See, e.g., the *Frank Lyon* case where the Supreme Court imagined that the nominal bank tenant of the building would not exercise its right to purchase after its nominal "rent" payments effectively reduced the exercise price after the nominal landlord, related party had gotten years of benefit from the depreciation paid for by the bank. *Frank Lyon Co. v. United States*, 435 U.S. 561, 581, 98 S. Ct. 1291, 1302 (1978). In *Frank Lyon*, eleven years intervened between the links – and worked. *Frank Lyon* 435 U.S. at 571. In *Compaq*, a few minutes to less than an hour intervened and worked. *Compaq*, 277 F.3d at 780. Should anywhere in between work? Cf. Kingson, *supra* note 57, at 1035 ("Tax shelters have been blamed on shoddy promoters, but few shelters are shoddier than those approved by the Court in *Lyon* and [Commissioner v. Brown, 380 U.S. 563, 85 S. Ct. 1162 (1965)]"). One could argue that *Compaq* surely gives *Lyon* and *Brown* a run for their money for the shoddiness crown. For the role of tacit understandings in business transactions to take out the risk of nominal breaks in links in a chain, see Alex Raskolnikov, *The Cost of Norms: Tax Effects of Tacit Understandings*, 74 U. CHI. L. REV. 601, 611-12 (2007).

83. See generally Richardson, *Audit Avoidance*, *supra* note 68, at \*13.

84. *Id.* at \*14.

85. *Id.* at \*17.

86. *Id.*

87. *Id.* at \*16.

88. Frederic G. Corneel, *Audit Avoidance: A Response to David Richardson*, 92 TAX NOTES 681 (2001).

89. *Id.* at \*2.

90. See *id.*

reference to audit avoidance planning and reporting.<sup>91</sup> It is clear that those new Guidelines do not condemn the practice and assume that the practitioner should consider and presumably implement some level of audit avoidance. In considering reporting transactions, the Guidelines state that the lawyer should ask: “What will be the impact of the form of reporting on the likelihood and nature of the audit?”<sup>92</sup> Then, in reporting the transaction, the *Guidelines* note that the boundaries are framed by the client’s desire to reduce tax where the proper tax treatment may be uncertain and avoid interest and penalties for failing to meet statutory requirements.<sup>93</sup> It is fair to conclude that it is appropriate, within these parameters, to report uncertain tax transactions truthfully but in a way to avoid red-flagging the problem for the IRS.

The discussion between these careful and thoughtful commentators in the ethical context helps frame the discussion here in the criminal context. Can it be that taking lawful and non-deceptive steps to avoid an audit without more is criminal? Turning that question back to the ethical issue, how can such steps be ethical, as these commentators certainly agreed, if they are criminal? In this regard, although noting that, under particular facts, audit avoidance planning may cross the line, the commentators do not suggest that it is per se unethical in all contexts and, more critically, do not suggest that it is criminal at all unless it crosses the line.

#### B. *Examples from the Real World of Tax Practice*

Tax practitioners are familiar from their practices and others’ practices with myriad examples of audit avoidance and similar steps may make the IRS’s job more difficult by arbitraging perceived deficiencies in the IRS administration of the tax law. For those who may be unfamiliar with tax practice or wanting to review some examples I present a number of examples in the Online Appendix to this Article.\*

I do want to present here one example. It is an extreme example – more extreme than most of the examples in the online appendix, but not, I think, distinguishable in any material respect. This example presents variations on a claim in the *Stein* case.<sup>94</sup> In considering these variations and the other examples in the online appendix, it is important to keep in mind that I make a key assumption – that the government cannot prove that the participating parties intended to violate any law, that charges for the

---

91. Frederic G. Corneel, *Guidelines to Tax Practices, Third*, 57 TAX LAW. 181 (2003).

92. *Id.* at 183.

93. *Id.* at 185.

\* John A. Townsend, *Tax Obstruction Crimes: Is Making the IRS’s Job Harder Enough?* Online Appendix, available at <http://www.hbtlj.org/v09p2/v09p2townsendappendixar.pdf>.

94. *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008).

substantive tax crimes, if made, would fail, and thus the question is whether tax obstruction is involved.<sup>95</sup>

#### Example: Structuring Partnership Distributions

The taxpayer has a large capital gain from sale of stock of a company he founded. Let us say the gain is \$50,000,000. An accounting firm promotes to the taxpayer a complex shelter that will produce \$50,000,000 in capital losses that will not cost him anything other than the transaction costs (say 7%, all in, or \$3,500,000) payable to the various promoters (including the accounting firm) and the brokerage firms. Assume that the taxpayer pays the transaction costs independent of the next steps so as not to muddy the analysis. The tax mechanism exploited to achieve the capital loss is to create a large artificial basis for a partnership interest by contributing to a partnership (1) cash of \$50,500,000, consisting of loan proceeds of \$50,000,000 and the taxpayer's own cash of \$500,000, thus giving him a \$50,500,000 basis in the partnership interest and (2) the liability generating the \$50,000,000 cash. Economically, the net value of the contribution is \$500,000 (the borrowed cash and the liability wash, leaving only the taxpayer's equity contribution), but under the tax construction exploited in the arrangement, the liability is claimed to be contingent which, if true, does not reduce the \$50,500,000 basis the taxpayer achieved in the partnership interest by contributing the cash.<sup>96</sup> The \$50,500,000 partnership interest basis – \$50,000,000 of which is artificial because of the offsetting liability – will generate the tax loss to offset the taxpayer's \$50,000,000 of real economic gain on sale of his company stock.

Now, inside the partnership, \$50,000,000 of the cash will be reserved and used to pay the liability. That leaves \$500,000 in the partnership that economically belongs to the taxpayer. Assume that the law is uncertain as to the legal construct upon which the taxpayer claims the artificial basis in the partnership interest, so as to the claim for that basis in the partnership interest, the government could not prove the willfulness required for the taxpayer or the promoters to be convicted of a substantive tax crime. Now let us consider the alternatives.

---

95. Since I submitted the original draft of this Article, the remnant of the *Stein* case was tried and the three of the four remaining defendants were convicted of certain of the substantive offenses but acquitted of the conspiracy count (which as previously noted included both an offense conspiracy charge (requiring willfulness) and a defraud conspiracy charge (not requiring willfulness as submitted to the jury)). I add an addendum to this Article to summarize the trial level result in the case as it relates to the discussion in this Article; suffice it to note here that the result is the opposite of the more likely result that I posit in the text.

96. The tax construct used for this apparent legerdemain is some variation of *Helmer v. Comm'r*, T.C.M. (CCH) 727 (1975).

Alternative A: Taxpayer arranges to have his partnership interest redeemed by distribution of the \$500,000 in cash. Under the Code, that is a taxable event.<sup>97</sup> He makes his loss calculation as follows:

Cash received:	\$ 500,000
Less basis:	<u>\$ (50,500,000)</u>
Loss:	\$ (50,000,000)

The taxpayer reports that loss on his return as a loss with respect to the partnership. Keep in mind that no document has been falsified, no misrepresentation made, and the reporting is precisely consistent with the rules Congress mandated for distributions of cash in redemption of a partnership interest.

Alternative B: What if the accountants and the taxpayer were concerned about showing a partnership loss of \$50,000,000? They believe that the IRS takes particular interest in large losses from partnerships which are a favored format for abusive tax shelters. So, at the inception of the partnership, the taxpayer directs the partnership to use his \$500,000 equity contribution to purchase ExxonMobil stock with a view toward later distributing that ExxonMobil stock to the taxpayer in redemption of his partnership interest. Under the tax rules, upon a property distribution (as opposed to a cash distribution), a taxable event has not occurred and the taxpayer may not claim a loss on the disposition of the partnership interest.<sup>98</sup> Instead, the partners' basis in the partnership interest attaches to the property distributed so that the taxpayer's gain or loss is deferred to another day.<sup>99</sup> After the distribution in redemption of his partnership

97. I.R.C. § 731(a)(2) (2006).

98. Indeed, neither gain nor loss is recognized on a distribution of property. In *Countryside L.P. v. Comm'r*, the Tax Court sustained an admitted tax avoidance transaction whereby property was distributed rather than cash in order to avoid triggering gain. 95 T.C.M. (CCH) 1006 (U.S. Tax Ct., 2008). The key point is that the planning sustained in *Countryside* is the same whether gain or loss is deferred by the distribution of property.

99. I.R.C. §§ 731, 732(b). These rules appear to be literally applied. If property is distributed in the liquidation of the partnership interest, the liquidated partner's basis in his partnership interest attaches to the property distributed. See, e.g., *Cemco Investors, L.L.C. v. United States*, 515 F.3d 749, 750-51 (2008) (referencing a similar transaction). The Solicitor General represented in opposing certiorari for a similar transaction that

[t]he purchase and sale of the euros was a necessary part of the scheme because, under 26 U.S.C. 732(b), a partner's outside basis attaches to any property distributed to him in kind in liquidation of his interest. The euros served as "property" to which the Trust's inflated outside basis in the Partnership could attach.

Brief for the United States in Opposition at 4 n.2, *Cemco Investors L.L.C. v. United States*, TAX NOTES TODAY, Aug. 7, 2008, available at 2008 LEXIS TNT 158-5. Perhaps inconsistently, but less authoritatively, the IRS recently has taken the position that this purchase of a partnership asset at the behest of the partner is the equivalent of a distribution of the cash purchase amount and acquisition by the partner of the asset individually, so that the indicated treatment does not apply. See I.R.S. Chief Couns. Mem. 200650014 (Sept. 7, 2006), TAX NOTES TODAY, Sept. 7, 2006, available at 2006 LEXIS TNT 242-17 (referred to as "ILM") (applying a principle claimed to have been announced in Rev. Rul. 55-39, 1955-1 C.B. 403). The position has not been tested in the courts, however, and in recognition of the fact that form often governs substance in the partnership provisions, the ILM takes the alternative position that the treatment seemingly mandated by the statute may be attacked under the IRS's

interest, the taxpayer sells the ExxonMobil stock for say \$500,000 (it has neither gained nor lost value since purchase) and reports \$50,000,000 of loss (based on the claimed \$50,500,000 basis in the ExxonMobil stock).

In this alternative also, no document has been falsified, no misrepresentation made, and the reporting is precisely consistent with the rules Congress mandated for distributions of property in redemption of a partnership interest and subsequent sales of the property distributed. Do the taxpayers' and promoters' intent to exploit the partnership property distribution rules in order to lower the audit profile make them criminally culpable?

Alternative C: What if the accountants and the taxpayer are still concerned that reporting a \$50,000,000 loss in ExxonMobil stock might attract attention because IRS agents eyeballing the loss might question such a large loss on ExxonMobil stock? If so, the accountants may recommend to the taxpayer the following series of events: (i) the brokerage firm will identify 10 stocks that, in the past year, have been big market losers, (ii) the partnership will then purchase those stocks rather than the ExxonMobil stock in Alternative B, (iii) the partnership will then distribute those stocks in redemption of the taxpayer's partnership interest thus permitting the inflated partnership basis to attach to those stocks, and (iv) the taxpayer will then sell those stocks to claim the desired capital loss. These actions which carefully comply with the mechanics of the tax rules governing partnerships are intended to make the claimed loss less visible. No document has been falsified, no misrepresentation made, and the reporting is precisely consistent with the rules Congress mandated for distributions of property in redemption of a partnership interest and subsequent sales of the property. Does the taxpayer and promoters' intent to exploit the partnership property distribution rules in order to lower the audit profile make them criminally culpable?

I think everyone would agree that, based on the key assumption of lack of willfulness for a substantive tax crime, Alternative A would not give rise to an obstruction claim, and of course the government made no such claim in *Stein*. Alternative B is more problematic, but still the government made no such claim in *Stein*.

Alternative C is a variation of B, but with a twist. The indictment alleges in *Stein* that one of the defendants "advised a BLIPS client to divide the phony tax shelter losses among 10 stocks that have been losers."<sup>100</sup> The precise government claim here seems uncertain because of the manner that the indictment charged the Count One conspiracy. The Count One

---

discretionary authority in the partnership anti-abuse rules. In theory, however, having structured a transaction within the scope of the literal rules which generally govern partnership provisions without reference to substance, a taxpayer would have few alternatives to reporting the transaction in any way other than as structured, with the IRS then attacking the transaction under its discretionary authority.

100. Superseding Indictment at 57, *United States v. Stein*, 541 F.3d 130 (2008) (No. S1 05 Cr.888 (LAK)).

conspiracy is charged as a single conspiracy with an object to commit substantive crimes (an offense conspiracy) and an object to defraud (defraud/*Klein* conspiracy).<sup>101</sup> Hence, the government's claim as articulated for this overt act is that the conduct is problematic because a predicate for the claim is that the shelter was "phony" – meaning willfully violating the law. I have assumed for my analysis here that the government cannot establish willfulness for the underlying shelter, and ask for purposes of analysis, would there be a defraud conspiracy if all the government had was the action in Alternative C when it could not prove willfulness as to the underlying artificial basis claim? To use Professor Green's litany, without willfulness there is no cheating or stealing, and since there is no falsehood made or implied (i.e., the transactions are reported exactly as the law commands), there is no lying.<sup>102</sup> All the parties have done is to structure the arrangement with real steps designed to thread the needle of the tax rules mandated by Congress. None of those rules have been violated. As shall be clear from the discussion below, Alternative C is not criminal obstruction.

#### IV. OBSTRUCTION THEORIES

##### A. *Introduction to Obstruction Theories*

##### 1. The Obstruction Statutes, Including § 7212

I begin with the obstruction context and the specific tax obstruction statute, § 7212. Section 7212 criminalizes (1) action which "corruptly or by force or threats of force" intimidates or impedes IRS employees and (2) action which "in any other way corruptly or by force or threats of force . . . obstructs or impedes . . . the due administration of this title."<sup>103</sup> Section 7212 is an obstruction statute with almost the same text, varied only for context, as several obstruction provisions of Title 18. Most importantly, for the present Article, I focus on the second branch, which is called the "Omnibus Clause" of § 7212 because that is the name given the parallel provisions of the obstruction statutes from which it is drawn.<sup>104</sup> The text of

---

101. *See id.* at 45-48.

102. GREEN, *supra* note 5, at 76.

103. I.R.C. § 7212.

104. *United States v. Aguilar*, 515 U.S. 593, 598, 115 S. Ct. 2357, 2361 (1995) (recognizing the historic description of this clause as the Omnibus Clause as it appears in 18 U.S.C. § 1503 dealing with obstruction of judicial proceedings). In the earliest appellate decision on § 7212, the court adopted the term "Omnibus Clause" to this statutory language because the text of the statute was drawn from the obstruction statutes. *United States v. Williams*, 644 F.2d 696, 699 n.11 (8th Cir. 1981), *cert. denied*, 454 U.S. 841 (1981). *See generally* U.S. DEP'T OF JUST., CRIMINAL TAX MANUAL § 17.00 (2008) available at <http://www.usdoj.gov/tax/readingroom/2008ctm/CTM%20TOC.htm> [hereinafter CTM]. Unless otherwise specifically noted, my references to the CTM are to the 2008 version. There have

the Omnibus Clauses of these various statutes parallels the defraud conspiracy interpretation to criminalize conduct intended to impair or impede. As with the defraud conspiracy, these Omnibus Clauses have no textual requirement that the defendant act willfully with intent to violate a criminal law.

## 2. Section 7212's Provenance - the Obstruction Statutes

When § 7212 was enacted in 1954, it had some predicates in the prior tax law criminalizing forcible conduct to influence tax administration, but § 7212 was drawn virtually verbatim from the general obstruction provisions in the criminal code. The general obstruction provisions, codified in Title 18, Chapter 73, are a part of an overlapping, poorly coordinated “medley” of statutes that criminalize conduct obstructive to the proper functioning of government.<sup>105</sup> Within the general obstruction provisions, I deal here with only the more commonly applied obstruction statutes with a direct textual link to the text of § 7212.

These general obstruction provisions and § 7212 have a common pattern. First, they criminalize the most obvious form of obstruction – force and threats of force.<sup>106</sup> Second, recognizing that non-coercive conduct can also be corrosive to the functioning of government, these provisions criminalize conduct which impairs or impedes the proper administration of some facet of government. The text of the respective obstruction statutes that addresses non-coercive obstruction is referred to as the “Omnibus Clause.” To illustrate, the Omnibus Clauses of the major obstruction statutes – § 1503 and § 7212 – are:

---

been two earlier versions – a 1994 version which apparently is not now available on the web and a 2001 version available at <http://www.usdoj.gov/tax/readingroom/2001ctm/>.

The obstruction statutes’ Omnibus Clause is so-called because the key text “is located at the end of the provision and broadens the set of acts that may be prosecuted under it.” *United States v. Miller*, 161 F.3d 977, 983 (6th Cir. 1998), *cert. denied*, 526 U.S. 1029 (1999). The specifically identified conduct that precedes the Omnibus Clause is covered by the more general and more inclusive text constituting the Omnibus Clause. Given this characteristic, it is interesting to note that the defraud conspiracy also might be viewed as an Omnibus Clause, because it covers and is broader than the conduct criminalized in the specific text that precedes it in § 371.

105. *United States v. Buckley*, 192 F.3d 708, 710 (7th Cir. 1999), *cert. denied*, 529 U.S. 1137 (2000); see generally Julie R. O’Sullivan, *The Federal Criminal “Code” is a Disgrace: Obstruction Statutes as a Case Study*, 96 J. CRIM. L. & CRIMINOLOGY 643, 679-85 (2006) (arguing that the medley of obstruction provisions spread throughout the Criminal Codes are unorganized and conceptually inconsistent). Obstruction crimes are found elsewhere in specific contexts, such as the general perjury and false declarations statutes, 18 U.S.C. §§ 1621, 1623 (2000 & Supp. 2008), materially false statements to executive, judicial or legislative branches, 18 U.S.C. § 1001(a)(2), and false claims to the government, 18 U.S.C. § 287. I have also noted that, conceptually, the substantive tax crimes such as evasion (I.R.C. § 7201), tax perjury (I.R.C. § 7206(1)), and aiding or assisting the submission of false documents in a tax context (I.R.C. § 7206(2)) are obstructive in character. See discussion *supra* Part II.B. The focus in the text is on the Title 18, Chapter 73 obstruction statutes most directly related to § 7212 which contain a textual requirement that the defendant have acted “corruptly.” For a discussion of a provenance of the obstruction provisions independent of the tax laws, see *United States v. Poindexter*, 951 F.2d 369, 379-82 (D.C. Cir. 1991).

106. See, e.g., 18 U.S.C. §§ 1503, 1505.



§ 1503. Influencing or injuring officer or juror generally

(a) Whoever . . . corruptly . . . influences, obstructs, or impedes, or endeavors to influence, obstruct, or impede, the due administration of justice.

§ 7212. Attempts to interfere with administration of internal revenue laws

(b) Whoever . . . in any other way corruptly . . . obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title [Title 26, Internal Revenue Code.]

It is not an accident that these two Omnibus Clauses are worded almost in haec verba: § 7212 was drawn directly from § 1503.<sup>107</sup> Indeed, § 1503 is the focal point of the general obstruction statutes,<sup>108</sup> so, not surprisingly, other obstruction statutes contain similarly worded Omnibus Clauses.<sup>109</sup>

Another obstruction provision with a similarly worded Omnibus Clause, § 1505, criminalizes obstruction of departments, agencies and congressional committees but requires that the obstructive conduct be directed at a “pending proceeding” rather than just the “due administration” of the respective body.<sup>110</sup> This word change may not be particularly important because § 1503’s “due administration of justice” has long been

---

107. For the legislative history of § 7212, *see* *United States v. Walker*, 514 F. Supp. 294, 304-07 (E.D. La. 1981); *see also* *United States v. Williams*, 644 F.2d 696, 699 n.12 (8th Cir. 1981) (“The language at issue in this case [(the Omnibus Clause)] does not appear in § 7212’s statutory predecessor, Int. Rev. Code of 1939, ch. 2, § 3601(c), 53 Stat. 435.”), *cert. denied*, 454 U.S. 841 (1981). The legislative history is quite sparse, and does not address the Omnibus Clause text at all. 1954 U.S.C.A.A.N. 4574, 5254.

Section 7212’s Omnibus Clause adds “in any other way” which is not found in the Title 18 obstruction Omnibus Clauses, but this addition does not seem to add anything other than to emphasize the broad scope of the Omnibus Clause. *See* CTM, *supra* note 104, § 17.04. What is uncertain is whether it suggests any lesser scope to the obstruction statutes such as § 1503 where the “in any other way” text is not used. I do not think it does, so that the scope of the respective obstruction statutes should be the same except as required by other text in the statutes (*e.g.*, the object of the obstructive conduct).

108. Ellen S. Podgor, *Arthur Andersen, LLP and Martha Stewart: Should Materiality Be an Element of Obstruction of Justice?*, 44 WASHBURN L. J. 583, 587-88 (2005). The other key obstruction statutes discussed in this article, including § 1505, § 1512(b) and § 7212 are patterned on § 1503. Daniel A. Shtob, *Corruption of a Term: The Problematic Nature of 18 U.S.C. §1512(c), the New Federal Obstruction of Justice*, 57 VAND. L. REV. 1429, 1435 (2004) (describing § 1503 as “the wellspring from which most of the obstruction of justice provisions . . . arose.”).

109. *See, e.g.*, 18 U.S.C. § 1505 (dealing with obstruction of departments, agencies and congressional committees).

110. 18 U.S.C. § 1505.

interpreted to require a pending judicial proceeding.<sup>111</sup> The two sections are parallel and in haec verba except for the nature of the pending proceeding involved (judicial as opposed to department, agency or legislative), and thus they are interpreted in the same way.<sup>112</sup>

Title 18, Chapter 73, contains one other relevant obstruction provision. In virtually the same words, § 1512(b) imposes punishment on anyone who “knowingly . . . corruptly persuades” or attempts to persuade another person to not testify before an administrative proceeding or otherwise respond properly or timely to appropriate process in the proceeding.<sup>113</sup> It is unclear to me precisely what work the word “knowingly” serves, but in any event the key word is “corruptly” – common to these obstruction provisions, including § 7212 – as I shall develop later in discussing the Supreme Court opinion in *Arthur Andersen L.L.P. v. United States*.<sup>114</sup>

The focal issue is the role of the word “corruptly” in these obstruction provisions.<sup>115</sup> The only statutory definition of the word “corruptly” is that, for § 1505, “‘corruptly’ means acting with an improper purpose, personally or by influencing another, including making a false or misleading statement, or withholding, concealing, altering, or destroying a document or other information.”<sup>116</sup> I discuss this special definition later in this Article,<sup>117</sup> but simply note now that the statutory definition applies neither

111. *Pettibone v. United States*, 148 U.S. 197, 205, 13 S. Ct. 542, 546 (1893); *see also* *United States v. Aguilar*, 515 U.S. 593, 600, 115 S. Ct. 2357, 2362 (1995) (requiring that not only must a pending proceeding exist, there must be a nexus, meaning that the defendants acted obstructively to influence the proceeding).

112. It is difficult to see why they would be interpreted differently simply because the settings are different, so the cases routinely apply the same interpretation. *See, e.g.,* *United States v. Laurins*, 857 F.2d 529, 536 (9th Cir. 1988), *cert. denied*, 492 U.S. 906 (1989). One court, in *United States v. Russo*, 104 F.3d 431, 436 (D.C. Cir. 1997), has suggested that they may be different in some respects, but this claim in a § 1503 case may have been dictated by the court’s concern that its precedent giving rise to the interpretation in a § 1505 case may be wrong. *See generally* *United States v. Poindexter*, 951 F.2d 369, 380-82 (D.C. Cir. 1991) (discussing the origins of § 1505). In any event, the shoals of logic that the *Russo* court was attempting to avoid is not present – at least I do not perceive it to be present – in the issues I address in this article.

113. 18 U.S.C. § 1512(b).

114. *Arthur Andersen L.L.P. v. United States*, 544 U.S. 696, 125 S. Ct. 2129 (2005).

115. For an interesting historical insight on the element of “corruptly” in the context of the grand jury, *see* Earl C. Dudley and Alan Silber, *Prosecuting Lawyers and Co-Opting Grand Juries: The Rise and Fall of an Embracery Prosecution*, 32 CHAMPION 8, 9 (2008) (describing a failed prosecution under Virginia law for the crime of embracery arising from contacts with state grand jurors). Black’s Law Dictionary defines the crime of embracery, which in England was an offense both at common law and by statute, as “the attempt to corrupt or wrongfully influence a judge or juror, especially by threats or bribery.” BLACK’S LAW DICTIONARY (8th ed. 2004). In England, the crime is regarded as obsolete and has since been codified “in sections on bribery[,] and the remainder in provisions dealing with obstruction of justice.” *Id.* This is a, if not the, historical antecedent to our federal obstruction crimes – also with a corruptly element.

116. 18 U.S.C. § 1515(b). Additionally § 1515(b) was added to address the holding in *Poindexter* and is discussed below.

117. *See infra* Part IV.B.2 (discussing Corruption and Misleading Truth).

to § 7212 nor to the other obstruction statutes that have a “corruptly” element, including most prominently § 1503.<sup>118</sup>

### 3. Section 7212’s Relationship to the Conspiracy Statute

There is no apparent textual relationship between § 7212’s Omnibus Clause and the defraud conspiracy, such as there is between § 7212 and the obstruction statutes. The texts are:

§ 7212. Attempts to interfere with administration of internal revenue laws

Whoever . . . in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title [Title 26, the Internal Revenue Code.]

§ 371. Conspiracy to commit offense or to defraud United States

If two or more persons conspire . . . to defraud the United States, or any agency thereof in any manner or for any purpose . . . .

Although not textually related, the defraud conspiracy is articulated in obstruction language. The Supreme Court in *Hammerschmidt v. United States*,<sup>119</sup> which I discuss in detail below,<sup>120</sup> held that the defraud conspiracy requires an attempt “to interfere with or obstruct one of its lawful governmental functions by deceit, craft or trickery, or at least by means that are dishonest.” As I develop in this section, § 7212 and the traditional obstruction statutes capture much the same concept in the “corruptly” element.

The Department of Justice Tax Division (“DOJ Tax”) explicitly articulates a relationship between the tax iteration of the defraud conspiracy – the *Klein* conspiracy – and § 7212. DOJ Tax asserts that § 7212(a) may be charged where the *Klein* conspiracy is “unavailable due to insufficient evidence of conspiracy.”<sup>121</sup> The claim therefore is that the same object – impairment of administration – can support either charge.

---

118. See O’Sullivan, *supra* note 105, at 706 (“This correction, by its terms, applies only to § 1505 and does little to clarify the meaning of the word “corruptly” for purposes of § 1503 and § 1512.”).

119. *Hammerschmidt v. United States*, 265 U.S. 182, 188, 44 S. Ct. 511, 512 (1924).

120. See *infra* Part V.C.1.

121. CTM (2001), *supra* note 104, § 17.02, (quoting Tax Division Directive No. 77, reproduced in CTM (2001) § 3.00). The 2008 version of the general subject is in § 17.03 and refers to Directive 129 which superseded Directive 77. The language quoted in the text from the 2001 version

In *United States v. Kassouf*,<sup>122</sup> the government, urging an expansive scope for § 7212, argued that the defraud conspiracy which, unlike § 1503 (as interpreted), has no pending proceeding requirement, should be used to interpret § 7212. The Sixth Circuit rejected the argument, holding that, because § 7212 was drawn directly from § 1503 where the “due administration” language required a pending proceeding, § 7212 should be similarly interpreted.<sup>123</sup> The court reasoned:

The government’s argument based on an analogy to § 371 is unpersuasive. First, the government itself concedes that the language used in the standard [defraud conspiracy] indictments (“lawful functions of the Internal Revenue Service”) is not identical to the [§ 7212] phrase “due administration of this title.” More important, however, is that the actual statute from which the charges are derived, is wholly inapposite to § 7212 because it uses the very broad terms “to defraud the United States, or any agency thereof in any manner or any purpose[.]” 18 U.S.C. § 371.<sup>124</sup>

As discussed below, the Sixth Circuit subsequently retreated from its sweeping importation of the pending proceeding requirement into § 7212, but has not yet retreated from its refusal to look to the defraud conspiracy provision to interpret § 7212.

A district court recently, however, did look to the *Klein* conspiracy to interpret and apply § 7212.<sup>125</sup> The court reasoned that the two crimes are given parallel constructions. Given the parallel constructions, “[t]here is no reason” that conduct constituting a *Klein* conspiracy by multiple actors should not be a § 7212 crime when committed by one.<sup>126</sup> I am not convinced that the logic is persuasive. Just because the two statutes, broadly construed, may cover much of the same ground does not mean that they cover all of the same ground.<sup>127</sup> Hence to apply *Klein* conspiracy

---

incorporating Directive 77 is omitted from the superseding Directive 129. I don’t think that omission is a concession of the point, however.

122. 144 F.3d 952, 955 (6th Cir. 1998).

123. See *United States v. Kassouf*, 144 F.3d 952, 956-57 (6th Cir. 1998).

124. *Id.* at 958.

125. *United States v. Willner*, No. 07 Cr. 183 (GEL), 2007 U.S. Dist. LEXIS 75597, at \*4-10 (S.D.N.Y. 2007).

126. *Id.* at \*17.

127. There are interesting, or at least noteworthy, differences in the three related statutes discussed here – the defraud conspiracy, § 7212 and the obstruction statutes. Obstructing judicial proceedings has a ten-year maximum sentence in the circumstances considered here (no killing or attempted killing), and obstructing agency proceedings has a five-year sentence. 18 U.S.C §§ 1503, 1505 (respectively). Conspiracy has a five-year maximum sentence. 18 U.S.C § 371. Section 7212(a) has a three-year maximum sentence, thus being significantly less than both judicial proceeding obstruction (ten years), administrative proceeding obstruction (five years) and conspiracy (five years). Just focusing on the defraud conspiracy, as interpreted, and § 7212(a)’s Omnibus Clause that deal with

authority to interpret § 7212, which has different text and certainly different history, could lead to error. It may well be that the interpretations substantially overlap, but they are not the same. That substantial overlap, however, may make the issue one of fine academic importance only.

On the other hand, I do want to articulate a proposition that necessarily flows from the overlapping theme of the defraud conspiracy, including its *Klein* tax iteration, and the obstruction provisions, including § 7212. That overlapping theme is obstruction of a governmental function, in this case agency obstruction. To the extent that agency obstruction is the evil being addressed in basically the same language as interpreted, logically the problems in and interpretive solutions for the defraud conspiracy should at least assist in interpreting the obstruction provisions, and vice-versa. In other words, if conduct is found not to be the type of obstruction to support a § 7212 charge, it also should not be the type of obstruction that could support a *Klein* conspiracy, and vice versa.

#### 4. Dangers Lurking in the Obstruction Statutes

The obstruction statutes offer the prosecutor powerful tools – perhaps too powerful. As with the defraud conspiracy, the tool is often marshaled when the prosecutor's opportunity to convict for a substantive crime is aggressive, risky or just too much trouble. There is an increasing tendency to rely on obstruction charges as a fall back.<sup>128</sup> The concern is that the

---

the parallel evils of impairing or impeding the functions of an agency, there is a significant maximum sentencing disparity (five years as opposed to three). This maximum sentencing disparity, although often of little importance at sentencing, still suggests that, whatever Congress was describing in § 7212(a), Congress viewed it qualitatively as a lesser offense than either obstruction of justice, obstruction of an administrative proceeding, or conspiracy. It is interesting to note that the prosecutors can end-run this Congressional judgment by packaging a § 7212(a) prosecution as a *Klein* conspiracy when it finds more than one actor.

128. See O'Sullivan, *supra* note 105 (citing, *inter alia*, the Quattrone, Fastow, Arthur Andersen and Scooter Libby prosecutions). For example, Martha Stewart was charged with securities fraud, and she and a co-defendant were charged with a melange of obstruction counts: (1) conspiracy "to obstruct justice, make false statements and commit perjury" (although it is not clear whether this was an offense conspiracy, defraud conspiracy or both, these are all obstruction crimes); (2) § 1001 false statements (which is an obstruction charge not usually called an obstruction charge); and (3) agency obstruction under § 1505. *United States v. Stewart*, 433 F.3d 273, 280 (2d Cir. 2006). At the close of the evidence, the district court entered a judgment of acquittal on the securities fraud charge – the government simply had not come close to proving securities fraud. The obstruction counts were then submitted to the jury. The jury convicted Stewart and the co-defendant on some of the obstruction counts. See *id.* Of course, obstructing justice is a serious crime independent of the substantive offense, but the government is often in a position to manipulate the circumstances to force an obstruction crime. A classic instance is the so-called "exculpatory no" in false statement prosecutions under § 1001. See *Brogan v. United States*, 522 U.S. 398, 408, 118 S. Ct. 805, 811-12 (1998). In rejecting the exculpatory no doctrine because of the plain reading of the statute, Justice Ginsburg, for the majority in *Brogan*, lamented the possibility of prosecutors abusing the false statement crime by manipulating the defendant to assert the exculpatory no doctrine. *Id.* at 411-12. Of course, the same can happen when the government manipulates a defendant to do something that the government imagines was designed to defeat the orderly conduct of the investigation. See, e.g., Robert L. Weinberg, *Not Guilty as Charged: A Revised Verdict for Alger Hiss*, 32 CHAMPION 18 (2008).

obstruction statutes may be so broadly applied as to sweep up the innocent with the guilty, thus permitting the prosecutor to selectively target those he or she chooses to prosecute. I cover cases dealing with this concern in the next section, which principally deal with the work of the word “corruptly” to limit potential overbreadth of the statute. I also discuss the same concern for the defraud conspiracy in the defraud conspiracy section below.<sup>129</sup>

There are other limiting factors for the general obstruction charges. Under either § 1503 or § 1505, the prosecution has to involve a specific intent to obstruct a pending proceeding. The general obstruction statutes most directly related to § 7212 do not apply unless there is a nexus to a pending proceeding – *i.e.*, the defendant must know that he is acting in a way to improperly affect the pending proceeding. I have already noted that some courts’ interpretations may not limit § 7212. But the real limiting work in these obstruction statutes is in the requirement that the defendant act “corruptly” – a requirement also contained in § 7212 – as the ultimate guardian to insure against overbreadth.<sup>130</sup>

## B. *Interpretation of the Obstruction Statutes*

### 1. Introduction to “Corruptly”

In *United States v. Aguilar*,<sup>131</sup> the defendant, a federal district judge, lied to FBI agents who were assisting in a grand jury investigation. The government charged obstruction under § 1503 for alleged obstruction of a grand jury proceeding. At trial, however, the government proved only that the defendant lied to FBI Agents and that a grand jury had been convened. In interviewing the defendant, the government did not prove that the FBI agents were assisting the grand jury or that the defendant knew or believed

---

129. Note that one of the obstruction charges leveled against Martha Stewart and her co-defendant was conspiracy to obstruct which may just be charge proliferation, principally for dramatic effect because the Sentencing Guidelines and certainly judicial discretion in the post-*Booker* environment takes the sentencing play out of charge proliferation. *Stewart*, 433 F.3d at 289.

130. There are other elements of an obstruction crime, but I focus only on the key element relevant to our discussion. The Second Circuit states the elements of § 1503 as follows:

(1) that there is a pending judicial or grand jury proceeding constituting the administration of justice, (2) that the defendant knew or had notice of the proceeding, and (3) that the defendant acted with the wrongful intent or improper purpose to influence the judicial or grand jury proceeding . . . .

*United States v. Quattrone*, 441 F.3d 153, 170 (2d Cir. 2006).

Others have given a more nuanced statement of the elements as follows: (1) “corruptly;” (2) “endeavored;” (3) to influence, obstruct or impede; (4) the due administration of justice; (5) the defendant must know that a judicial proceeding is pending; (6) must specifically intend to obstruct justice; and (7) a “nexus” between the wrongful conduct and the due administration of justice. O’Sullivan, *supra* note 105, at 686-87, 690.

131. 515 U.S. 593 (1995).

that the results of the interview would be reported to the grand jury.<sup>132</sup> The defendant certainly intended that whatever investigation the FBI Agents were conducting would be impaired or impeded by his lies (otherwise, presumably, he would not have lied), but the government did not prove that he knew he was obstructing a grand jury investigation. The question presented was whether he could be convicted under § 1503.

The court held that the defendant could not be convicted on the facts proved. First, the court's long-standing precedent established that a person lacking knowledge of a pending proceeding lacked the proscribed intent to obstruct.<sup>133</sup> Second, subsequent court of appeals decisions had placed "metes and bounds" around the broad Omnibus Clause language by establishing a "nexus" requirement: "[t]he action taken by the accused must be with an intent to influence judicial or grand jury proceedings; it is not enough that there be an intent to influence some ancillary proceeding, such as an investigation independent of the court's or grand jury's authority."<sup>134</sup> Third, applying the rule of lenity,<sup>135</sup> the court concluded: "We do not believe that uttering false statements to an investigating agent – and that seems to be all that was proved here – who might or might not testify before a grand jury is sufficient to make out a violation of the catch-all [Omnibus] provision of § 1503."<sup>136</sup>

*Aguilar* is an important obstruction case for its holding requiring a nexus between the alleged obstructive act and the investigation or

---

132. *Aguilar*, 515 U.S. at 601. The crime that would typically be charged for false statements to government agents is 18 U.S.C. § 1001(a)(2) (2000 & Supp. 2008), which at the time of *Aguilar*'s conduct criminalized false statements to government agents "in any matter within the jurisdiction of any department or agency of the United States." 18 U.S.C. § 1001(a)(2). In *Aguilar*, the government argued that the FBI agents to whom the false statements were made were not functioning in an executive agency capacity but as assistants to the grand jury, a "branch" that is separate from each of those enumerated branches. *Aguilar*, 515 U.S. at 600; *see also* *United States v. Williams*, 504 U.S. 36, 47, 112 S. Ct. 1735, 1742 (1992) (noting that the grand jury, mentioned only in the Bill of Rights rather than the text of the Constitution, is not assigned to any of the branches of government but is a separate constitutional fixture; "[T]he whole theory of its function is that it belongs to no branch of the institutional Government, serving as a kind of buffer or referee between the Government and the people."). Section 1001(a) was amended in 1996 to include judicial proceedings. False Statements Accountability Act of 1996, Pub. L. No. 104-292, § 1, 110 Stat. 3459.

133. *Aguilar*, 515 U.S. at 599 (citing *Pettibone v. United States*, 148 U.S. 197, 13 S. Ct. 542 (1893)).

134. *See id.*

135. *See id.* at 600. The majority opinion does not refer to the rule of lenity by name, but articulates the underlying rule requiring the exercise of restraint in construing criminal statutes "both out of deference to the prerogatives of Congress, and out of concern that a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed." *Id.* (citations and quotation marks omitted); *see Note, The New Rule of Lenity*, 119 HARV. L. REV. 2420, 2432 (2006) [hereinafter *The New Rule of Lenity*] (citing also another case related to the criminal tax arena, *Ratzlaf v. United States*, 510 U.S. 135, 114 S. Ct. 655 (1994) (dealing with the requirement of willfulness)). Justice Scalia (with Justices Kennedy and Thomas), dissenting in part in *Aguilar*, calls this quote the application of the rule of lenity and there is no indication that the label to put on the concept employed was disputed among the justices. *Aguilar*, 515 U.S. at 612.

136. *Aguilar*, 515 U.S. at 600.

proceeding. I want to focus, however, not on that holding but on the assumption implicit in the case that Aguilar acted “corruptly” in lying to the agents. I think everyone recognizes that the assumption is correct. But why is it correct, and does it tell us anything about the limitations on the obstruction crime element of corruptness?

## 2. Corruption and Misleading Truth

To focus on the “corruptly” element, let us make two critical changes to the *Aguilar* facts. Those changes are: (1) the government met the nexus requirement by proving that Aguilar knew that the answers he gave would or at least could affect the grand jury investigation in which the FBI Agents were assisting; and (2) Aguilar told the truth but that truth as selectively presented in fact could mislead the FBI Agents, so that despite the truth of the statements, the inferences the FBI Agents could draw are false. The latter could have two subsets – (i) Aguilar intended his true statements to convey his best case with inferences in his favor although, unbeknownst to Aguilar, the inferences are false, yet Aguilar did not intend to mislead the FBI Agents; or (ii) Aguilar intended his true statements to permit inferences he knew to be false and thereby to mislead the FBI Agents.

I think all of us have encountered truth intended to mislead,<sup>137</sup> and a key Supreme Court case holds that truth is not perjury even if intended to mislead.<sup>138</sup> The question presented is whether Aguilar’s intent to mislead the grand jury investigation by stating the truth would subject him to obstruction charges under § 1503. I think the answer to that should be “no;” the implications of a “yes” answer are startling and far reaching indeed.

In agency and grand jury investigations, in trials and in lobbying Congress, as in all of life, “truth” often does not exist in any objective sense and may come in many variations. The proponents present their respective versions of the truth in the hope that their versions will persuade the investigators, triers or congressmen, respectively, to achieve the result the proponents seek. So long as that truth does not cross the bounds and become objectively false, there is no criminality under the criminal provisions that most directly apply to the conduct – perjury and false statements.<sup>139</sup> Specifically, there is no criminality under those provisions even if the defendant intended his or version of the truth to influence the proceedings and the defendant intended to mislead. In each case, literal

---

137. The truth of this statement is even the stuff of literature:

A truth that’s told with bad intent  
beats all the lies you can invent.

William Blake, *Auguries of Innocence*, lines 53-54 (c. 1803).

138. See *Bronston v. United States*, 409 U.S. 352, 360-62, 93 S. Ct. 595, 602 (1973).

139. See 18 U.S.C. §§ 1621, 1001(a)(2).



truth is a complete defense.<sup>140</sup> If, however, the literal truth were not a defense to obstruction, then perjury and false statements (which, after all, are merely specific instances of obstruction) would be crimes that, like handkerchiefs, are already covered by the obstruction blanket.<sup>141</sup> Why would not the government just forego the perjury charge requiring strict proof and assert the obstruction charge, which would be far more efficacious in terms of conviction. Moreover, a case could easily be made that, in a civil trial that involves critical disputed facts, the “loser” has obstructed justice by presenting a version of the facts that the trier has found not to be true or at least not the best version of the truth. By definition, the loser’s case had to be false or, at a minimum, truth packaged differently than the truth found by the trier.<sup>142</sup> The mere presentation of

---

140. As to perjury, the Supreme Court so held in *Bronston v. United States*, 409 U.S. 352, 362, 93 S. Ct. 595, 602 (1973). As to the false declarations counterpart to perjury (§ 1623), see *United States v. Earp*, 812 F.2d 917, 919 (4th Cir. 1987) (citing *Bronston*). As to false statements, the weight of authority is that literal truth is a defense, with the cases often citing *Bronston*. E.g., *United States v. Good*, 326 F.2d 589, 592 (4th Cir. 2003) (“The principle articulated in *Bronston* holds true for convictions under § 1001 and in this case today.”). The government claims that literal truth may not be a defense to a false statement charge, CTM, *supra* note 104, § 24.05 (citing *Peterson v. United States*, 344 F.2d 419, 427 (5th Cir. 1965)). But *Peterson* has been questioned on this point by the very court that decided *Peterson*. *United States v. Moses*, 94 F.3d 182, 188 (5th Cir. 1996) (“We cannot uphold a conviction . . . where the alleged statement forming the basis of a violation of section 1001 is true on its face.”); see also *Good*, 812 F.2d at 592 (citing *Moses* for the proposition that literal truth is a defense); *United States v. Mandanici*, 729 F.2d 914, 921 (2d Cir. 1984); *United States v. Carriles*, 541 F.3d 344, 362 (5th Cir. 2008) ([F]alse statements crimes require that “the statement was false and that the defendant knew it to be false.”). See also GREEN, *supra* note 5, at 137.

In *United States v. Mahaffy*, 2008 U.S. App. LEXIS 17496 (2d Cir. 2008) (unpublished), in a false statement prosecution under § 1001, the court found plain error as a matter of law in the following instruction:

A statement or representation is “false” or “fictitious” or “fraudulent” if it was untrue when made, and known at the time to be untrue by the person making it or was made or caused to be made with the intent to deceive the Government agency to which it was made.

2008 U.S. App. LEXIS at \*7. The court said “[t]he actual charge given by the district court, insofar as it indicated that an intent to deceive, without more, could be sufficient for the jury to convict O’Connell of the false statement charge, was wrong as a matter of law.” *Id.* at \*6.

141. *Chicago Stock Yards Co. v. Comm’r*, 129 F.2d 937, 948 (1st Cir. 1942), *rev’d* 318 U.S. 693 (1943) (referring to the “blanket” of presumptions and the connection between the burden of proof and the burden of production); *United States v. Gallo*, 859 F.2d 1078, 1080 (2d Cir. 1988), *cert. den. sub nom Miron v. United States*, 490 U.S. 1089 (1989) (quoting Judge Weinstein, who compared the effect of immunized testimony to “having a horse blanket and throwing it on top of . . . a little handkerchief, no effect whatsoever”).

142. The examples of this are legion, but I present here only one from a famous trial, with the particular insight drawn from LEONARD MLODINOW, *THE DRUNKARD’S WALK: HOW RANDOMNESS RULES OUR LIVES* 120 (Pantheon Books 2008), a book about randomness and probability (probability being, of course, the very stuff of trials, since certainty or truth in any absolute sense is hardly ever known). In the O.J. Simpson trial, a key building block of the prosecutor’s case was proving Simpson’s propensity for violence toward Nicole, permitting an inference that he killed her. Turning the tables on that strategy, Simpson’s lawyer Alan Dershowitz argued that, according to the statistics, 4 million women are battered annually by husbands or boyfriends, yet of that universe only some 1,423 women are killed. The statistic is 1 out of 2,500; few men who slap around and beat up on their wives and girlfriends go on to kill them, Dershowitz argued, so that the jury should draw no inference from the fact of Simpson’s abuse of his wife. But, according to Mlodinow, the defense was presenting the wrong statistics to support the conclusion it sought. Rather:

such evidence has impaired and impeded the functioning of justice and the tribunal in question because it has required the expenditure of valuable and limited resources to discern the truth from the untruth. Certainly, this case could be made that with respect to every loser in a civil case by motion for summary judgment, directed verdict or for judgment notwithstanding the verdict. And, it could even potentially apply to the prosecutor who suffers a Rule 29 motion for judgment of acquittal.<sup>143</sup> That losing party and counsel have pursued a case by presenting a version of the facts that no reasonable juror could accept,<sup>144</sup> and obviously that has impeded or impaired the administration of justice because substantial trial and pretrial time has been spent on a false case. And, what about the lawyers who intentionally misstate or stretch the “truth” of the law to try to affect the result?<sup>145</sup> I think these examples alone caution that we not accept, without more critical thought, any notion that literal but misleading truth is obstruction.

---

According to the Uniform Crime Reports for the United States and Its Possessions, the probability Dershowitz (or the prosecution) should have reported was this one: of all the battered women murdered in the United States in 1993, some 90 percent were killed by their abuser. That statistic was not mentioned at trial.

Did Simpson’s counsel mislead the jury; does that fit within the glittering generality of at least an endeavor to obstruct justice? What if Dershowitz knew that he was presenting improper or misleading statistics?

For another dramatic example of this type of even more egregious misleading presentation of trial testimony establishing an alibi at a particular time when the defense knew that the defendant misspoke about the time of the event, see Peter J. Henning, *The DNA of White Collar Crime*, 11 NEW CRIM. L. REV. 323, 344-45 (2008) (citing his prior discussion in Peter J. Henning, *Lawyers, Truth, and Honesty in Representing Clients*, 20 NOTRE DAME J.L. ETHICS & PUB. POL’Y 209, 276 (2006)).

Consider also cross-examination of the truthful witness in a way intended to make the witness appear untruthful. See GREEN, *supra* note 5, at 181 (noting that some obstructive conduct is sanctioned because, I suppose, it is imagined that the jury is best situated to deal with that and the proffering party can still rehabilitate the witness).

143. Federal Rules of Criminal Procedure, Rule 29 requires judgment of acquittal where the evidence is not sufficient to sustain conviction. The standard, variously worded by the courts, is basically whether the evidence would permit a “reasonable” or “sensible” jury to find guilt beyond a reasonable doubt as to all elements. FED. R. CRIM. P. 29. See *United States v. O’Keefe*, 825 F.2d 314, 319 (11th Cir. 1987); *United States v. Genova*, 333 F.3d 750, 757 (7th Cir. 2003).

144. For summary judgment, when there is no genuine issue as to any material fact, the moving party is entitled to judgment as a matter of law. FED. R. CIV. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 325, 106 S. Ct. 2548, 2553-54 (1986)). For a directed verdict, the court must consider whether “a reasonable jury would not have a legally sufficient evidentiary basis to find for the party.” FED. R. CIV. P. 50(a). This same standard applies to a judgment notwithstanding verdict. FED. R. CIV. P. 50(b)(3).

145. For example, in *United States v. Black*, 2008 U.S. App. LEXIS 17595 (7th Cir. 2008), Judge Posner, writing for a unanimous panel, found that the defendants “proposed a misleading instruction” and then complained, on appeal, about the trial court not giving it. Judge Posner then concluded: “[b]ut given the number and skill of the defendants’ lawyers, the misleading character of their proposed instruction cannot be regarded as a merely ‘technical’ failing, as opposed to an effort to mislead.” There are, of course, variations of this theme carried on by zealous, sometimes too zealous, counsel every day, and given the scienter posited by Judge Posner in the example, the conduct may be said to have intended to influence improperly the outcome of the case. Are they guilty of obstruction?

Let us look therefore at the contexts in which this notion gets bandied about. I have found only two cases in which courts have suggested that literally true answers with an intent to mislead may be obstruction.<sup>146</sup> I discuss them briefly, turning first to the earliest case.

In *United States v. Browning*,<sup>147</sup> the defendant was charged under § 1505 with obstructing a Customs Service investigation into the importation of certain firearms. Analogizing to the Supreme Court's holding that literal truth is a defense to perjury, the defendant argued that his statement of literal truth could not form the basis for obstruction.<sup>148</sup> The court ultimately held that facts did not support the argument that literal truth was involved at all.<sup>149</sup> In the course of reaching that holding, the court said:

The ultimate question in the case at bar is not whether the defendant told the truth but whether the defendant obstructed or interfered with the process of truthfinding in an investigation in the process of enforcing the law. In other words, was the defendant, Mr. Browning, seeking to counsel to answer the questions in a manner which would interfere with the process of truth finding? Literal truth is not the test here, and, in any event, Browning did not counsel to tell the literal truth.<sup>150</sup>

As decided, any suggestion that literal truth is not a defense is dicta.

In *United States v. Safavian*, the defendant was indicted for § 1505 obstruction for certain statements made by a high ranking General Services Administration ("GSA") official to GSA investigators about certain dealings with Jack Abramoff, a then Washington power broker who crossed the line in his power brokering and has since fallen from grace.<sup>151</sup> At trial, the defendant offered an expert witness to testify to the word usage conventions used in the GSA contracting community, as a way to prove that his statements to the investigators were literally true under those conventions. The district court did not allow the testimony. On appeal, the D.C. Circuit said:

One is guilty of obstruction if he "corruptly . . . influences, obstructs, or impedes or endeavors to influence, obstruct, or impede" an investigation. Section 1515 [(b)] defines "corruptly" as "acting with an improper purpose . . . including making a false or misleading statement, or

---

146. See *United States v. Safavian*, 528 F.3d 957, 968 (D.C. Cir. 2008); *United States v. Browning*, 630 F.2d 694, 699 (10th Cir. 1980), *cert. denied* 451 U.S. 988 (1981).

147. *Browning*, 630 F.2d at 699.

148. *Id.*

149. *Id.* at 700.

150. *Id.* at 699 (citations omitted).

151. *United States v. Safavian*, 528 F.3d 957, 959 (D.C. Cir. 2008).

withholding, [or] concealing” information. Even a literally true statement may be misleading and so, unlike § 1001(a)(1), literal truth may not be a complete defense to obstruction. Even so, if Safavian’s expert witness had convinced the jury of the truth of his statements, this would have gone at least part of the way to convincing the jury that he had not obstructed justice. We therefore believe that excluding the expert’s testimony had “a substantial and injurious effect or influence in determining the jury’s verdict” on Count 1, particularly since the audience for his statement about Abramoff’s lack of “business” at GSA was a GSA official presumably versed in the technical meaning of the term.<sup>152</sup>

The court reversed to permit the jury to consider the expert testimony that showed the defendant told the literal truth and could consider the literal truth in determining whether the defendant had the corrupt intent to obstruct.<sup>153</sup> The defendant got the reversal for a new trial he sought, but presumably will not get an instruction that literal truth is a “complete defense.” Perhaps he will get an instruction that it is a defense, although the court may have some difficulty explaining in any meaningful way the practical difference between a complete defense and a defense. Consider that the only distinction that could make the statement criminal or noncriminal is his intent to mislead; his words alone will not be the guide because the words are true, and the jury will be left to divine or speculate about his intent.

The *Safavian* court’s reliance upon *Browning* is questionable because of the limited scope of the *Browning* holding. However, the special statutory definition of “corruptly” for purposes of § 1505 to include “false or misleading statement” can be interpreted to support the *Safavian* statement that literal truth, if misleading, may be prosecuted under § 1505.<sup>154</sup> That special definition was enacted in 1996 to cure a problem Congress perceived in the D.C. Circuit’s *Poindexter* decision interpreting § 1505.<sup>155</sup> As discussed below, *Poindexter* held § 1505 unconstitutional in context because it was “too vague to provide constitutionally adequate

---

152. *Id.* at 967-68 (citations omitted).

153. *Id.* at 967. Professor Green discusses the analogous case of President Clinton’s heralded equivocation about the definition of sex. GREEN, *supra* note 5, at 141-43. In the underlying Paula Jones case, the trial judge provided a definition of sex, which at least permitted some equivocation, and Paula Jones’ attorneys did not sharpen their questions to take out the wiggle room. By responding literally and truthfully under the special definition, but with an intent to mislead, Clinton’s guilt of perjury was problematic. But, if that conduct was sufficient to support an obstruction charge, then it would appear that all of those legions of bright lawyers on the special prosecutor’s staff and all the other pundits such as Professor Green were simply focused on the wrong crime. *See id.*

154. 18 U.S.C. § 1515(b) (emphasis added).

155. False Statements Accountability Act, Pub. L. No. 104-292, § 3(2), 110 Stat. 3459 (1996).

notice that it prohibits lying to the Congress.”<sup>156</sup> On its face, that statutory cure to *Poindexter* does not apply to any other obstruction provision, including § 1503 and § 7212. Given its provenance as a cure for a specific problem in § 1505, it would be a stretch to force the provision onto the other sections without congressional action.<sup>157</sup> Certainly, there is evidence that the other obstruction statutes do not apply where literal truth alone is involved.<sup>158</sup>

More importantly, however, the issue here is not about misleading conduct. In the Alternative C situation discussed above,<sup>159</sup> the law requires that partnership interest basis attach to property distributed by the partnership; and the IRS designed form directs that the basis be reported in making the familiar § 1001 calculation a gain or a loss. The taxpayer states only that he sold the stock for \$X and his basis in the stock is \$Y with the resulting gain or loss determined simply by mathematics. The taxpayer makes no statement, explicit or implicit, that the loss being reported was attributable to economic loss in the property sold (stock in this example).<sup>160</sup> The law and the IRS form have no requirement the taxpayer make such a statement. The IRS is thus not misled – certainly not entitled to claim it was misled – by any inference it may draw from the limited scope of the

156. *United States v. Poindexter*, 951 F.2d 369, 379 (D.C. Cir. 1991); *see also* *United States v. Brady*, 168 F.3d 574, 577 n.2 (1st Cir. 1999) (citing legislative history for congressional intent to clarify that lying or otherwise obstructing Congress is covered by § 1505, thus meeting the vagueness concerns in *Poindexter*).

157. Eric J. Tamashasky, *The Lewis Carroll Offense: The Ever-Changing Meaning of “Corruptly” Within the Federal Criminal Law*, 31 J. LEGIS. 129, 151 n.181 (2004); O’Sullivan, *supra* note 105, at 706 (“This correction, by its terms, applies only to § 1505 and does little to clarify the meaning of the word ‘corruptly’ for purposes of § 1503 and § 1512.”); *see also* Shtob, *supra* note 108, at 1442 n.75 (“Nowhere does the statute attempt to define ‘corrupt’ or ‘corruptly’ standing alone outside of their use in 1505.”).

158. Judge Mikva’s dissent in *Poindexter* (discussed below) noted that, as to obstruction of Congress under § 1503, which is the same standard for investigations and judicial proceedings, “while ‘corruptly’ cannot be read to criminalize all attempts to influence Congress, there is a clear distinction between politically misleading (but literally true) advocacy and outright lying.” I think his point is that the obstruction statutes address the lie but not the truth, even if misleading. Judge Mikva’s comments are in a dissent, but I do not think the comments were a point of difference with the majority which found the statute unconstitutional in its application out of basically the same concern. *See Poindexter*, 951 F.2d 369, 391 (Mikva, J., dissenting).

Moreover, the Sentencing Guidelines’ treatment of obstruction suggests that literal truth is not an obstruction. *See* U.S. SENTENCING GUIDELINES MANUAL § 3C1.1, app. n.2 (2007) (discussing “alleged false testimony or statements”); § 3C1.1., app. n.4 (listing “non-exhaustive” but illustrative examples of materially “false” statements or information, without a hint that true statements will suffice). For an argument using the Sentencing Guidelines interpretations as persuasive to the construction of the obstruction statutes, *see* Podgor, *supra* note 108, at 597-600 (citing *inter alia* Judge Posner’s decision *United States v. Buckley*, 192 F.3d 708 (7th Cir. 1999)).

159. *See supra* Part III.B.1.

160. The IRS could easily devise a form question such as the following: “If any portion of a loss, deduction, or credit that you claim on this return represents a loss that you will not economically incur, describe the loss item on the return and describe the transaction.” Obviously, this is a rough and ready proposal and it would have to be refined with limiting definitions, but the concept is there.

statement made directly responding truthfully to the information requested.<sup>161</sup>

When Alternative B<sup>162</sup> was in issue, as it usually was in the shelters involved in *Stein*, the government made no claim of impropriety beyond its claim that the tax shelter itself was “phony;” meaning the defendants’ participation in it was willful, which I have assumed away here for analysis. Everyone can recognize, however, that the loss was not generated by the ExxonMobil stock, but rather that the law compels that the loss, if any, be claimed with respect to the ExxonMobil stock exactly as the IRS required it to be reported. How is that different simply because loss stocks (as opposed to gain stocks) generate the artificial loss? It is not, and there is nothing misleading about attaching the artificial loss to the stocks – whether gain or loss.

### 3. Obstruction and Covertness

In the audit avoidance context, the problem is at best formulated as one of covertness rather than deception, whether by truth or by misguidance. Professor Green distinguishes in a related context between deception and covertness.<sup>163</sup> Deception is a moral foot-fault that is sometimes criminalized (indeed, as we shall see it is in the obstruction and in the conspiracy areas). Covertness, on the other hand, is not the same as deception and appears to be morally neutral.

### 4. “Corruptly” is No Potted Plant<sup>164</sup>

Another way of stating the issue is whether there can be intentional conduct to impair, impede or influence that is not corrupt. If the mere intent to impair, impede or influence is per se corrupt, then the word

---

161. This analysis parallels Professor Green’s distinction between lying and merely misleading, with the latter category being less socially harmful and thus subject to no or certainly lesser retributive state action. See GREEN, *supra* note 5, at 78-81. In truth, the issue in this ugly example is really one of the IRS asking specific questions eliciting targeted information and then claiming it has been misled because it drew inferences from truthful and direct answers that neither the questions nor the answers fairly permit. That is, of course, why any charge of tax perjury would fail. See *United States v. Pirro*, 212 F.3d 86, 95 (2d Cir. 2000). Also the problem is not cured by asserting the IRS’s claim elicited a misleading answer. As in the testimony involved in *Bronston v. United States*, 409 U.S. 352, 361-62, 93 S. Ct. 595, 601-02 (1973), the context is a testimonial setting (a return is signed under penalty of perjury just for that reason) and it is the IRS’s responsibility to hone the questions to elicit answers that fairly justify the inferences it makes. The IRS simply failed in this “ugly” example.

162. See *supra* Part III.B.1.

163. GREEN, *supra* note 5, at 57.

164. The heading is inspired by a famous quote from Brendan Sullivan, counsel to Oliver North in the Iran-Contra hearings, that resulted in a prosecution of Oliver North and John Poindexter discussed later in the text. The congressional interrogator, Senator Inouye, was trying to short-circuit Sullivan’s objections by suggesting that North speak himself. To which, Sullivan responded: “What am I, a potted plant? I’m here as a lawyer. That’s my job.” See Brendan Sullivan, [http://en.wikipedia.org/wiki/Brendan\\_Sullivan](http://en.wikipedia.org/wiki/Brendan_Sullivan) (last visited Jan. 26, 2009). The same question is asked for the word “corruptly” and I address here exactly what the job of “corruptly” is.

corruptly is redundant and serves no purpose in the statute. If the word is not redundant, but somehow limits the universe of otherwise intentional conduct to impair, impede or influence, then the focal issue becomes how to distinguish between those intentional actions which are obstruction and those which are not.

Certainly intentionality is present in the other words of these obstruction statutes, as it is in the word corruptly. Corruptly connotes not just intentionality, but a particularly bad type of intentionality: a type of moral foot-fault that even exceeds willfulness to violate a law.<sup>165</sup>

Facially, corruptly would seem to require something more – and more evil – than intentionality. Case law will show that it does add some meaning, so that there can be intentional conduct to impair or impede that is not corrupt and thus not criminalized.

More importantly is whether a layperson can perceive the distinction so that he is able to recognize that which puts him at criminal jeopardy and conform his behavior accordingly. Several decisions poke around that question, many doing little more than deciding the case at hand, and often after making statements of the most glittering generality; certainly, in the aggregate they do not offer comprehensible guidance.<sup>166</sup> I discuss here only the cases I feel are particularly important to informing the interpretation of § 7212. I present the cases in their chronological order.

I start the discussion with the famous criminal episode involving Oliver North and Admiral John Poindexter arising from the Iran-Contra scandal. One of the charges was obstruction of Congress under § 1505.<sup>167</sup> In one of the appeals arising from the case, a key issue was whether “corruptly” adds some additional element or whether the simple intent to impede or endeavor suffices for criminalizing the conduct.<sup>168</sup> In *United States v. Poindexter*,<sup>169</sup> the D.C. Circuit made two key holdings related to this issue:

“Corruptly” is not redundant and adds a limiting element to the requirement of conduct impeding or endeavoring to impede.

That term must have some meaning . . . because otherwise the statute would criminalize all attempts to “influence” congressional inquiries – an absurd result that the Congress could not have intended in enacting the statute.<sup>170</sup>

---

165. See *infra* note 269.

166. Others have noted that, in respect to the key word “corruptly,” and related concepts in the obstruction provisions, the case law is hardly a model of clarity, and indeed really a mess. See O’Sullivan, *supra* note 105, at 698-711; see generally Tamashasky, *supra* note 157.

167. *United States v. Poindexter*, 951 F.2d 369, 372 (D.C. Cir. 1991).

168. See *id.* at 378, 386.

169. *Id.*

170. *Id.* at 377-78 (citing *United States v. North*, 910 F.2d 843, 882 (D.C. Cir. 1990)).

The “corruptly” element was too vague in the context of the facts of the case to give the defendants the constitutionally required notice of criminality.

Only the second holding drew a vigorous dissent from Judge Mikva,<sup>171</sup> who did not quarrel with the first holding that the “corruptly” element adds a limitation so that not all intentional attempts to impede or endeavor are criminalized. Judge Mikva said:

But while “corruptly” cannot be read to criminalize all attempts to influence Congress, there is a clear distinction between politically misleading (but literally true) advocacy and outright lying. No matter how devious the intent, a mere act of lobbying or otherwise seeking to persuade an official cannot fall under the definition of “corruptly” in the context of section 1505, since advocacy is not “inconsistent with a legal duty.” As we recognized in *North*, executive personnel “constantly attempt, in innumerable ways, to obstruct or impede congressional committees” as part of “legitimate political jousting between the executive and legislative branches.”<sup>172</sup>

Note the parameters Judge Mikva set, with the prohibited one being “outright lying.”

The uncontroversial part of the holding in *Poindexter* was that more than an intent to impede or endeavor to impede was required. Expanding this holding to § 1503, more than merely attempting to influence a judicial proceeding is required, for our adversary system of justice assumes that parties and their attorneys every day will be set about influencing or attempting to influence the outcome of judicial proceedings. There must also be a corrupt act or endeavor. And, further extrapolating to the parallel language in § 7212, corruptly would seem to not criminalize any action or attempt to impede or endeavor or otherwise influence the outcome of IRS actions, but necessarily only covers those actions that are similarly corrupt.

In *United States v. Farrell*, the Seventh Circuit addressed the “corruptly” requirement in § 1512(b)(3).<sup>173</sup> This statute “makes it a crime to attempt to ‘corruptly persuade’ someone in order to ‘hinder, delay, or prevent the communication to a law enforcement officer or judge of the United States of information relating to the commission or possible commission of a Federal offense.’”<sup>174</sup> The defendant who was a target of a Department of Agriculture investigation into the sale of adulterated meat urged a co-conspirator to exercise his Fifth Amendment privilege to not

---

171. See *Poindexter*, 951 F.2d at 390-92 (Mikva, J., dissenting).

172. *Id.* at 391 (Mikva, J., dissenting).

173. *United States v. Farrell*, 126 F.3d 484, 485-86 (3d Cir. 1997).

174. *Id.* at 486 (quoting 18 U.S.C. § 1512(b)(3)).



provide information to the investigators.<sup>175</sup> The defendant was charged with the underlying substantive offense of selling meat product and with obstruction under § 1512 (b)(3).<sup>176</sup> The defendant pled to the substantive offense and then was found guilty of the obstruction charge in a bench trial.<sup>177</sup> The defendant appealed.<sup>178</sup> The Third Circuit reversed, holding that the statute's element of corrupt persuasion could not apply where the defendant made simply a non-coercive attempt to get the other person to exercise his constitutional right to remain silent.<sup>179</sup> In focusing on the "corruptly" requirement,<sup>180</sup> the court reasoned that it added some limitation other than that the conduct be intentional, so that a mere intent to persuade someone to hinder an investigation is not criminalized. The court reasoned:

We read the inclusion of "corruptly" in § 1512(b) as necessarily implying that an individual can "persuade" another not to disclose information to a law enforcement official with the intent of hindering an investigation without violating the statute, i.e., without doing so "corruptly." Thus, more culpability is required for a statutory violation than that involved in the act of attempting to discourage disclosure in order to hinder an investigation.<sup>181</sup>

In dissent, Judge Campbell,<sup>182</sup> took the majority to task with respect to the outcome, but did not appear to quarrel with the quoted interpretation of the corruptly requirement. Judge Campbell said:

However, interpreting "corruptly" to mean "motivated by an improper purpose" does not create statutory redundancy. It is true that many courts have loosely declared that the term "corruptly" in § 1503 "does not superimpose a special and additional element on the offense," but rather includes any act "done with the purpose of obstructing justice." But such broad statements overlook that not all actions taken with the intent to hinder or obstruct justice necessarily violate § 1503 or § 1512. In such instances, the term "corruptly" can play an important

---

175. *Id.* at 488-89.

176. *Id.* at 486-87.

177. *Id.* at 487.

178. *United States v. Farrell*, 126 F.3d 484, 487 (3d Cir. 1997).

179. *See id.* at 487-88.

180. Unlike the Supreme Court in *Andersen*, the *Farrell* court did not hint that the word "knowingly" somehow modified the word corruptly to give corruptly a meaning for § 1512(b) that it might not have in the other obstruction statutes which do not add the "knowingly" word. *See id.* at 488.

181. *Id.* at 489.

182. *Id.* at 491 (Campbell, J., dissenting).

role in limiting the reach of the statutes. For example, a mother urging her son, in his own interest, to claim his Fifth Amendment right to remain silent would hardly be acting “corruptly,” that is, with an improper purpose. A newspaper attacking a particular prosecutor as going too far, or an altruistic citizen writing a letter to the prosecutor or the judge seeking clemency for the accused – would be other examples where the corruption requirement, i.e., improper purpose, would limit prosecutions under both statutes.<sup>183</sup>

In *United States v. Shotts*, the Eleventh Circuit rejected a *Poindexter* inspired argument that the “corruptly persuading” element of § 1512(b)(3) was unconstitutionally vague.<sup>184</sup>

The indictment alleged that Shotts, a lawyer, violated the statute by corruptly persuading and attempting to corruptly persuade a law firm employee not to tell federal agents about matters within the scope of the investigation.<sup>185</sup> In doing so, the court disagreed with the holding of *Farrell*, but seems not to have disagreed with the points noted immediately above.<sup>186</sup> Indeed, the *Shotts* court quoted with favor the following from a Second Circuit case:

The court noted that § 1512(b) does not prohibit all persuasion, but only that which is “corrupt.” By targeting only such persuasion as is “corrupt,” § 1512(b) clearly limits only constitutionally unprotected speech, and is not, therefore, overbroad.<sup>187</sup>

The *Shotts* court also cites the key portion of the dissent in *Farrell*:

Furthermore, the scienter role played by “corruptly” is not redundant, according to the [*Farrell*] dissent, because “not all actions taken with the intent to hinder or obstruct justice necessarily violate § 1503 or § 1512.”<sup>188</sup>

---

183. *Id.* at 493 (Campbell, J., dissenting) (citations omitted).

184. *United States v. Shotts*, 145 F.3d 1289, 1301 (11th Cir. 1998), *cert. denied* 525 U.S. 1177 (1999). In a subsequent case, *United States v. Davis*, 183 F.3d 231, 250 n.6 (3d Cir. 1999), *amended by* 197 F.3d 662 (1999), the Third Circuit found that instructions which did not so indicate would be deficient and instructed the district court on remand to “clarify that “corrupt persuasion” involves more than an improper motive, and includes inducements to violence.”

185. *Shotts*, 145 F.3d at 1299.

186. *See id.* at 1301. Also, like the *Farrell* court, but unlike the later Supreme Court *Andersen* opinion, the Eleventh Circuit gave no importance to the word “knowingly.” *See id.* (bypassing discussion of the “knowingly” element of the crime, instead focusing on the idea of “corruption”).

187. *Id.* at 1300 (discussing *United States v. Thompson*, 76 F.3d 442, 452 (2d Cir. 1996)).

188. *Id.* at 1300-01.

After warding off the constitutional attack on this basis, the *Shotts* court then approved conviction based on the propriety of the instruction requiring that the defendant “knowingly and dishonestly with the specific intent to subvert or undermine the integrity or truth-seeking ability of an investigation by a federal law enforcement officer.”<sup>189</sup> Note that, in this formulation of the instruction, the work performed by “knowingly” is the word knowingly itself, and the work performed by “corruptly” is the word “dishonestly.”

The Supreme Court granted certiorari in *Arthur Andersen L.L.P. v. United States* in order to resolve a split of circuit authority with respect to § 1512(b), citing *Shotts* and *Farrell* as cases illustrating the split.<sup>190</sup> Note that the points from those cases that I discuss above are not in conflict, and, as I shall note, the Supreme Court agrees with those points.

Arthur Andersen L.L.P. (“AA”), the late major accounting firm, encouraged its employees to apply its document retention policy after its major client, Enron, was facing major financial difficulties which were expected to lead to an SEC investigation.<sup>191</sup> If the document retention policy were implemented (and it was), then it would have the effect – an intended effect – of limiting the universe of documents that might be available to the SEC in the expected investigation. The government obtained an indictment under the quoted statute in part on the theory that destroying documents in advance of an anticipated SEC investigation was obstruction under this statute.<sup>192</sup> The mere indictment brought the downfall of AA.<sup>193</sup> AA was convicted, the Fifth Circuit sustained the conviction and the Supreme Court granted certiorari. The issue resolved pertained to the adequacy of the instructions and, as we shall see, focused on the “corruptly” element of the statute.

The Court started its analysis with a discussion of the rule of restraint and fair notice for criminal statutes.<sup>194</sup> “[T]he act underlying the conviction – ‘persuasion’ – is by itself innocuous,” and even “‘persuad[ing]’ a person ‘with intent to . . . cause’ that person to ‘withhold’

---

189. *Id.* at 1301.

190. *Arthur Andersen L.L.P. v. United States*, 544 U.S. 696, 702 n.7, 125 S. Ct. 2129, 2134 n.7 (2005).

191. *Id.* at 698.

192. *Id.* at 702.

193. *See id.* AA’s demise upon indictment is perversely related to the *Stein* case, which is the impetus for this Article. The district court in *Stein* found that, under threat of death sentence by indictment (with AA as the poster child for this proposition), the government pressured KPMG to withdraw attorney fee support for its personnel and that the pressure violated the Sixth and Fifth Amendments. *See United States v. Stein*, 495 F. Supp. 2d 390, 414 (S.D.N.Y. 2007). The district court accordingly dismissed the indictment as to the affected defendants in *Stein*. *Id.* at 427; *see also United States v. Stein*, 440 F. Supp. 2d 315, 337 n.115 (S.D.N.Y. 2006) (preceding decision to *United States v. Stein*, 495 F. Supp. 2d 390), *aff’d*, *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008).

194. *Arthur Andersen*, 544 U.S. at 703. The Court cited earlier precedents, including *United States v. Aguilar*, 515 U.S. 593, 600, 115 S. Ct. 2357, 2362 (1995), which I discuss below in a separate section on lenity and related concepts. *See infra* Part VII.

testimony or documents from a government proceeding or government official is not inherently malign.”<sup>195</sup> The Court reasoned from two examples: (1) a mother’s importuning a son in jeopardy of prosecution to invoke the Fifth Amendment can impair and impede the proceedings and (2) an attorney’s “persuasion” via advice to a client to invoke an attorney-client privilege.<sup>196</sup> In each instance, the action would not warrant an assertion that the action was done corruptly.

The Court also reasoned that one of the effects of document retention policies is that documents may not be available in proceedings or investigations within the scope of the obstruction provisions. But “[i]t is, of course, not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances.”<sup>197</sup>

The Court then moved into the focal consideration of the “corruptly” element and its limiting work to insure that not all actions otherwise described in the obstruction provisions are criminalized.<sup>198</sup> The Court noted that § 1512(b) requires that the defendant “knowingly . . . corruptly persuade,” and that, since the other obstruction statutes do not contain the word “knowingly,” “any analogy [is] inexact.”<sup>199</sup> The Court then quoted some dictionary definitions of the key words “knowingly” and “corruptly” to suggest that they meant conscious of wrongdoing, “[a]nd limiting criminality to persuaders conscious of their wrongdoing sensibly allows § 1512(b) to reach only those with the level of ‘culpability . . . we usually require in order to impose criminal liability.’”<sup>200</sup>

I pause here to make a key point about the Supreme Court’s comment that the analogy to §§ 1503 and 1505 is inexact.<sup>201</sup> The limited point the Supreme Court makes is that “knowingly” modifies “corruptly” in § 1512(b) and §§ 1503 and 1505 do not have that modifier. The comment was directed at the government’s argument that “knowingly” meant nothing so that “corruptly” was the focal element in issue. If the government had been correct (or more, precisely, had the Court as the final

195. *Arthur Andersen*, 544 U.S. at 703-04.

196. *Id.* The Court cited its decision in *Upjohn Co. v. United States*, 449 U.S. 383, 101 S. Ct. 677 (1981), where the Court sustained the assertion of the privilege. *Arthur Andersen*, 544 U.S. at 704.

197. *Arthur Andersen*, 544 U.S. at 704 (citations omitted).

198. *Id.* at 704-05.

199. *Id.* at 704-05 & n.9.

200. *Id.* at 706 (citing *United States v. Aguilar*, 515 U.S. 593, 602, 115 S. Ct. 2357, 2363 (1995)) (noting that this is a § 1503 case, which contains only the “corruptly” element).

201. Perhaps I quibble, but analogies are by definition inexact. Analogy is defined as:

1. A resemblance of relations; an agreement or likeness between things in some circumstances or effects, when the things are otherwise entirely different. Thus, learning enlightens the mind, because it is to the mind what light is to the eye, enabling it to discover things before hidden.

WEBSTER’S REVISED UNABRIDGED DICTIONARY (2008), <http://dictionary.reference.com/browse/analogy>. By contrast, in Euclidian logic, things which are equal to the same thing are also equal to one another, and that is what I imagine would be an exact analogy. But, of course, that is then not an analogy but the same thing.

arbiter accepted the government as correct), the analogy (if that is the right word) to the other two sections would be exact (if that is the right word). The Court said merely that “knowingly” means something and does modify “corruptly.”<sup>202</sup> But, the word “corruptly” means the same in these obstruction statutes.<sup>203</sup> The Court certainly did not say that the interpretation of the word corruptly in the other statutes is not relevant, which is a more usual way of thinking about such cross-statute analysis for interpretation.<sup>204</sup> And, finally to close the loop, the Court did not say that its interpretation in *Andersen* of the meaning of the word “corruptly” in § 1512(b) was not relevant to the interpretation of that same word in the other statutes. This difference is important to the Court’s further consideration which focused on the word “corruptly” and the limiting work that it does.<sup>205</sup> So, I let the *Anderson* Court speak on that subject:

The outer limits of this element<sup>206</sup> need not be explored here because the jury instructions at issue simply failed to convey the requisite consciousness of wrongdoing. Indeed, it is striking how little culpability the instructions required. For example, the jury was told that, “even if [petitioner] honestly and sincerely believed that its conduct was lawful, you may find [petitioner] guilty.” The instructions also diluted the meaning of “corruptly” so that it covered innocent conduct.

The parties vigorously disputed how the jury would be instructed on “corruptly.” The District Court based its instruction on the definition of that term found in the Fifth Circuit Pattern Jury Instruction for § 1503. This pattern instruction defined “corruptly” as “knowingly and dishonestly, with the specific intent to subvert or undermine the integrity” of a proceeding. The Government, however, insisted on excluding “dishonestly” and adding the term “impede” to the phrase “subvert or undermine.” The District Court agreed over petitioner’s objections, and the jury was told to convict if it found

---

202. See *Arthur Andersen*, 544 U.S. at 705-06.

203. Cf. *United States v. Matthews*, 505 F.3d 698, 705-06 (7th Cir. 2007).

204. The court noted the relationship between the word corruptly in § 1505 and § 1503, stating “cases interpreting section 1503 are relevant to constructions of section 1505.” *United States v. Laurins*, 857 F.2d 529, 536 (9th Cir. 1988), *cert. denied*, 492 U.S. 906 (1989).

205. In *United States v. Matthews*, the Seventh Circuit explained this facet of *Arthur Andersen L.L.P. v. United States*, 544 U.S. 696 (2005) as follows: “the [*Andersen*] Court explained how the word ‘corruptly’ serves to separate criminal and innocent acts of obstruction.” 505 F.3d 698, 705 (7th Cir. 2007).

206. It is not clear, but contextually an argument might be made that, at this point, the Court had conflated “knowingly” and “corruptly” into a single element, and this particular statement may be referring to both; immediately after this, however, the Court clearly has unpacked the corruptly element to deal only with it.

petitioner intended to “subvert, undermine, or impede” governmental factfinding by suggesting to its employees that they enforce the document retention policy.

These changes were significant. No longer was any type of “dishonesty” necessary to a finding of guilt, and it was enough for petitioner to have simply “impeded” the Government’s factfinding ability. As the Government conceded at oral argument, “impede” has broader connotations than “subvert” or even “undermine,” and many of these connotations do not incorporate any “corruptness” at all. The dictionary defines “impede” as “to interfere with or get in the way of the progress of” or “hold up” or “detract from.” By definition, anyone who innocently persuades another to withhold information from the Government “gets in the way of the progress of” the Government. With regard to such innocent conduct, the “corruptly” instructions did no limiting work whatsoever.<sup>207</sup>

Notice that this discussion is focused only on the word “corruptly,” which is common to all these obstruction statutes. The Fifth Circuit jury instruction serving as the model at trial defined corruptly in terms of dishonesty. But that Fifth Circuit pattern jury instruction was modified in the AA trial to exclude dishonesty, and therein lay the fatal error.

The Supreme Court’s concerns with an expansive interpretation of the obstruction statute echo concerns about the other obstruction statutes with a corruptly element and the defraud conspiracy, a variation on an obstruction statute, which Supreme Court for much the same reason has required dishonesty in impeding or impairing government functions.

Not surprisingly, the lower courts also have struggled with the “corruptly” and related concepts in the obstruction context. The state of the law is a mess and little would be served at this point to attempt a detailed reconciliation or criticism of that law.<sup>208</sup> I will, of course, discuss principally appellate court decisions interpreting § 7212, because the Supreme Court has yet to interpret that statute.

---

207. *Matthews*, 505 F.3d at 706-07 (internal citations omitted).

208. See O’Sullivan, *supra* note 105. In support of my decision not to attempt that exercise at this stage, I can simply say that I think that, given the inconclusive state of the myriad decisions, it would waste the readers’ time and ultimately would not be enlightening. Since I am a tax lawyer, I think much of the lower court case law on obstruction suffers the same phenomenon described by the Supreme Court in *Welch v. Helvering*, 290 U.S. 111, 54 S. Ct. 8 (1933). “Many cases in the federal courts deal with phases of the problem presented in the case at bar. To attempt to harmonize them would be a futile task. They involve the appreciation of particular situations, at times with borderline conclusions.” *Id.* at 116. It also suffers the phenomenon in *Haas v. Henkel*, where the Supreme Court used sweeping language beyond the context of the case and then had to throttle back when presented with a different case. See 216 U.S. 462, 30 S.Ct. 249 (1910).

### C. Section 7212

#### 1. Introduction

As previously noted, § 7212's Omnibus Clause was enacted with the Internal Revenue Code of 1954, and its parentage was the obstruction statute's Omnibus Clause.<sup>209</sup> Judging from § 7212's absence from reported cases, this tax enforcement tool languished for some time until the first appellate case in 1981, some twenty-six years after enactment, and then blossomed into full bloom in the 1990s when the government began to imagine and apply § 7212 as a work-around for the burdens – including willfulness – it encountered in the specific tax offenses that might otherwise apply.<sup>210</sup>

In *United States v. Williams*, the defendants undertook a variation of a tax protestor<sup>211</sup> gambit by filing false W-4 statements.<sup>212</sup> The enterprise was masterminded by a four year janitorial employee who upon self-study concluded that the tax code was unconstitutional and proceeded to rally others to his cause. Although it is not clear that the defendants themselves actually succeeded in achieving the desired exemptions from withholding, the government charged them under § 7212 and § 7205 which imposes a misdemeanor crime for the filing of false withholding information with the employer.<sup>213</sup>

The court started its analysis by noting that “the proper interpretation of this clause presents us with an issue of first impression;” so “we proceed cautiously where for over twenty-five years the Government has feared to tread.”<sup>214</sup> The Court acknowledged the obstruction statutes – §§ 1503 and 1505 – as the parents of § 7212 and thus adopted the now-accepted short hand for the pertinent text as the “Omnibus Clause.”<sup>215</sup> As for § 7212 generally, the court noted that, prior to this case, the government had asserted that § 7212 applied only to situations involving force or threats of

---

209. 18 U.S.C. § 1503 (1996); 18 U.S.C. § 1512(c)(2) (2008).

210. *Level of Criminal Tax Fraud Cases Leveling Off, Justice Department Official Says*, 1998 DTR 45 d6 (March 9, 1998) (quoting a prominent criminal tax practitioner, Bob Fink of New York City, as saying about § 7212, “The children at the IRS found a new toy to play with.” The new toy, of course, was middle-aged (having been birthed in 1954), but the new imagination of the scope of the section only hinted earlier came to fruition in the 1990s.)

211. I use the term “tax protestor” as historically used for this movement. DOJ Tax seeks to rebrand the tax protestor movement into the “tax defier” movement. Press Release, Nathan J. Hockman, Tax Division's Assistant Attorney General, Announces the Creation of the National Tax Defier Initiative (Apr. 8, 2008), available at [http://www.usdoj.gov/opa/pr/2008/April/08\\_tax\\_275.html](http://www.usdoj.gov/opa/pr/2008/April/08_tax_275.html). For more history on the movement, see Tax Protester (United States), [http://en.wikipedia.org/wiki/Tax\\_protester\\_\(United\\_States\)](http://en.wikipedia.org/wiki/Tax_protester_(United_States)) (discussing the DOJ Tax attempt to rebrand).

212. *United States v. Williams*, 644 F.2d 686 (8th Cir. 1981), cert. denied, 454 U.S. 841 (1981).

213. See *id.*

214. *Id.* During this interim period, the government sometimes proceeded under § 1505 rather than § 7212. See e.g., *United States v. Henderson*, 386 F. Supp. 1048, 1055-56 (S.D.N.Y. 1974).

215. *Williams*, 644 F.2d at 699 n.11.

force.<sup>216</sup> In *Williams*, the government sought to avoid this earlier limited application by describing it as “timid.” Agreeing with the government that § 7212 should be more broadly construed than just force or threats of force, the court nevertheless reversed most of the defendants’ § 7212 convictions because the court interpreted § 7205’s language to make it the exclusive crime for false withholding certificates. It sustained the mastermind’s conviction under § 7212 by analytical legerdemain to avoid the shoals of § 7205’s exclusivity requirement that it had just applied. The court reasoned that although not charged, the criminal code’s aiding and abetting provision (18 U.S.C. § 2) would make the mastermind guilty of assisting others who filed false withholding statements, thus violating § 7206(2), a felony provision which has no exclusivity language like § 7205.<sup>217</sup> Hence, that mastermind could be guilty of violating § 7212.

Despite its clear relationship to the obstruction provisions which generally require a judicial or administrative proceeding (including an investigation in place), the courts do not require a pending IRS administrative proceeding for a § 7212 prosecution.<sup>218</sup> In this regard, however, echoes of a predicate proceeding requirement are reflected in DOJ Tax’s statement that:

In general, the use of the “omnibus” provision of Section 7212(a) should be reserved for conduct occurring after a tax return has been filed – typically conduct designed to impede or obstruct an audit or criminal tax investigation, when 18 U.S.C. 371 charges are unavailable due to insufficient evidence of conspiracy.<sup>219</sup>

But, obviously the DOJ’s claim subsumes a claim that a pending audit or other proceeding is not required, and that is consistent with the case authority.<sup>220</sup>

---

216. *Id.* at 699 n.12 (citing *United States v. Henderson*, 386 F. Supp. 1048, 1055-56 (S.D.N.Y. 1974)).

217. It would seem to me that the aiding and abetting statute would more logically make the mastermind a “principal” of the § 7205 crime, thus running squarely into the exclusivity provision which, in turn would prohibit prosecution under any other provision, including § 7206(2).

218. *See United States v. Kassouf*, 144 F.3d 952 (6th Cir. 1998). The Sixth Circuit subsequently retreated from its decision in *Kassouf*. *See United States v. Bowman*, 173 F.3d 595, 600 (6th Cir. 1999) (limiting *Kassouf* to its facts). Similarly, other courts have rejected that requirement for § 7212. *See, e.g., United States v. Kelly*, 564 F. Supp. 2d, 843, 844-45 (N.D. Ill. 2008).

219. CTM (2001), *supra* note 104, § 17.02. This language has been omitted from the current 2008 version of the CTM.

220. *See id.* § 17.03.



## 2. I Am Corruptly; Let Me Work<sup>221</sup>

### a. Cases

In *United States v. Reeves*, Reeves had been the subject of a criminal investigation.<sup>222</sup> Irritated by that investigation, Reeves filed a common law lien against the agent for \$250,000 in the deed records of the local courthouse. The lien was, of course, false. Reeves nevertheless claimed that he did not file the lien “corruptly” because it was in anticipation of suing the agent.<sup>223</sup> As did the Supreme Court in *Andersen* and the lower courts discussed above in the obstruction context, the court grappled with the meaning of “corruptly:”

It is unlikely that “corruptly” merely means “intentionally” or “with improper motive or bad or evil purpose.” First, the word “endeavor” already carries the requirement of intent; one cannot “endeavor” what one does not already “intend.” Similarly, the mere purpose of obstructing the tax laws is “improper” and “bad;” therefore, to interpret “corruptly” to mean either “intentionally” or “with an improper motive or bad or evil purpose” is to render “corruptly” redundant. A statute should be read to avoid rendering its language redundant if reasonably possible. This is especially true in the present case where “the key words in the statute are ‘corruptly’ and ‘endeavors.’” “Corruptly” is a word with strong connotations; it is difficult to believe Congress included this “key” word only to have it read out of the statute or absorbed into the meaning of “endeavor.”<sup>224</sup>

The court reasoned that intentional action in some cases obstructing a pending court proceeding to achieve an advantage is per se corrupt, and everyone would be on fair notice that it is corrupt and criminal under the general obstruction statutes. For this reason, the Fifth Circuit had previously sustained § 1503 against a constitutional attack for void for vagueness. That is not the case with § 7212, however, and corruptness is not necessarily subsumed in mere intentionality.

Since § 7212(a) is not restrained by the fact that it is narrowly applicable, we cannot say with as much assurance that potential violators will be put on notice that

---

221. This heading is a word play on Carl Sandburg’s poem, *Grass*, from CORNHUSKERS. See Carl Sandburg, CORNHUSKERS (New York, Henry Holt & Co.) (1918); available at: <http://www.bartleby.com/134/91.html> (last visited March 8, 2009) (“I am the grass. Let me work.”).

222. *United States v. Reeves*, 752 F.2d 995 (5th Cir. 1985), cert. denied, 474 U.S. 834 (1985).

223. See *id.*

224. *Id.* at 998.

their conduct is “corrupt” in the eyes of the law by the context involved as is the case under § 1503. Accordingly, we are obligated to interpret § 7212(a) to specifically insure that potential violators will be on notice of what constitutes corrupt behavior under § 7212(a); merely prohibiting “bad,” “evil” and “improper” purposes is very probably insufficient where, as here, a statute reaches such a broad category of circumstances.<sup>225</sup>

The court concluded that § 7212’s corruptly requirement forbids “those acts done with the intent to secure an unlawful benefit either for oneself or for another.”<sup>226</sup>

This formulation of the standard is the one that has gained traction in the subsequent cases (some of which are discussed below).<sup>227</sup> Bottom-line in the case before it, the court applied the standard as follows:

We hold that the filing of frivolous common law liens with the intention of securing improper benefits or advantages for one’s self or for others constitutes a prohibited corrupt endeavor under section 7212(a). In the present case it may be that Reeves meant to impede or intimidate officers or agents of the Internal Revenue Service from collecting his just debt of taxes due or from scrutinizing his tax accounts; or it may be that he engaged in this conduct to secure an improper advantage or benefit for other unnamed persons or groups of persons. If this is the case, his actions constituted a corrupt endeavor under section 7212(a).<sup>228</sup>

The case was remanded and, upon remand, Reeves again was convicted on the ground that the filing of the lien met the standard. On subsequent appeal,<sup>229</sup> the court of appeals affirmed with the simple conclusion that there was no basis for the filing of the lien other than to, in some way, influence the pending investigation by “harassing” the agent and “diverting his energies.”<sup>230</sup> In so holding, the court did not change the applicable standard it had set in the earlier Reeves decision.

In *United States v. Popkin*, the defendant was convicted under § 7212(a)’s Omnibus Clause. Popkin was a tax lawyer who had previously represented a drug dealer named Musick who, while in jail, ratted on the

---

225. *Id.* at 999-1000. The *Reeves* court later stated: “[t]he definition of ‘corruptly’ as meaning ‘with improper motive or bad or evil purpose’ could potentially raise a question about the overbreadth of section 7212(a) as well as the question of vagueness touched on above.” *Id.* at 1001.

226. *Id.* at 1001.

227. Tamashasky, *supra* note 157, at 175 (discussing the problems courts have faced in defining corruptly).

228. *Reeves*, 752 F.2d at 1001-02.

229. *Id.*

230. *Id.* at 1326.

lawyer for past sins for which the government apparently did not want to prosecute.<sup>231</sup> Musick agreed to participate with the government in a sting against Popkin. Musick arranged a meeting with Popkin and advised the unsuspecting Popkin that Musick had about \$200,000 in offshore drug money he needed to repatriate and launder. Popkin implemented a structure involving a new California corporation, incorporated by Popkin, to effectively launder the money by creating a fictitious sale of the stock for \$200,000 and also prepared and presented two false tax returns to Musick and the agents.<sup>232</sup>

Popkin was charged on several counts, including a § 7212(a) Omnibus Clause count, but was convicted only on the Omnibus Clause count. The amended indictment stated the § 7212 allegation as follows: “did corruptly obstruct and impede and endeavor to obstruct and impede the due administration of Title 26, United States Code, by creating a California corporation for Stephen Musick to disguise the character of illegally earned income and repatriate it from a foreign bank.”<sup>233</sup> Popkin’s opening brief on appeal argued that § 7212(a) required assaultive conduct or threats which were not present here. Apparently, recognizing in light of the government’s answering brief that that argument was a loser,<sup>234</sup> Popkin re-focused and sharpened his argument on reply to assert the following Omnibus Clause argument:

[T]here was no evidence that the only act charged in the redacted indictment – creating a California corporation for Musick to disguise the character of illegally earned money and repatriate it – either obstructed or was intended to obstruct or impede the due administration of the Internal Revenue Code.<sup>235</sup>

The court handily rejected the argument that assaultive conduct was a required element of § 7212(a) because the Omnibus Clause, on a plain reading, was not limited to such conduct.<sup>236</sup> The court then focused on the second argument which it viewed as addressed to the word “corruptly” in

---

231. *United States v. Popkin*, 943 F.2d 1535, 1536 (11th Cir. 1991), *cert. denied*, 502 U.S. 1004 (1992). Perhaps the statute of limitations did not allow enough time for the type of complete investigation the government requires; more likely, Musick would have been so easily impeachable that the government may have felt its prosecution was at risk under the high standards it normally requires.

232. *Id.*

233. *Id.* at 1541.

234. *See* Department of Justice Brief at 5-10, *United States v. Popkin*, 943 F.2d 1535 (11th Cir. Jan. 1991). In light of the express language of the statute, of course, the defendant’s argument was an easy straw man to knock down. The use of such an argument might suggest less than careful or credible lawyering and also may have contributed to the court’s fuzziness on the key issue discussed in the text.

235. *Popkin*, 943 F.2d at 1538.

236. *Id.* at 1539.

the statute.<sup>237</sup> The court rejected Popkin's argument, adopting reasoning from the opinion in *United States v. Reeves*,<sup>238</sup> as follows:

We agree with the definition adopted in *Reeves*. It comports with our view that "corruptly" was used in § 7212(a), as in the general obstruction of justice statute, to prohibit all activities that seek to thwart the efforts of government officers and employees in executing the laws enacted by Congress. In a system of taxation such as ours which relies principally upon self-reporting, it is necessary to have in place a comprehensive statute in order to prevent taxpayers and their helpers from gaining unlawful benefits by employing that "variety of corrupt methods" that is "limited only by the imagination of the criminally inclined." We believe that § 7212(a) is such a statute and that the use of "in any other way corruptly" in the second clause gives clear notice of the breadth of activities that are proscribed.<sup>239</sup>

Notice the linkage between the imagination of the criminally inclined and the word "corruptly." This would suggest that the result might be different if the actor had believed that his or her acts were not criminal. To bring the matter home directly, the court said:

Popkin acted corruptly, moreover, because at least one intent in creating the corporation was to secure an unlawful benefit for his client. The purpose of the corporation went beyond repatriating money held in a foreign bank. It provided a means, in creating a paper loss from inter-corporate transactions, by which the funds held abroad and repatriated appeared to be less than the actual amount of untaxed money that Musick should have reported for 1983 and 1984.<sup>240</sup>

By "paper loss," the court meant a false loss. Popkin's actions were designed to permit the client to pay less tax than he owed,<sup>241</sup> and Popkin knew his criminal tax conduct was willful in every sense of the word. *Popkin* does not stand for the broader proposition that, if Popkin did not

---

237. *Id.*

238. 752 F.2d 995 (5th Cir.), *cert. denied*, 474 U.S. 834 (1985).

239. *Popkin*, 943 F.2d at 1540.

240. *Id.*

241. *Id.* ("He wanted to avoid paying full income taxes on the \$220,000. As Musick said to the defendant, 'I wanna pay taxes a little bit, but, you know, I don't wanna get raped again, you know.' He also wanted to avoid acknowledging an interest bearing foreign account."). In *United States v. Mitchell*, 985 F.2d 1275, 1278 (4th Cir. 1993), the court interpreted *Popkin* as a case where an "attorney . . . created a corporation to enable his client to disguise the character of his income earned on drug deals, repatriate the tainted money, and avoid reporting income in the taxable year it was earned."

know – in the *Cheek* sense – that the client owed the tax and would not properly report and pay the tax, Popkin’s mere intent to create a structure more obtuse – i.e., lower audit profile – to the IRS would be criminalized under § 7212’s Omnibus Clause. In effect, on the facts presented and applying *Reeves*’ requirement of an unlawful benefit, the court imported a willfulness element into § 7212’s Omnibus Clause. Similarly, the Supreme Court effectively imported a willfulness, or at least deceit, element into the obstruction statute in *Andersen* and into the defraud conspiracy in *Hammerschmidt*.

The dissent in *Popkin* focused on the limited claim in the amended indictment:

After striking the accusations concerning filing false returns, the indictment alleges only that the defendant created a corporate entity for the purpose of disguising illegal income in violation of Title 26. The indictment does not allege and the Government even now does not satisfactorily explain how this without more violates the tax laws. Although the illegal nature of the funds would have been successfully concealed, Musick still could have paid any tax obligations owed on the money without violating the tax laws at all.

....

The court’s interpretation of this section of the tax law has the effect of virtually eliminating the word “corruptly” from the statute. The statute requires that the defendant must “corruptly” obstruct or endeavor to obstruct the execution of the tax laws. This should mean something more than just obstructing the execution of the laws as a matter of fact. There is nothing inherently “corrupt” about the formation of a corporation.

....

In this case, the single allegation of activity is that the defendant created a corporation, a lawful act under the laws of California. Without the allegation of false tax returns, the defendant is not charged with a corrupt act, but simply charged with forming a corporation for the purpose of laundering money [which was then not a crime].<sup>242</sup>

The dissent’s predicate is that the pertinent allegation of the indictment does not allege violation of the tax laws, but the dissent does not address the fact that, as noted above, the majority opinion specifically said that evasion was at the heart of the scheme. So, in terms of requiring evasion, it is not clear that there is a difference between the dissent and the

---

242. *Popkin*, 943 F.2d at 1541-42 (Roney, J., dissenting).

majority. Indeed, the difference between the majority and dissenting opinions may be over what is called a variance or constructive amendment of the indictment – whether the proof required for conviction went beyond the allegations in the indictment.<sup>243</sup> Perhaps more importantly, taking the dissent on its own terms,<sup>244</sup> the dissent’s analysis presages the Supreme Court’s holding in *Andersen*: destruction pursuant to document retention policies is not inherently evil, and even if the intent to make the documents unavailable for an expected SEC investigation is part of the motive, the action is not done corruptly.<sup>245</sup> In other words, the Supreme Court says that a legal act facially neutral as to corruptness cannot support a finding that the defendant acted corruptly. And the dissent’s analysis presages Judge Kozinski’s analysis in *Caldwell* that I discuss in more detail below,<sup>246</sup> but which is captured in his holding that merely making the government’s job more difficult is not a crime.

Applying this analysis (and adopting conspiracy language), there would have to be an unlawful object or an unlawful means. A legal means (e.g., the incorporation) to an unlawful object (tax evasion) certainly is what is criminalized. Popkin would not have been convicted if he had incorporated with (i) Popkin having no knowledge that the structure was designed to foster the underpayment of tax but (ii) with an intent only to lower the audit profile.

In *United States v. Kassouf*, the indictment alleged that Kassouf, *inter alia*, (i) used partnerships and controlled general partners to conduct transactions without keeping records necessary to determine the tax consequences of the transactions, (ii) transferred funds between bank accounts to make it more difficult for the IRS to discover and trace the funds, and (iii) affirmatively misled the IRS by filing tax returns failing to report the transactions.<sup>247</sup> The Sixth Circuit sustained dismissal based on importing the pending proceeding interpretive element from § 1503, citing, *inter alia*, *Aguilar*.<sup>248</sup> Echoing *Aguilar*’s lenity discussion, the court said that:

In construing § 7212(a) to require a pending IRS action under the code of which the defendant is aware, we are

---

243. Without saying so, the majority may have just not wanted to deal with what it thought was a trifle that the dissent felt more important because of the role of proper charging at the inception of the criminal case. For the effects of variance, *see, e.g.*, *United States v. Farr*, 536 F.3d 1174, 1181 (10th Cir. 2008).

244. Taking the dissent on its own terms and reading out the majority discussion of tax evasion noted above, *Popkin* is viewed by one author “as the broadest, and perhaps most erroneous, application of Section 7212(a).” Kathryn Keneally, *Hard Facts & Tax Protestors*, 21 CHAMPION 25, 28 (1997).

245. *Arthur Andersen L.L.P. v. United States*, 544 U.S. 696, 703-04, 125 S. Ct. 2129, 2134-35 (2005).

246. *See infra* notes 322-35 and accompanying text.

247. *United States v. Kassouf*, 144 F.3d 952, 953 (6th Cir. 1998).

248. *Id.* at 956-58.

also mindful that courts should interpret statutes that impose criminal liability narrowly to ensure proper notice to the accused. See *Aguilar*, 515 U.S. at 600, 115 S.Ct. 2357 [sic] (noting that courts traditionally exercise restraint in assessing the reach of a federal criminal statute “out of concern that ‘a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed.’”); *United States v. Salisbury*, 983 F.2d 1369, 1378 (6th Cir. 1993) (noting that statutes must be specific enough to give reasonable and fair notice to warn people to avoid conduct with criminal consequences). In this day, when Congress is attempting to curb the reach of the IRS into the homes of taxpayers, we cannot construe a penal law such as § 7212(a) to permit such an invasion into the activities of law-abiding citizens. As the district court noted, out of the hundreds of people who file taxes every day, there is no guarantee that a particular tax return will be audited. Therefore, it would be highly speculative to find conduct such as the destruction of records, which might or might not be needed, in an audit which might or might not ever occur, is sufficient to make out an omnibus clause violation. Were the court to find otherwise, we would be opening the statute to legitimate charges of overbreadth and vagueness, particularly where the statute may impose liability for otherwise lawful conduct. Kassouf may have had no idea that conduct such as the failing to maintain records (before his tax returns were ever filed) might obstruct IRS action because he had no specific knowledge that the IRS would ever investigate his activities. If upon hearing that the IRS was conducting an audit of his returns, however, Kassouf had begun destroying records and funneling money through various accounts to prevent detection of his illegal activities, § 7212(a) would clearly apply.<sup>249</sup>

In *Bowman v. United States*,<sup>250</sup> the defendant began a pattern of obstructive behavior by filing false 1099 and 1096 forms reporting alleged, but false, forgiveness of indebtedness income for financial institutions and related individuals with whom he was aggrieved because they had recovered judgment from him on legitimate debt.<sup>251</sup> For this behavior, he was

---

249. *Id.* at 958 (some internal citations omitted).

250. 173 F.3d 595 (6th Cir. 1999).

251. *Id.* at 596-97.

indicted under § 7212.<sup>252</sup> He urged that, under *Kassouf*, he could not be convicted because there was no pending proceeding.<sup>253</sup> The court framed the issue as follows:

[W]hether one who deliberately files false 1099 and 1096 forms with the IRS as a part of a malicious scheme to cause the IRS to investigate one's creditors must, at the time he files those false forms, be aware of "some pending IRS action," in order to be guilty of a violation of 26 U.S.C. § 7212 (a).<sup>254</sup>

The court affirmed the conviction, holding that:

*Kassouf* must be limited to its precise holding and facts, and that it cannot be read to encompass the kind of activity for which Bowman was indicted. All of the reasoning in *Kassouf* supports the conclusion that an individual's deliberate filing of false forms with the IRS specifically for the purpose of causing the IRS to initiate action against a taxpayer is encompassed within § 7212(a)'s proscribed conduct. The filing of false tax forms is not legal when undertaken; it is not speculative; it is specifically designed to cause a particular action on the part of the IRS. The action it is designed to cause is not routine; rather, the intended action is one that, but for the false filing, would not be undertaken at all relative to the victimized taxpayers. Finally, unless *Kassouf* is limited to its facts, its effect would be to prevent the prosecution of actions whose sole purpose is to obstruct or impede the IRS in the administration of its duties, as those acts of obstruction only trigger or attempt to trigger investigations by the IRS. Prosecution of such acts does not offend the goal of *Kassouf*: "In this day, when Congress is attempting to curb the reach of the IRS into the homes of taxpayers, we cannot construe a penal law such as § 7212(a) to permit such an invasion into the activities of law abiding citizens." *Kassouf*, 144 F.3d at 958. Indeed, to preclude the prosecution of such acts may tend to proliferate the very invasion *Kassouf* sought to prevent, but the law abiding citizens whose homes will be invaded would be those of the hapless victims of Bowman and his ilk.

---

252. *Id.* at 600.

253. *Id.* at 599.

254. *Id.* at 599-600. The court may be attributing this continuing holding to a government position.



Therefore, we conclude that Bowman's activities are proscribed by § 7212(a).<sup>255</sup>

However, *Bowman* did not undercut all the lessons from *Kassouf*. *Kassouf* still applies "to situations where the underlying conduct was lawful, involved no misrepresentation to the IRS, and its impact on the administration of the tax code was entirely speculative."<sup>256</sup> Note that the latter condition is not that the impact on administration was unintended – meaning that it could have been intended without being criminal – but that it's impact was speculative. Just taking the bare text of the decision, the court seems to have imposed a type of objective materiality requirement for the obstruction.<sup>257</sup>

In *United States v. Kelly*,<sup>258</sup> the Second Circuit held that, although § 7212 does not have as a stated willful conduct element, the corrupt action requirement applies when the defendant "act[s] with the intent to secure an unlawful advantage or benefit either for one's self or for another."<sup>259</sup>

Further, the Second Circuit approved a jury instruction for § 7212 that required conduct encompassing the concept of willfulness, and then held:

The district court's definition of the proof required for the section 7212(a) violation was as comprehensive and accurate as if the word "willfully" was incorporated in the statute . . . . [W]e are reluctant, therefore, to add the word "willfully" to section 7212(a), where Congress has seen fit to omit it.<sup>260</sup>

In *United States v. Josephberg*,<sup>261</sup> the district court seized on this language in *Kelly* to interpret "corruptly" as coextensive with "willfulness."<sup>262</sup> On this basis and using a double jeopardy analysis, the

255. *Id.* at 600.

256. *United States v. Kelly*, 564 F. Supp. 2d 843, 844 (N.D. Ill. 2008).

257. *See infra* text accompany notes 471-73 (discussing the need for materiality in applying these obstruction provisions).

258. 147 F.3d 172 (2d Cir. 1998).

259. *Id.* at 177.

260. *Id.*

261. *United States v. Josephberg*, 418 F. Supp. 2d 297, 304 (S.D.N.Y. 2005), *rev'd*, 459 F.3d 350 (2d Cir. 2006). *Josephberg* was re-tried and convicted after remand on seventeen counts (including one count of tax obstruction); on a subsequent appeal, the court did not address the tax obstruction separately and said nothing relevant to our current topic. *United States v. Josephberg*, 2009 U.S. App. LEXIS 7645 (2d Cir. 2009).

262. *But see* *United States v. Swanson*, No. 96-4213, 1997 U.S. App. LEXIS 9881, at \*8 (4th Cir. May 5, 1997), where, in footnote 2 of this unreported, non-precedential opinion, the court held: Swanson's claim that "willfully" and "corruptly" constitute the same element is meritless. "Willfulness" is a voluntary, intentional violation of a known legal duty. "Corruptly," by contrast, describes an act done with an intent to give some advantage inconsistent with the official duty and rights of others . . . . Misrepresentation and fraud . . . are paradigm examples of activities done with an intent to gain an improper benefit or advantage.

*Id.* (internal citations omitted).

district court dismissed the § 7212 Count as multiplicitous to other counts based on the facts alleged in the indictment.<sup>263</sup> On appeal, the Second Circuit reversed the dismissal as premature and hence did not reach the issue of whether Count 16 was multiplicitous. The key point, of course, is that, as interpreted, the “corruptly” requirement in § 7212 incorporates the same concept as the “willfulness” requirement in the other tax crimes. Other courts addressing § 7212’s Omnibus Clause have routinely included some variation of the requirement of an intent to secure an unlawful advantage, again as in *Kelly* connoting willfulness.<sup>264</sup> For example, in *United States v. Dean*, the court said:

Our Pattern Jury Instruction on this offense advises that a defendant acts “corruptly” if he acts “knowingly and dishonestly with the specific intent to secure an unlawful benefit either for himself or another.”<sup>265</sup>

The specific link between the intent and unlawfulness is clear. As with the defraud conspiracy in Judge Kozinski’s language in *Caldwell*, merely making or intending to make the government’s job harder will not alone suffice.

Similarly, in the interpretation of the “corruptly” requirement in the related obstruction statutes, courts equate the requirement with *Cheek*’s intentional violation of a known legal duty. For example, in *United States v. Kay*,<sup>266</sup> the court approved instructions defining “corruptly” as

---

263. *Josephberg*, 418 F. Supp. 2d, at 304.

264. *See, e.g., United States v. Massey*, 419 F.3d 1008, 1010 (9th Cir. 2005) (“With respect to § 7212(a), the district court correctly instructed the jury that ‘corruptly’ means ‘performed with the intent to secure an unlawful benefit for oneself or another . . . . It is sufficient that the defendant hoped ‘to benefit financially’ from threatening letters or other conduct.”); *see also United States v. Dykstra*, 991 F.2d 450, 453 (8th Cir. 1993) (defining corruptly as “an effort to secure an unlawful advantage or benefit, and, in particular, to secure a financial gain”); *United States v. Bowman*, 173 F.3d 595, 600 (6th Cir. 1999) (involving “an individual’s deliberate filing of false forms with the IRS specifically for the purpose of causing the IRS to initiate action against another taxpayer”).

On a related issue, the courts are not in agreement as to whether the end the defendant sought must be some financial gain as opposed to edification from simply disrupting the tax system. *See, e.g., United States v. Saldana*, 427 F.3d 298, 305-06 (5th Cir. 2005) (“We do not address whether a defendant must be seeking a financial advantage, as in *Yagow*, or whether § 7212 is aimed at any behavior that seeks to thwart government efforts to execute tax laws, as the Eleventh Circuit has held [in *Popkin*], because the defendants in this case sought to do both.”).

265. *United States v. Dean*, 487 F.3d 840, 853 (11th Cir. 2007). *See also, e.g., COMM. ON FED. CRIM. JURY INSTRUCTIONS FOR THE SEVENTH CIRCUIT, PATTERN FEDERAL CRIMINAL JURY INSTRUCTIONS FOR THE SEVENTH CIRCUIT* 362 (1998), <http://www.ca7.uscourts.gov/pjury.pdf> (defining the word “corruptly” in I.R.C. § 7212 as “mean[ing] that the act or acts were done with the purpose to secure an unlawful benefit for oneself or another by obstructing or impeding the administration of the internal revenue laws”). The Committee Comment indicates that the instruction is drawn from *Popkin* and *Reeves I. Id.* One commentator who surveyed the landscape of interpreting of this key term has described the Seventh Circuit’s pattern instruction as correct and, not only correct, a model. Tamashasky, *supra* note 157, at 147-48.

266. *United States v. Kay*, 513 F.3d 461 (5th Cir. 2008), *on reh’g from* 513 F.3d 432 (5th Cir. 2007).

“voluntarily and intentionally, and with a bad purpose or evil motive of accomplishing either an unlawful end or result, or a lawful end or result by some unlawful method or means.”<sup>267</sup> The *Kay* Court discussed *Cheek* and *Bryan* and explained that the instructions as a whole adequately conveyed a requirement that the government must prove that defendants knew that their conduct was not legal – “knowledge of unlawfulness.”<sup>268</sup> Note how that analysis echoes the analysis above quite nicely – the defendant must intend either an illegal means or an illegal object (or both); legal means with no dishonesty and legal object will not suffice. The key point for present purposes of course is the requirement that the defendant act unlawfully and know that he is doing so.<sup>269</sup>

#### b. DOJ Position

Besides its assertions in cases (discussed above), DOJ Tax states its claims for § 7212 in the CTM. Relying heavily on *Reeves I*, the government concedes that “corruptly” is not redundant to the word “endeavor,”<sup>270</sup> necessarily admitting that there can be endeavors to impede or impair tax administration which are not done corruptly. But, the government claims, the term corruptly is to be given a “broad reading.”<sup>271</sup> Even the government, however, does not ascribe infinite elasticity to that slogan. “The acts themselves need not be illegal, as long as the defendant commits them to secure an unlawful benefit for himself or others.”<sup>272</sup> Illegality and unlawfulness in some aspect is the hallmark of the criminal acts required for obstruction.

The CTM’s examples of corrupt endeavors within the meaning of § 7212(a) are:

- Filing a false complaint against an IRS Revenue Agent.

---

267. *Id.* at 463.

268. *Id.* at 463 n.1.

269. For an interesting digression on the relationship between the concept of “willfulness” and “corruptly,” see Judge Posner’s concurring opinion in *United States v. Gage*, 183 F.3d 711 (7th Cir. 1999). Judge Posner wrote not to disagree with the majority opinion but to open discussion on “a latent tension in the case law on obstruction of justice.” *Id.* at 717. Judge Posner noted that, for a sentencing enhancement for obstruction, the defendant must have acted “willfully” whereas for conviction of the crime of obstruction under 18 U.S.C. § 1503, the defendant must have acted “corruptly.” *Id.* at 718. Judge Posner was concerned that some courts’ formulation of “willfully” for sentencing enhancement required more than the word “corruptly” would require for conviction of the underlying crime:

[T]he paradox that it is easier to convict a person of obstruction of justice than to enhance his sentence because he obstructed justice in the investigation or prosecution that led up to his conviction. It leads to the further paradox that “willfully” is made to require more proof than “corruptly,” though the latter connotes the higher degree of culpability.

*Id.* at 719. Although the contexts are different, this Article does address the concern that somehow the word “corruptly” means less than willfulness. I gather from Judge Posner’s dissent that he does not buy into that notion in any context.

270. CTM, *supra* note 104, § 17.04.

271. *Id.*

272. *Id.*

- Making statements, whether threats or not, designed to persuade witnesses not to talk to IRS employees or cooperate with an IRS investigation.
- Attempting to interfere with an auction of property to pay a tax debt, by filing a *lis pendens* action and distributing copies of the notice to prospective buyers.
- Backdating documents and using nominees in order to conceal assets and disguise the nature of income.
- Filing fraudulent petition to place IRS revenue agent assigned to girlfriend's case into involuntary bankruptcy.
- Filing fraudulent Forms 1099 claiming that defendant paid compensation to IRS employees and others.<sup>273</sup>

In support of the claim that the improper benefit need not be financial, the government cites a case where a defendant filed false Forms 1099 intended to unleash IRS efforts to collect taxes from persons who had taken non-tax related legal action against him and his family.<sup>274</sup>

An endeavor may be corrupt even when it involves means that are not illegal in themselves. *Mitchell*, 985 F.2d at 1279 (and cases cited); *Popkin*, 943 F.2d at 1537 (attorney acted corruptly where he created a corporation “expressly for the purpose of enabling the defendant to disguise the character of illegally earned income and repatriate it from a foreign bank”).

The Second Circuit rejected a request by the defendant for a *Cheek* willfulness instruction since section 7212(a) does not include that term and the district court's instructions as to “corruptly” and “endeavors” were as comprehensive and accurate as if the word “willfully” were incorporated.<sup>275</sup>

Note carefully the claim as to the scope of the *Popkin* holding. It is more limited than a casual reading of the case might suggest in regard to its implications to the specific issue discussed here. Indeed, it substantially parallels the analysis above in that *Popkin* really does require a step in a plan otherwise legal (the incorporation) to achieve an illegal benefit for another (the nonpayment of tax by disguising the nature of the illegally earned income). In other words, *Popkin* knew the income was taxable and willfully set about disguising it to avoid paying the tax.<sup>276</sup> By contrast, the

---

273. CTM, *supra* note 104, § 17.04 (case citations omitted). Earlier versions of the CTM had a different, but similar listing.

274. *Id.* (discussing *United States v. Dykstra*, 991 F.2d 450 (8th Cir. 1993)).

275. *Id.* (citations omitted).

276. *See id.* (interpreting *Popkin*'s holding to support the claim that an attorney can be prosecuted under the omnibus clause when he attempts to hinder “the IRS on behalf of another”).

issue addressed in this Article is not an attempt to avoid a known tax but simply an attempt to lower the audit profile. *Popkin* does not proclaim, nor does the government in the CTM claim that broad a reading of the “corruptly” element.

## V. CONSPIRACY THEORIES

### A. *Introduction to Conspiracy Theories*

#### 1. Dangers that Lurk in Conspiracy Charges

Conspiracy charges are frequent “add-ons” in charging traditional tax crimes to permit the government to increase its chances of obtaining a conviction.<sup>277</sup> Even beyond the considerable elasticity of the conspiracy concept from a substantive perspective, the conspiracy charge offers the government great advantages.<sup>278</sup> The mere charge of “conspiracy” connotes something sinister,<sup>279</sup> and the law treats a conspiracy as a serious criminal act independent of any offense which might be the object of the conspiracy.<sup>280</sup> Moreover, herding a gaggle of defendants into a single case with an overarching conspiracy charge may make it difficult for the jury to assess independently the guilt or innocence of each defendant and invite a finding of guilt by association. Conspiracy cases tend to be more complex as the government mounts extensive evidence to connect the dots – real or imagined – among the alleged conspirators, particularly in allegedly large

---

277. In this section, I have learned from and relied on several seminal articles. The article I find best regarding the defraud *Klein* conspiracy is Abraham S. Goldstein, *Conspiracy to Defraud the United States*, 68 YALE L.J. 405 (1959). Goldstein, a professor at Yale Law School, was not just an academic; he also served as co-counsel to a defendant in *Klein*, the seminal tax defraud conspiracy case, and his article was inspired by that experience. I have also found particularly helpful two articles that deal generally with conspiracy (without special focus on the defraud conspiracy): Benjamin E. Rosenberg, *Several Problems in Criminal Conspiracy Laws and Some Proposals for Reform*, 43 No. 4 CRIM. L. BULL. 1, 427 (2007) and Neal Kumar Katyal, *Conspiracy Theory*, 112 YALE L. J. 1307 (2003) (arguing, in the federal conspiracy context, that there is societal justification founded in the dynamics of group behavior to separately criminalize and punish a group agreement, which is the underpinning of the conspiracy laws, but deferring on the propriety of the procedures that have been developed to apply the general justification). See also Philip E. Johnson, *The Unnecessary Crime of Conspiracy*, 61 CAL. L. REV. 1137, 1176 (1973).

278. See *Krulewitch v. United States*, 336 U.S. 440, 445-46, 69 S. Ct. 716, 719-720 (1949) (Jackson, J., concurring) (“[The crime of conspiracy is an] elastic, sprawling, and pervasive offense. . . . The modern crime of conspiracy is so vague that it almost defies definition.”); Goldstein, *supra* note 277, at 428 (calling the defraud conspiracy a crime “of many meanings and of seemingly infinite elasticity”).

279. *Krulewitch*, 336 U.S. at 448 (“The crime comes down to us wrapped in vague but unpleasant connotations. It sounds historical undertones of treachery, secret plotting and violence on a scale that menaces social stability and the security of the state itself.”).

280. See *United States v. Recio*, 537 U.S. 270, 274-75, 123 S. Ct. 819, 822 (2003) (“That agreement is ‘a distinct evil,’ which ‘may exist and be punished whether or not the substantive crime ensues.’”) (quoting *Salinas v. United States*, 522 U.S. 52, 65, 118 S. Ct. 469, 478 (1997)).

conspiracies such as involved in *Stein*.<sup>281</sup> Furthermore, the government gets vicarious *Pinkerton* liability for offenses committed by others in furtherance of the conspiracy, ability to admit statements that would otherwise be inadmissible hearsay, relaxed standard of proof and relevancy, tolling or refreshing of the statute of limitations by remote participants, and venue in remote judicial forums of the government's choosing.<sup>282</sup> With all of these benefits and more, Judge Learned Hand long ago noted, correctly, that conspiracy is the "darling of the modern prosecutor's nursery."<sup>283</sup>

Not surprisingly, therefore, the government trots out the conspiracy charge whenever it can imagine more than one bad guy behind the tree – it

281. In *Stein*, the government listed nearly seventy witnesses and two-thousand exhibits totaling more than 150,000 pages and estimated that the case in chief would take four months, from which the trial judge extrapolated that the trial would be six to eight months. See *United States v. Stein*, 495 F. Supp. 2d 390, 418 (S.D.N.Y. 2007). For the dangers inherent in such a lengthy and sprawling criminal trial to a jury, see the dissenting opinion to the order denying petition for rehearing en banc in *United States v. Warner*, 506 F.3d 517, 522 (7th Cir. 2007), *cert. denied*, 128 S. Ct. 2500 (2008).

282. See Goldstein, *supra* note 277, at 407 (standards disappear), 409 (vicarious liability, hearsay, statute of limitations, and venue), 411-12 (relaxed standard of proof and relevancy); see also *Pinkerton*, 328 U.S. at 650; *Nye & Nissen v. United States*, 336 U.S. 613, 626, 69 S. Ct. 766 (1949) (Frankfurter, J., dissenting) ("Prosecutors seem to think that by this practice all statutes of limitations and many of the rules of evidence established for the protection of persons charged with crime can be disregarded.").

283. *Harrison v. United States*, 7 F.2d 259, 263 (2d Cir. 1925); see also Goldstein, *supra* note 277, at 409 (noting that conspiracy has been a prosecutor favorite for centuries). One author has noted that conspiracy charges are included in "more than one-quarter of all federal criminal prosecutions . . ." Katyal, *supra* note 277, at 1310. In *United States v. Reynolds*, Judge Easterbrook lamented that the conspiracy add-ons are "inevitable because prosecutors seem to have conspiracy on their word processors as Count I; rare is the case omitting such a charge." *United States v. Reynolds*, 919 F.2d 435, 439 (7th Cir. 1990); see also Kathleen F. Brickey, *In Enron's Wake: Corporate Executives on Trial*, 96 J. CRIM. L. & CRIMINOLOGY 397, 401, 420-23 (2006) (noting empirical research that shows, in federal corporate crime cases during the period 2002 through 2006, over two-thirds had multiple defendants. Moreover, all of the cases featuring multiple defendants contained at least one conspiracy count). Judge Easterbrook proceeds to discount the value of piling on this charge, calling it "pointless" because of the way the Sentencing Guidelines work; although, "once a formidable weapon in the prosecutor's arsenal, has become a distraction, useful only to obtain an extra \$50 special assessment and to generate complex issues for appeal." *Reynolds*, 919 F.2d at 439. Over my many years of practice, I find that disagreeing with Judge Easterbrook carries considerable risk of error, but in this case I do disagree for the reasons noted in the text. Prosecutors perceive the conspiracy charge as a conviction enhancer, even if not a sentencing enhancer; otherwise, if it were only a mere distraction, prosecutors would not encourage – perhaps a euphemism for direct – grand juries to add the charge to the indictment. Moreover, I have observed that in complex, multi-defendant white collar (including tax) crime cases, the government is not indifferent as to which counts a pleading defendant admits guilt; rather, the government wants the conspiracy plea for the benefits it will bring – psychological, publicity wise, and trial wise – in the trial of the remaining defendants. That pleading defendant will mount the stand and admit that he is guilty of the loosey-goosey conspiracy charge the government is attempting to prove beyond a reasonable doubt, thus giving that government's claim a credibility that it might not otherwise have. With regard to defendants pleading to achieve a deal – a common phenomenon of our system so heavily dependent upon pleas, this ability to offer a deal to a co-conspirator is itself a powerful tool to incentivize access to information to ferret out and punish the bad guys. See Katyal, *supra* note 277, at 1328-33. Finally, by piling on this or some other obstruction count along with substantive counts, the prosecutor further increases the pressure for a plea for the risk averse facing a potential long sentence. O'Sullivan, *supra* note 105, at 673.

is so easy to do.<sup>284</sup> The conspiracy count allegations are framed as a cascade of allegations telling a damning story (if true and, although literally true, not misleading),<sup>285</sup> but often producing more heat than light.

This contrasts with counts for the tax offenses which are dry, sparse, boring, and usually not even flowered up for dramatic effect.<sup>286</sup> The benefits for the government are great, and the downsides are few; after all, the prosecutors' life and liberty are not at stake. This means, of course, that the government's power to tack on conspiracy charges can be abused, particularly with a weapon as potent and elastic as conspiracy. The Supreme Court has cautioned that:

We agree that indictments under the broad language of the general conspiracy statute must be scrutinized carefully as to each of the charged defendants because of the possibility, inherent in a criminal conspiracy charge, that its wide net may ensnare the innocent as well as the culpable.<sup>287</sup>

---

284. Much as Joe McCarthy imagined a communist behind every tree. Even if this statement is hyperbole, I think it is moderate hyperbole. See The Left Coaster, <http://www.theleftcoaster.com/archives/002233.php> (last visited February 10, 2009).

285. There is a critical difference between truth that is fair and truth that is misleading. In *Bronston v. United States*, the defendant charged with perjury answered the questions with the literal truth, but in context clearly intended to mislead. 409 U.S. 352, 360, 93 S. Ct. 595, 601 (1973). My suggestion in the text is that the same phenomenon of truthful but contextually misleading statements can be made in an indictment by cherry-picking some snippets of literal truth that, in context, are not representative and are therefore misleading. When citizens (as opposed to prosecutors) do that, however, the prosecutors claim foul and consider some obstruction crime. Why is it not some form of obstruction when the government does it?

286. See, e.g., the prototypical pattern § 7201 instruction in the CTM, *supra* note 104, that is so dry, spare, and to the point, that I will not disserve the reader by quoting it here. The tax counts in *Stein* are cut from the same cloth – forty-three counts covering only four paragraphs (presenting multiple counts in tabular format) and seven pages (although these counts perfunctorily incorporate by reference the conspiracy count paragraphs). By contrast, *Stein* illustrates the embellishments encountered with conspiracy claims. The *Stein* conspiracy count, Count One, takes the government sixty-two pages and one-hundred and fifty-four paragraphs (numbered paragraphs and subparagraphs) to charge. Suffice it to say, the government resists any temptation to state just the facts in an objective way as it spins its tale of alleged evil doing. Of course, one advantage of sparse criminal counts for substantive tax crimes is that, the more that is said, the more possibility of a fatal variance. See, e.g., *United States v. Farr*, 536 F.3d 1174, 1181 (10th Cir. 2008) (the government added detail to the count for tax evasion from which it varied, resulting in reversal of the conviction; “[h]ad the government simply charged Ms. Farr generically under Section 7201 with the willful evasion of a tax, we might have a different situation”).

287. *Dennis v. United States*, 384 U.S. 855, 860, 86 S. Ct. 1840, 1843 (1966).

## B. *The Agreement, Scope and Pinkerton Liability*

### 1. The Agreement

The essence of conspiracy is the agreement to undertake a prohibited object<sup>288</sup> and some reasonably foreseeable overt act in furtherance of the agreement.<sup>289</sup> The object must be the commission of a specific offense (an offense conspiracy) or defrauding the government (a defraud conspiracy).<sup>290</sup> A good summary of the object element of the crime is:

The law of conspiracy requires agreement as to the “object” of the conspiracy. This does not mean that the conspirators must be shown to have agreed on the details of their criminal enterprise, but it does mean that the “essential nature of the plan” must be shown.

. . . .

Proof of the essential nature of the plan is required because “the gist of the offense remains the agreement, and it is therefore essential to determine what kind of agreement or understanding existed as to each defendant.” The importance of making this determination cannot be overstated. “Agreement is the essential evil at which the crime of conspiracy is directed” and it “remains the essential element of the crime.” “Nobody is liable in conspiracy except for the fair import of the concerted purpose or agreement as he understands it.”<sup>291</sup>

#### a. Object Jargon - Semantical Games

As traditionally defined (see above), the object of the conspiracy must be illegal, and this definition fits the offense of conspiracy itself quite nicely. The definition, however, might not fit as nicely with the defraud conspiracy as interpreted. The problem should be apparent in the formulation of the defraud conspiracy in a tax setting (*Klein*): the object is the intent to impair, impede or influence tax administration. Thus, is the bare intent to impair, impede or influence tax administration an illegal object? For reasons previously discussed, it is not in the tax obstruction context under § 7212; the mere intent to impede, impair or influence the

---

288. See *United States v. Rosenblatt*, 554 F.2d 36, 38 (2d Cir. 1977).

289. See *United States v. Recio*, 537 U.S. 270, 274, 123 S. Ct. 819, 822 (citing, *inter alia*, *Iannelli v. United States*, 420 U.S. 770, 777, 95 S. Ct. 1284, 1289-90 (1975)); see generally *Pinkerton v. United States*, 328 U.S. 640, 66 S. Ct. 1180 (1946).

290. See CTM, *supra* note 104, § 23.07[1][a].

291. *Rosenblatt*, 554 F.2d at 38-39, (quoting *United States v. Borelli*, 336 F.2d 376, 384 (2d Cir. 1964)) (citations omitted); *United States v. Peoni*, 100 F.2d 401, 403 (2d Cir. 1938); *Pinkerton v. United States*, 328 U.S. 640, 645, 66 S. Ct. 1180, 1183 (1946)).



outcome of a judicial, administrative or legislative proceeding is not an obstruction unless it is done corruptly, and the courts have required additional evil than mere intent to impair, impede or influence.<sup>292</sup> Similar to the “corruptly” element of obstruction crimes, the congressional use of the word “defraud” to define the defraud conspiracy limits the defraud conspiracy to only certain types of recognizably bad and wrongful attempts to impair, impede or influence tax administration. These concepts shall be addressed below.

b. Scope of the Agreement; Pinkerton Liability.

The prohibited conspiratorial agreement is an agreement. An agreement requires essential terms and definiteness to be an agreement; otherwise, in contract jargon, it is an illusory agreement.<sup>293</sup> The terms of the agreement commonly focused on are the object and the agreed upon means to achieve the object. These are often conflated in the concept of the “scope” of the agreement. The scope determines whether the defendant has joined a conspiracy in the first place and, if so, which conspiracy and then whether actions of others may give rise to vicarious *Pinkerton* liability.

In *United States v. Pinkerton*,<sup>294</sup> the Court held that a conspirator can be guilty of both the conspiracy (a separate crime as noted above) as well as any separate substantive offense committed within the scope of the conspiracy even if that conspirator did not commit the substantive offense and did nothing other than join the conspiracy.<sup>295</sup> *Pinkerton* liability may be divided into three categories for analysis: (1) where the substantive offense is the object of the conspiracy, (2) where the substantive offense facilitates the object of the conspiracy, and (3) where the substantive offense is not itself an object or facilitator of the conspiracy, its commission was reasonably foreseeable.<sup>296</sup> In terms of foreseeability and the purposes of imposing substantive liability, the first and second

---

292. See *United States v. Marek*, 548 F.3d 147, 149 (1st Cir. 2008).

293. One notable example of an illusory agreement is from the great Hardy Dillard, former contracts professor and dean of my law school, the University of Virginia School of Law: A young beau promises a young lass upon whom he is lavishing attention for obvious reasons, “I’ll marry you if I choose to.” There is no contract, no agreement to marry, and any consideration the lass tenders for that noncommitment is irrelevant.

294. 328 U.S. 640, 66 S. Ct. 1180 (1946).

295. *Ianelli v. United States*, 420 U.S. 770, 777-78, 95 S. Ct. 1284, 1289-90 (1974), (citing *Pinkerton*, 328 U.S. at 644). For a very good recent discussion of *Pinkerton* liability, see Mark Noferi, *Towards Attenuation: A “New” Due Process Limit on Pinkerton Conspiracy Liability*, 33 AM. J. CRIM. L. 91 (2006); see also Rosenberg, *supra* note 277. For a justification of *Pinkerton* based on its ability to incentivize a co-conspirator to cooperate and help convict the others by making a deal with the prosecution, see Katyal, *supra* note 277, at 1372-75.

296. *United States v. Alvarez*, 755 F.2d 830, 850 (11th Cir. 1985), *cert. denied*, 474 U.S. 905 (1985); *State v. Kerr*, 945 A.2d 1004 (Conn. App. Ct. 2008).

categories are obvious. The third category, by contrast, turns upon a concept that may or may not be so obvious.<sup>297</sup>

Let us take examples on the extremes to illustrate. A and B enter a conspiracy to commit armed robbery. A and B expressly agree that they will not fire their weapons unless someone else shoots first. During the robbery, despite the express scope of the agreement, A shoots the victim who dies as a result. Is B liable for the murder A committed? I think most of us would see the nexus and answer the question yes. What if, however, B's only involvement was to drive A to a house so that A could break in and commit a burglary while B waited outside, without B even knowing that A had a gun? Was the murder reasonably foreseeable for purposes of tagging B with criminal liability for the murder? Is reasonable foreseeability the only consideration? Or are there notions of proportionality and due process that should apply to the conduct – the conduct of B in this example – to prevent the unmitigated extension of *Pinkerton* liability?<sup>298</sup> Is the notion of reasonable foreseeability sufficiently flexible to offer the courts wiggle room to avoid the worst instances of the *Pinkerton* concept? Do the constitutional requirements of due process require some nexus between the crime and the individual's unique culpability under the specific facts? These are significant issues that have troubled courts as prosecutors have attempted to press the conspiracy advantage to its maximum; some courts and commentators now recognize that the government can press the concept too far. This is too large a subject to address in more detail here, so I cite further reading in the footnotes.<sup>299</sup> One short example, however, illustrates how one court dealt with this issue in a *Klein* context.

The Eleventh Circuit stated that “[the] tax purpose must be the object of a *Klein* conspiracy, and not merely a foreseeable consequence of some other conspiratorial scheme” and noted that “[w]ere it otherwise, the robbery of a bank by two or more persons who subsequently fail to report this income on their tax returns would be a tax conspiracy.”<sup>300</sup>

These scope issues may be illustrated quite nicely in the context of audit avoidance conspiracy theories.<sup>301</sup> Assume that ten persons agree to

---

297. See Noferi, *supra* note 295, arguing that there is a Due Process limitation on imposition of the third category of *Pinkerton* liability.

298. Cf. *Kennedy v. Louisiana*, 128 S. Ct. 2641, 2677 (2008) (holding the death sentence was disproportionate and hence unconstitutional under the Cruel and Unusual Punishment Clause of the Eight Amendment as punishment for rape, but not murder, of a child).

299. See generally Noferi, *supra* note 295. It is interesting to note that, in formulating the sentencing guidelines which have different policies than substantive liability, the drafters recognized some of the complaints about full bore *Pinkerton* liability and the problem of unique culpability in sentencing. *Id.* at 113-16.

300. *United States v. Adkinson*, 158 F.3d 1147, 1155 (11th Cir. 1998) (citing *Dennis v. United States*, 384 U.S. 855, 86 S. Ct. 1840 (1966)).

301. This example is inspired by a common phenomenon where an automobile has a design defect known to the design team but unknown to the sales people on the dealership floor. In this spare

market a tax shelter. Five of the ten are the design team, principally lawyers, who package the best possible position into a more-likely-than-not tax opinion. The other five are the sales team, responsible for locating potential investors, selling the product with the tax opinion, assisting the investors in implementation, and reporting the tax results on the return. The design team creates a complex shelter, with a supporting tax opinion of more than one hundred pages that concludes that the claimed tax result will more-likely-than-not prevail. The design team believes, however, that the more-likely-than-not assessment is not true and that, in truth, the tax results would not prevail if audited.<sup>302</sup> The tax opinion is therefore false as to the nature of their opinion, and the design team's participation is willful as to the tax result touted. The government therefore can convict the design team for both the substantive offense and the offense conspiracy. The sales team, however, is not aware that the opinion is not truthful. Taking the opinion at face, the sales team is only aware that the opinion is just barely more-likely-than not – say just 50.1% (so, let us call it an aggressive more-likely-than not opinion, with aggression determined by proximity to 50%, but anything in excess of 50% works, even though it is difficult to discern a difference between 49.9% and 50.1%).<sup>303</sup> Since the sales team thinks the tax shelter works and has no intention to peddle phony tax shelters to their clients, the sales team members agree among themselves to offer audit avoidance techniques involving no dishonesty.<sup>304</sup> The techniques seek simply to arbitrage perceived IRS audit deficiencies. For example, the sales team recommends that the investors consider using the perfectly legal grantor trust to implement the shelter on the notion that the IRS audits fewer grantor trust returns than individual returns and are less likely, on

---

situation, the sales people on the floor are not criminally or civilly liable for the design defect although, in a broad sense, the sales people are critical to putting a defective product into a position to bring great harm. The example in the text presents one possible way of looking at the facts alleged in *Stein*.

302. I assume for purposes of this example that the objective element required by *James* and its progeny is present – i.e., the law is sufficiently certain at the time that a hypothetical reasonable defendant could know that the tax results would not prevail. I posit in the text that they believed that, but as I discussed earlier, the teaching of *James* is that believing one is committing a tax crime is not criminal if the conduct is not objectively sufficiently certain to establish criminality. See *supra* notes 47-50 and accompanying text (discussing this concept).

303. I realize that, in the real world, slicing and dicing the predictions of outcomes this thin is unrealistic, but it is helpful for analysis if the example can work with broader divergences (e.g. 60% / 40%).

304. This is a critical assumption of a fact that, I think, exists in *Stein*. Professor Buell explains the *Stein* superseding indictment as based upon the government's assertion that the defendant has a consciousness of wrongdoing; this seems to be a core requirement of criminal law. Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971, 2003 (2006). In support of that claim, Professor Buell cites an exchange in which the KPMG sales team was cautioned not to leave copies of the presentation documents with the prospective clients because those documents would reveal the true purpose of the transaction and thus invalidate the shelter. Whether or not that characterization of the particular document in question is accurate on its face or in context, as characterized by Buell, the document evidences the writer's belief and perhaps, by inference, the recipients' belief that the shelter would not work. That is not the assumption I make in the example above.

audit of individual returns, to audit the flow-through from grantor trusts. Since the sales team has no intention to participate in promoting shelters that do not work, the sales team should not be at risk of being convicted of the underlying offense of tax evasion or the offense conspiracy to commit tax evasion.<sup>305</sup> Conceptually, there are two separate agreements in conspiracy theory in this example – (1) the design team agreement that includes participation willfully in the violation of the tax law and (2) the sales team agreement that does not include participation willfully in the violation of the tax law. At least in crisp conspiracy theory, the sales team would not be guilty of the substantive offense or the offense conspiracy under *Pinkerton*.<sup>306</sup> The question presented in this Article is whether the sales team would be guilty of the defraud conspiracy because the sales team members did agree among themselves to take audit avoidance action.<sup>307</sup>

---

305. I assume that the risk that the “conspiracy” the sales team entered did not include a reasonable risk that the design team would falsely represent to the sales team the quality of the opinion that they asked the sales team to market. Of course, under the facts posited in the text, that is what happened, but the facts do not posit that the sales team could have reasonably foreseen that the design team would lie about the quality of the opinion.

306. This scenario involving two separate conspiracies might well have common players (in the example, persons on either team who intended to join both conspiracies). If they did not, this would be a so-called “hub and spoke” conspiracy where, in the language of the Supreme Court in the seminal decision of *Kotteakos v. United States*, the proof showed “separate spokes meeting in a common center, though, we may add, without the rim of the wheel to enclose the spokes.” 328 U.S. 750, 755 (1946). The spokes are the separate agreements or conspiracies without sufficiently commonality other than the hub to join them together in a single overarching conspiracy. *United States v. Chandler*, 388 F.3d 796, 808 (11th Cir. 2004).

307. There are variations of this example that would highlight some key conspiracy concepts related to the issues presented in this article and in *Stein*. For example, what if the key to the shelter was the investor’s affirmative factual representation that he or she has a profit motive for entering the transaction? In truth, that representation is not crisply a pure factual representation, but contains an inherent legal ambiguity as to what precisely is meant by profit, an ambiguity that is exploited by many shelters that have some component of investment, risk and potential profit that have varying degrees of tangentiality to the underlying transactions generating the tax shelter. For one illustration of the ambiguity, see *Compaq Computer Corp. v. Commissioner*, 277 F.3d 778 (5th Cir. 2001) (where the parties and the lower and appellate courts disagreed as to whether the allegedly abusive tax credits could be included in the calculation of profit). Indeed, to the extent that profit motive is ambiguous, the requirement of its presence may create a knowability issue and thus may not be a basis for prosecution under *James* and its progeny. But assume here that the presence of profit motive is a knowable standard, and that the sales team received the representation from the investors knowing that it was false in at least some of the cases (e.g., the investors winked, smirked and crossed their fingers when they made the representation). Then, of course, the sales team’s agreement would include a goal to commit a specific offense (tax evasion); the agreement, properly characterized, would be an offense conspiracy. The acts to decrease audit visibility rather than being the object of a potential defraud conspiracy would be a means or step in an offense conspiracy. The government unquestionably must prove willfulness for the properly pled offense conspiracy. This blending of the characteristics of the offense and defraud conspiracies will be discussed later, but I am sure you can see that if the defraud conspiracy is easier to prove than the offense conspiracy (as imagined by the government), it will charge the defraud or both defraud and offense, as it did in *Stein*, with defraud as the fall back if it can’t prove the offense conspiracy. I should also note a nuance that a single count improperly alleging two separate conspiracies may be defective because of the possibility of a non-unanimous verdict (some jurors finding one conspiracy and not the other). See *United States v. Gordon*, 844 F.2d 1397, 1401-02 (9th

### C. *The Defraud / Klein Conspiracy*

#### 1. It Depends on What the Meaning of Defraud Is<sup>308</sup>

The statute requires a conspiracy to “defraud” the United States or an agency. In ordinary usage, defraud means a taking of something of value through fraud,<sup>309</sup> and generally the federal criminal statutes adopt that definition when using the word defraud.<sup>310</sup>

There is nothing in the text or the legislative history<sup>311</sup> of the conspiracy statute that suggests that Congress meant anything other than this ordinary usage of the term. In a tax setting, this ordinary usage would suggest that the taking of taxes otherwise due and owing must be the object of the defraud conspiracy. If this traditional interpretation of the word defraud controlled, the defraud conspiracy would effectively import the willfulness element because the defendants must have intended to evade the payment of tax otherwise due. Despite its common meaning, defraud in the defraud conspiracy statute is interpreted more broadly.<sup>312</sup>

Cir. 1988); see also Rosenberg, *supra* note 277 (for more on the dangers of not properly differentiating between single and multiple conspiracies); see also *United States v. Rigas*, 565 F. Supp. 2d 620 (M.D. Pa. 2008) (for an excellent discussion of this genre of problem in a double jeopardy context).

308. I do not necessarily intend to allude to the classic Clinton quote: “[i]t depends on what the meaning of the word ‘is’ is.” It seems to me that the same genre of word game goes on in parting from the common meaning of the word “defraud” in the conspiracy statute as Clinton unpersuasively attempted for the word “is” in the context of sex.

309. “Defraud” is defined as “[t]o take something from [someone] by fraud; swindle.” THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 490 (4th ed. 2000). Fraud is defined as “1. A deception deliberately practiced in order to secure unfair or unlawful gain. 2. A piece of trickery; a trick. 3a. One that defrauds; a cheat. b. One who assumes a false pose; an impostor.” *Id.* at 722.

310. *McNally v. United States*, 483 U.S. 350, 107 S. Ct. 2875, 2881 (1987). See also *United States v. Pierce*, 224 F.3d 158, 165 (2d Cir. 2000) (“In the context of mail fraud and wire fraud, the words ‘to defraud’ commonly refer ‘to wronging one in his property rights by dishonest methods or schemes,’ and ‘usually signify the deprivation of something of value by trick, deceit, chicane or overreaching.’” (citations omitted); see also *United States v. Ballistrea*, 101 F.3d 827, 831 (2d Cir. 1996), *cert. denied*, 520 U.S. 1150 (1997). In other words, it is the taking of money or something of value.

311. Professor Goldstein notes that the original statute containing the key language that morphed into the current defraud conspiracy statute criminalized conspiracies “to defraud the United States” of revenue. Goldstein, *supra* note 277, at 417-18. Over time, the tax specific statute was ported to the general criminal laws as the defraud conspiracy. In the process of original enactment through the change into a general criminal law, there is no pertinent legislative history. *Id.* at 418. The Supreme Court in *Tanner v. United States* described the legislative history as “stingy.” 483 U.S. 107, 131, 107 S. Ct. 2739, 2753 (1987).

312. In *McNally v. United States*, the Court noted in dictum that the term defraud as used in the wire fraud statute was interpreted more narrowly than the term in the defraud conspiracy statute. 483 U.S. 350, 358 n.8, 107 S. Ct. 2875, 2881 n.8 (1987). Just two days before *McNally*, the Court in *Tanner* declined to reconsider the broader scope of § 371. *Tanner v. United States*, 483 U.S. 107, 128, 107 S. Ct. 2739, 2752 (1987); see also *United States v. Tuohey*, 867 F.2d 534, 536-37 (9th Cir. 1989) (noting similar provenance of wire fraud and conspiracy, but noting that although wire fraud requires fraudulent economic advantage, “the key word ‘defraud’ now has a fundamentally different meaning in a conspiracy case than it does in a mail fraud prosecution” and “[t]hus, the ‘defraud’ part of section 371

The relevant history of the interpretation of the defraud conspiracy has been recounted elsewhere.<sup>313</sup> Suffice it to say that, over time, the lower courts interpreted the defraud conspiracy to include “wilful [sic] or corrupt misconduct” that impairs the administration of a government agency.<sup>314</sup> This sets the stage for the two seminal Supreme Court cases.

In *Haas v. Henkel*, a person named Holmes was an employee of the Bureau of Statistics within the Department of Agriculture.<sup>315</sup> In that capacity he obtained information in advance of publication.<sup>316</sup> Two others, including Haas, obtained that information from Holmes in advance of its publication.<sup>317</sup> The indictment alleged that the defendants thereby “defraud[ed] the United States by defeating, obstructing and impairing it in the exercise of its governmental function in the regular and official duty of publicly promulgating fair, impartial and accurate reports concerning the cotton crop.”<sup>318</sup> The Supreme Court held:

But it is not essential that such a conspiracy shall contemplate a financial loss or that one shall result. The statute is broad enough in its terms to include any conspiracy for the purpose of impairing, obstructing or defeating the lawful function of any department of Government. Assuming, as we have, for it has not been challenged, that this statistical side of the Department of Agriculture is the exercise of a function within the purview of the Constitution, it must follow that any conspiracy which is calculated to obstruct or impair its efficiency and destroy the value of its operations and reports as fair, impartial and reasonably accurate, would be to defraud the United States by depriving it of its lawful right and duty of promulgating or diffusing the information so officially acquired in the way and at the time required by law or departmental regulation. That it is not essential to charge or prove an actual financial or property loss to make a case under the statute has been more than once ruled.<sup>319</sup>

Although the context of *Haas* was obtaining information by bribe which was clearly fraudulent under the traditional meaning of the word, the

---

criminalizes any willful impairment of a legitimate function of government, whether or not the improper acts or objective are criminal under another statute”); *see generally* Goldstein, *supra* note 277; *see also* CTM, *supra* note 104, § 23.07[1][b].

313. The seminal work is Goldstein, *supra* note 277.

314. *See, e.g.*, *Tyner v. United States*, 23 App. D.C. 324, 324 (D.C. Cir. 1904); *accord* *Curley v. United States*, 130 F. 1, 10 (1st Cir. 1904).

315. *Haas v. Henkel*, 216 U.S. 462, 476-80, 30 S. Ct. 249, 252-54 (1910).

316. *Id.* at 478.

317. *See id.* at 476-77.

318. *Id.* at 478.

319. *Id.* at 479-80.

sweeping language was that the defraud conspiracy includes any action the object of which was to impair or impede the actions of a government agency.<sup>320</sup> This language addressing a situation beyond the facts presented suggested that the object to gain property by fraud – normally connoted by the statutory word defraud – or even any skullduggery beyond an attempt to impede is not required.<sup>321</sup>

In *Hammerschmidt v. United States*, the Court retreated from *Haas*'s quoted expansive dictum on scope of the defraud conspiracy.<sup>322</sup> Thirteen persons had been convicted of conspiring "to defraud the United States by impairing, obstructing and defeating a lawful function of its government" by opposing the draft "through the printing, publishing and circulating of handbills, dodgers and other matter intended and designed to counsel, advise and procure persons subject to the Selective Act to refuse to obey it."<sup>323</sup> The government justified the defraud conspiracy indictment and conviction on *Haas*'s sweeping statement that the mere object to impair or defeat the action of a government agency sufficed.<sup>324</sup> After recounting the facts and holding of *Haas* (including the sweeping language), the Court said:

It is obvious that the writer of the [*Haas*] opinion and the Court were not considering whether deceit or trickery was essential to satisfy the defrauding required under the statute. The facts in the case were such that that question was not presented. The deceit of the public, the trickery in the advance publication secured by bribery of an official, and the falsification of the reports, made the fraud and deceit so clear as the gist of the offenses actually charged that their presence was not in dispute. The sole question was whether the fraud there practiced must have inflicted upon the Government pecuniary loss, or whether its purpose and effect to defeat a lawful function of the Government and injure others thereby was enough. That was all that Mr. Justice Lurton's words can be construed to mean. The cases in which this case has been referred to involved *unquestioned deceit or false pretense*, and it was only cited in them to the point that financial loss of the Government is not necessary to violate the section.

---

320. See *id.* at 478-79.

321. Thus, one author notes "[a]fter *Haas*, the only limits on the application of the conspiracy statute were federal court interpretations of what constituted interference with lawful government functions." Lance Cole & Ross Nabatoff, *Prosecutorial Misuse of the Federal Conspiracy Statute in Election Law Cases*, 18 YALE L. & POL'Y REV. 225, 230-31 (2000).

322. *Hammerschmidt v. United States*, 265 U.S. 182, 44 S. Ct. 511 (1924).

323. *Id.* at 185.

324. See *id.* at 185-86.

To conspire to defraud the United States means primarily to cheat the Government out of property or money, but it also means to interfere with or obstruct one of its lawful governmental functions *by deceit, craft or trickery, or at least by means that are dishonest*. It is not necessary that the Government shall be subjected to property or pecuniary loss by the fraud, but only that its legitimate official action and purpose shall be defeated by misrepresentation, chicane or the overreaching of those charged with carrying out the governmental intention.<sup>325</sup>

*Hammerschmidt* establishes that the defraud conspiracy has a more limited application than the language of *Haas* suggested when read out of its context.<sup>326</sup> The object of the defraud conspiracy must be to (1) interfere with or obstruct a government function, in this case the IRS function (2) by means of deceit, craft, trickery or dishonesty.<sup>327</sup> For convenience I will refer to this latter element as the deceit element of the defraud conspiracy. An intent to defeat or impair a government function without deceit will not suffice. Requiring the government to square the corner on this deceit element is critical to keeping the defraud conspiracy within reasonable boundaries.<sup>328</sup> Indeed, the deceit element proclaimed in *Hammerschmidt* is the key to anchoring the defraud conspiracy in the statutory text “defraud” which should require at a core level some form of dishonesty or deceit.<sup>329</sup>

---

325. *Id.* at 187-88 (emphasis added and citations omitted).

326. *United States v. Peltz*, 433 F.2d 48, 51 (2d Cir. 1970) (noting in *Hammerschmidt*, the Court “narrowed” *Haas*).

327. *See Hammerschmidt*, 265 U.S. at 188. It is interesting to note that this *Hammerschmidt* formulation echoes the formulation in § 1001, commonly called the False Statements crime. *See* 18 U.S.C. § 1001 (2006). Section 1001(a)(2) and (3) criminalizes false statements and false documents provided to executive, judicial or legislative branches. *See id.* § 1001(a)(2)-(3). Subsection (a)(1) more generally criminalizes conduct that “falsifies, conceals, or covers up by any trick, scheme, or device a material fact.” *Id.* § 1001(a)(1). It is perhaps not surprising that this echo is present because the defraud conspiracy and § 1001 are just iterations of the panoply of obstruction statutes, all of which deal with some facet of obstruction. For the more generally applied obstruction statutes (*Id.* §§ 1503, 1505 and 1512(b), discussed later in the text), the echo is present in there requirement that the defendant act “corruptly” before there can be an obstruction. *See infra* Part VII.

328. Professor Goldstein says that the statutory terminology “defraud the United States,” “as interpreted by the Supreme Court, is too vague to be understood by the man of ‘common intelligence’” and should be held unconstitutional. Goldstein, *supra* note 277, at 442. Professor Goldstein says that it is unlikely that it will be held unconstitutional and that, instead, the courts are likely to limit its scope to take out its more abusive potential. *See id.* at 442-43. Of course, given its scope as interpreted, it is likely that the government has exercised some discretion to avoid extending the concept to the ultimate limit because the jails would fill with involuntary guests and the courts would almost certainly push back with limitations the government may not want.

329. *See generally* GREEN, *supra* note 5, at 148-50 (although, after developing the concepts, Professor Green cites *Hammerschmidt* as holding, as did *Haas*, that a conspiracy to defraud includes interfering or obstructing a lawful governmental function, without also citing the key defraud element that the *Hammerschmidt* court took great pains to insist upon).



Take an extreme example to illustrate the issue: assume that a tax practitioner and the persons for whom he prepares returns writes the Commissioner of Internal Revenue a letter requesting that those persons' returns not be audited and, in order to insure that they not be audited, request that the IRS computers be programmed to prevent any type of audit, random or otherwise. Have they agreed to attempt to interfere with the normal functions of the IRS? Yes. Have they committed an overt act in furtherance of that agreement? Yes. They wrote the letter in every hope, however unreasonable the hope, that it would result in disrupting the normal administration of the IRS as to them. They did a perfectly legal, nondeceitful act with the intent to lower the audit profile. Are they guilty of the crime of conspiracy? No.

How about Judge Kozinski's answer to basically the same question in a more complex and representative case? In *United States v. Caldwell*, Judge Kozinski for the majority states the question succinctly: "[w]e consider whether conspiring to make the government's job harder is, without more, a federal crime."<sup>330</sup> The relevant facts are simple. The defendant was a bookkeeper for a "warehouse bank" which "used numbered accounts, promised to keep no records of clients' transactions and vowed not to disclose information about the accounts to third parties."<sup>331</sup> These helped the customers avoid paying taxes.<sup>332</sup> From these facts, the bookkeeper was charged with and convicted of the defraud conspiracy.<sup>333</sup>

The court starts by stating the general law of the defraud conspiracy essentially the same as I discuss it above.<sup>334</sup> The court then states the government's claim as follows:

[A]ny conspiracy to obstruct a government function is illegal, even if the obstruction is not done deceitfully or dishonestly. Under this reading, the government argues, people have a duty "not to conduct their business affairs in such a manner that the IRS would be impeded and impaired in its . . . collection of revenue." Or, as government counsel candidly asserted at oral argument, "if what you're doing, legal or illegal, is intended to impede and impair the Internal Revenue Service, . . . that constitutes a crime under section 371."<sup>335</sup>

For the court, Judge Kozinski soundly rejected that nonsense:

---

330. *United States v. Caldwell*, 989 F.2d 1056, 1058 (9th Cir. 1993).

331. *Id.*

332. *See id.*

333. *Id.*

334. *See id.*

335. *Id.* at 1059 (citations omitted).

We think not. The Supreme Court has made it clear that “defraud” is limited only to wrongs done “by deceit, craft or trickery, or at least by means that are dishonest.” *Hammerschmidt*, 265 U.S. at 188, 44 S.Ct. at 512. Obstructing government functions in other ways - for example, by violence, robbery or advocacy of illegal action - can’t constitute “defrauding.” *Id.*; see also *United States v. Murphy*, 809 F.2d 1427, 1431-32 (9th Cir. 1987) (not disclosing something that one has no independent duty to disclose isn’t conspiracy to defraud, even if it impedes the IRS).<sup>336</sup>

Footnote three explains away some of the loose language in prior cases:

As the government points out, some recent cases do talk of section 371 punishing any conspiracy to obstruct a function of the government, without mentioning the dishonest means requirement. But we answer this argument the same way *Hammerschmidt*, 265 U.S. at 187, did when distinguishing *Haas*, 216 U.S. at 479, a case that also seemed to read “conspiracy to defraud” as broadly as the government suggests: Because those cases involved deceitful and dishonest conduct, they didn’t have to decide whether section 371 reached conspiracies to obstruct the government in ways that were neither deceitful nor dishonest.

Certainly the Supreme Court thinks *Hammerschmidt* is still good law: *McNally v. United States*, 483 U.S. 350, 358-59 & n.8, 107 S. Ct. 2875, 2880-81 & n.8 (1987), cited (albeit in dictum) *Hammerschmidt*’s “deceit, craft or trickery” language as representing the correct reading of section 371. Moreover, *Dennis* itself cited *Hammerschmidt* with no indication it was being overruled.<sup>337</sup>

The court then goes on to explain *Hammerschmidt*’s deceit element is required:

And surely this is the sensible reading of section 371. Under the government’s theory, a husband who asks his wife to buy him a radar detector would be a felon - punishable by up to five years in prison and a fine of \$10,000 - because their actions would obstruct the

---

336. *Caldwell*, 989 F.2d at 1059.

337. *Id.* at n.3 (citations omitted).

government function of catching speeders. So would a person who witnesses a crime and suggests to another witness (with no hint of threat) that they not tell the police anything unless specifically asked about it. So would the executives of a business that competes with a government-run enterprise and lowers its prices to siphon off the government's customers. So would co-owners of land who refuse to sell it for use as a military base, forcing the government to go to the extra trouble of condemning it. So would have Elliot Richardson and William Ruckelshaus, had they agreed with each other to quit if asked by President Nixon to fire Archibald Cox.

The federal government does lots of things, more and more every year, and many things private parties do can get in the government's way. It can't be that each such action is automatically a felony. The government may, if it wants to, explicitly outlaw conduct it thinks unduly obstructs its functions; in fact, in 1987, it enacted a regulation, 31 C.F.R. § 103.37, prohibiting the very conduct at issue in this case. But we're unwilling to conclude Congress meant to make it a federal crime to do *anything*, even that which is otherwise permitted, with the goal of making the government's job more difficult.<sup>338</sup>

Based on this analysis, the court found the jury instructions fatally defective because they did nothing more than state the government's "spurious" theory without telling the jury that, as an element of the offense, the government must prove "deceitful or dishonest means."<sup>339</sup> Judge Kozinski ends with rhetorical flourish:

There are places where, until recently, "everything which [was] not permitted [was] forbidden . . . . Whatever [was] permitted [was] mandatory . . . . Citizens were shackled in their actions by the universal passion for banning things." Yeltsin Addresses RSFSR Congress of People's Deputies, BBC Summary of World Broadcasts, Apr. 1, 1991, available in LEXIS, Nexis Library, OMNI file. Fortunately, the United States is not such a place, and we plan to keep it that way. If the government wants to forbid certain conduct, it may forbid it. If it wants to mandate it, it may mandate it. But we won't lightly infer that in enacting 18 U.S.C. § 371 Congress meant to forbid all

---

338. *Id.* at 1059-60 (emphasis in original). Government counsel conceded at oral argument that her reading of § 371 would outlaw the conduct described in the first two hypotheticals. *Id.* at 1059.

339. *Id.* at 1060.

things that obstruct the government, or require citizens to do all those things that could make the government's job easier. So long as they don't act dishonestly or deceitfully, and so long as they don't violate some specific law, people living in our society are still free to conduct their affairs any which way they please.<sup>340</sup>

Judge Kozinski's *Caldwell* analysis has been cited by and relied upon by other courts.<sup>341</sup> I have found no cases rejecting this analysis, as Judge Kozinski notes, the analysis is, after all, compelled by *Hammerschmidt* and a healthy dose of common sense.<sup>342</sup> Bottom line, making the IRS' job more difficult is not a crime without acts of deception – at least certainly not a crime under the defraud conspiracy statute.

I would have thought Judge Kozinski's resounding rejection of the government's claims in *Caldwell* was so straightforward, definitive and correct that the government would not have the brass to reassert them. But, DOJ Tax makes clear its distaste for *Caldwell*'s insistence on the deceit element to the defraud conspiracy. In its CTM, DOJ Tax attempts to treat the *Caldwell* decision as a misapplication of the conspiracy statute to that

---

340. *Id.* at 1061.

341. *See, e.g.,* *United States v. Shellef*, 507 F.3d 82, 104 (2d Cir. 2007) (quotation marks omitted). The court repeated the formula and by implication the subsequent interpretation:

The elements of a conspiracy to defraud the United States (also known as a defraud clause conspiracy) are (1) [that defendant] entered into an agreement (2) to obstruct a lawful function of the government (3) by deceitful or dishonest means and (4) at least one overt act in furtherance of the conspiracy.

*Id.* (citations omitted).

342. I have tracked the relevant case law after *Caldwell* and found no dissenting voices. In *United States v. Martin*, 332 F.3d 827, 835 (5th Cir. 2003), the court said: "a charge under the 'defraud clause' does not require a 'deceit and dishonest means' instruction." The court's bare quoted text, out of context, might suggest that the court disagrees with both with both *Caldwell* and *Hammerschmidt* (although the court does not express disagreement with *Hammerschmidt* and does not even cite *Caldwell*). *See id.* at 828-35. The text's context, however, shows that it is consistent with both. In *Martin*, in addition to his lie, Martin tried to defeat the IRS attempt to collect taxes by diverting income to an account in a third party's name and by filing an offer in compromise falsely omitting a source of income. *Id.* at 828. You will recall that *Hammerschmidt* held that the defraud conspiracy covered both an attempt to defraud a government agency out of something of value (*i.e.*, taxes) to which it was entitled (the usual meaning of defraud) and, even where there was not an attempt to defraud in its usual meaning, an attempt to impair or impede a government agency (here the IRS) via an act of deceit would suffice. *Hammerschmidt*, 265 U.S. 188. In *Martin*, the trial judge covered the usual meaning of defraud but did not include the "deceit and dishonest means" instruction. *Martin*, 332 F.3d at 834. The defendant did not object at trial and did not submit a proposed instruction with the language. *Id.* at 834. The defendant first raised the argument on appeal that the deceit and dishonest means instruction was required. *Id.* Under the plain error standard, the *Martin* Court found no error because the instructions viewed as a whole did instruct on the defraud clause. *Id.* at 835. The text quoted earlier in this footnote was made in that context. There was clearly an attempt to defraud in its usual sense. If the *Martin* Court meant more than that then it is clearly dicta because the discussion of prejudice would have been meaningless. In all events, the case it cites for the proposition is distinguishable because the judge in that case did read the indictment to the jury which contained the *Hammerschmidt* required language. *Id.*

case.<sup>343</sup> Nevertheless, in grudging recognition that *Caldwell* has some merit, the CTM cautions:

Although the Department does not believe that the jury instructions in *Caldwell* were deficient, the wiser course of action may be to use jury instructions incorporating language similar to that found in *Hammerschmidt v. United States*, 265 U.S. at 188. In other words, the prudent course of action is to instruct the jury that section 371 prohibits not only conspiracies to defraud the United States by cheating the government out of money, such as income tax payments or property, but also conspiracies to defraud the United States for the purpose of impairing, impeding, obstructing, or defeating of the lawful functions of an agency of the government, such as the IRS, by deceit, craft, trickery, or means that are dishonest. See, e.g., pattern jury instructions cited in *Caldwell*, 989 F.2d at 1060.<sup>344</sup>

I think it is instructive to look now at the leading tax defraud conspiracy case, *United States v. Klein*. In *Klein*, the government argued both substantive counts (such as evasion) and a defraud conspiracy.<sup>345</sup> The trial court directed verdict of acquittal on the substantive counts.<sup>346</sup> This left only the defraud conspiracy count for submission to the jury, which found the defendants guilty of that count.<sup>347</sup> The facts in *Klein* were complex, but the court gave the following helpful summary of the acts that the jury could have considered in determining guilt for the defraud conspiracy charged:

7. Summary of Acts of Concealment. We summarize the acts of concealment of income which the jury might have found, pointing out that, as indicated, some of these are alternatives: (1) alteration of the books of [a foreign corporation] to make liquidating dividends appear as commissions; (2) alteration of those books to make a gratuitous payment of \$1,500,000 from [the foreign corporation] to Regan Potter appear as repayment of a loan; (3) a false entry in the corporation's books to disguise as commissions paid what was actually a dividend paid to Klein which he diverted to [foreign] corporate nominees of his personal friends; (4) a false entry in the

---

343. CTM, *supra* note 104, § 23.07[2][c].

344. *Id.*

345. *United States v. Klein*, 247 F.2d 908, 910 (2d Cir. 1957).

346. *Id.*

347. *Id.*

[foreign corporation] books to disguise as a commission paid the \$35,000 paid to Haas' [foreign] corporation; (5) the removal of \$8,000,000 in bonds from New York to Canada; (6) the false statement in Klein's personal income tax return for 1947 to the effect that he purchased stock in Tivoli from the three Canadians for \$375,000; (7) the false statement in the same return to the effect that Tivoli had "contingent liabilities" when it sold its assets to Hannes; (8) Klein's false answer in 1949 to Treasury interrogatories seeking him to identify the owners of various Cuban corporations and to state the nature and amount of funds paid to them by Tivoli; (9) Klein's false answer at the same time regarding his purchasing [the foreign corporation] from the three Canadians; (10) Roer's false return for 1950 in which he claimed that he sold [foreign corporation] stock in that year for an immense profit; (11) Alprin's false statement to Treasury officials in 1952, claiming that his draft was in liquidation of his interest in [the foreign corporation]; (12) Koerner's false statement at the same time to the same effect; (13) Roer's similar [similarly false]<sup>348</sup> statement; (14) Haas' corroborating [similarly false]<sup>349</sup> statement; (15) Klein's signing his [similarly false]<sup>350</sup> 1949 interrogatories in 1952; (16) Klein's statement in 1952 clinging to his earlier [false] position and denying that the drafts were in liquidation of [the foreign corporation]; (17) Klein's 1952 [false] implication to the Treasury that the true value of Regan Potter could be obtained without treating as one of its assets the \$1,500,000 due to Regan Potter from [the foreign corporation] in repayment of a loan; (18) Rokoff's evasive affidavit in 1953 denying that he remembered altering the Tivoli books; (19) Koerner's 1952 income tax return which falsely claimed a sale of Tivoli stock in 1952; (20) Alprin's 1952 income tax return, which made an identical false claim.<sup>351</sup>

The court even indicated that this was a "still incomplete recital;"<sup>352</sup> in overall context, this recitation clearly establishes a pattern of deceit so egregious that it is fair to say it is overwhelming. You will note that nineteen of the twenty items in this litany involved action that was facially

---

348. The context indicates that the Court considered this to be a false statement. *See id.* at 915.

349. *Id.*

350. *See* summary points (8) and (9) listed above for further information.

351. *Klein*, 247 F.2d at 915.

352. *Id.*

false and thus deceitful, easily falling within the *Hammerschmidt*'s interpretation of the defraud conspiracy.<sup>353</sup> Perhaps even considered individually and certainly considered together, the court easily found that these clearly deceitful items supported the defraud conspiracy.

However, focus on item 5 – “the removal of \$8,000,000 in bonds from New York to Canada.”<sup>354</sup> There is nothing on the face of this spare description that establishes some act of deceit. Facially, the text says only that the bonds were moved; it does not say that the defendants ever lied about their location or underpaid their tax with respect to the bonds. All it says is that they were removed.<sup>355</sup> For this reason, the government claims that *Klein* does not require a false or deceitful act (apparently in defiance of any reasonable interpretation of *Hammerschmidt*). Thus, the government in *Stein* opposed the defendants' assertion that, under *Hammerschmidt*, the defraud conspiracy must rest on some action that is false (either statement or document) as follows:

The defense proposal also incorrectly suggests that a *Klein* conspiracy case must rest on a particular false document or statement, and in support of this proposition, the defendants cite *Klein* and state that it catalogued “false statements or documents.” (Defendants' Instruction 12 at 22). In fact, *Klein*'s catalogue, which is a catalogue of particular acts of concealment proven in the *Klein* case and not an exhaustive list of the type of acts that would establish a conspiracy to defraud the Internal Revenue Service, includes certain acts that are not false statements or documents. For example, one of the acts listed is “(5) the removal of \$8,000,000 in bonds from New York to Canada,” which though listed by *Klein* as an act of concealment, is not a false statement or document. See *United States v. Klein*, 247 F.2d 908, 915 (2d Cir. 1957).<sup>356</sup>

The government wrenches this claim from its context in *Klein* (just as it unsuccessfully tried in *Hammerschmidt* to wrench the same claim from the facts of *Haas*). In context, the *Klein* court believed that the bonds were moved to keep the IRS from discovering them;<sup>357</sup> hiding them in Canada is functionally little different than hiding them in a hole in the back yard or in a foreign tax haven financial account with the taxpayer's name on the

---

353. See, e.g., *United States v. Rosengarten*, 857 F.2d 76, 77 (2d Cir. 1988) (“The aim of the alleged conspiracy was to create false income tax deductions by backdating documents . . .”).

354. *Klein*, 247 F.2d at 915.

355. *Id.* In this sense it might be analogized to the *Popkin* case, which some people read incorrectly as permitting prosecution on such spare facts.

356. Government's Objections to Defendants' Proposed Preliminary Jury Instructions at 10, *United States v. Stein*, 2008 WL 4810065 (S.D.N.Y. Nov. 3, 2008) (No. S1 05 Cr. 888 (LAK)).

357. *Klein*, 247 F.2d at 914.

account. Moreover, the analytical question I ask the reader of *Klein* is whether, if the removal in exactly the terms stated by the court (no embellishments because the court provided none) were the only fact in the case and there is no fact that the defendants did anything to hide the bonds' removal to Canada and left a clear and truthful paper trail of that removal, the government could have sustained a defraud conspiracy? Is the mere removal of the bonds to Canada without more a deceit so as to support a defraud conspiracy even though no tax is due and owing? I suggest that as a stand alone fact, even with the intent to make more difficult the IRS's ability to discover the bonds, that mere removal would not support a defraud conspiracy. One or more actual deceitful facts – otherwise present in abundance in *Klein* are required. If actual deceit is not required, then the crime has no practical boundaries, as Judge Kozinski recognized in *Caldwell* based squarely on *Hammerschmidt*.<sup>358</sup>

I think it is instructive that, even when it is trying to distill the key *Klein* case elements in a more dispassionate setting, the government focuses only on the clearly deceitful conduct which is, in fact, false and deceitful. Thus, the CTM provides the following in explaining the *Klein* holding:

1. Alteration of the books to make liquidating dividends appear as commissions;
2. Alteration of the books to make a gratuitous payment of \$1,500,000 appear as a repayment of a loan;
3. A false entry in the books disguising as commissions what was actually a dividend, which in turn was diverted to corporate nominees;
4. A false statement in Klein's personal income tax return regarding the payment for a stock purchase;
5. Klein's false answer to Treasury interrogatories seeking to identify the owners of various Cuban corporations;
6. A return falsely reporting that stock was sold in 1950 for an immense profit;
7. The evasive affidavit of Klein's secretary denying that he remembered altering certain books; and
8. Income tax returns which falsely claimed a sale of stock.<sup>359</sup>

It is true that the CTM refers to the case as including these eight key facts, but nowhere does the CTM hint that some false, deceptive or similar act is

---

358. United States v. Caldwell, 989 F.2d 1056, 1059 (9th Cir. 1993). I hope the reader recalls that I represented one of the dismissed defendants in *Stein*, and thus will test my analysis against a fair reading of *Hammerschmidt*, *Klein*, and *Caldwell*, the leading cases.

359. CTM, *supra* note 104, § 23.07[2][a] (citing *Klein*, 247 F.2d at 915).



not required. And, of course, *Hammerschmidt* and *Caldwell* say that it is required.

*United States v. McGill* involved an analogous fact pattern.<sup>360</sup> The taxpayer owed delinquent taxes that had already been quantified and assessed.<sup>361</sup> With the specific intent to delay the IRS's collection of those taxes, the taxpayer deposited funds into a bank account that was not known to the IRS.<sup>362</sup> The taxpayer used no deceit in doing so — i.e., the bank account was in his name and his social security number.<sup>363</sup> The taxpayer never denied the existence of the account or otherwise misled the IRS as to the existence of the account.<sup>364</sup> The government charged McGill with tax evasion (evasion of payment), using the deposit of the funds into that bank account as a *Spies* affirmative act of evasion.<sup>365</sup> Echoing the interpretation of the defraud conspiracy, the court said:

An affirmative act is anything done to mislead the government or conceal funds to avoid payment of an admitted and accurate deficiency. The offense is complete when a single willful act of evasion has occurred. Section 7201 explicitly refers to “attempts [to evade] in any manner.” Generally, affirmative acts associated with evasion of payment involve some type of concealment of the taxpayer's ability to pay his or her taxes or the removal of assets from the reach of the Internal Revenue Service. Thus, “any conduct, the likely effect of which would be to mislead or to conceal” is sufficient to establish an affirmative act of evasion.<sup>366</sup>

The court then rejected the government's claim that the mere use of the account was an act of concealment constituting an affirmative act of evasion:

We find that, unless a taxpayer is in the situation of giving voluntary admissions during an investigation or a forced response to a subpoena, the failure of the taxpayer to report the opening of an account in his or her own name in his or her own locale cannot amount to an affirmative act of evasion. Omissions, including failures to report, do not satisfy the requirements of § 7201; the Government must

---

360. *United States v. McGill*, 964 F.2d 222 (3d Cir. 1992).

361. *Id.* at 227.

362. *Id.* at 228-29.

363. *Id.* at 228.

364. *See id.* at 228-29.

365. *Id.* at 230, 233, 243 (citing *Spies v. United States*, 317 U.S. 492, 499, 63 S. Ct. 364, 368 (1943)).

366. *McGill*, 964 F.2d at 230 (citations omitted).

prove a specific act to mislead or conceal . . . . McGill testified that he opened the account on the advice of counsel in response to IRS criticism for banking under the names of others. There is no evidence that McGill concealed this new account from the IRS apart from the fact that he did not inform the IRS of its existence.<sup>367</sup>

Although *McGill* is an evasion case and not a conspiracy case, I think it frames the concern nicely. In terms of imposing criminal liability for conduct that defeats the lawful functions of the IRS, the government claims § 7212 to be a one-person counterpart of the defraud conspiracy. The question is whether McGill's actions, although failing the affirmative act requirement of § 7201 evasion, could be an attempt to defeat the lawful functions of the IRS under § 7212. And, if two or more people, conspired to perform the same act, they could be charged with the underlying substantive act (through § 7212) and a conspiracy framed both as an offense conspiracy (to violate § 7212) and a defraud conspiracy. Of course, *McGill* did not address § 7212 or either conspiracy, so any conclusion has to be an extrapolation, but the *McGill* court's concerns would be equally present in the context of a conspiracy or § 7212 charge. The *McGill* court's animating concerns are basically the same that prompted the Supreme Court in *Hammerschmidt* to limit the scope of criminality except where Congress has spoken clearly, which it has not in the spare language of the defraud conspiracy and § 7212.<sup>368</sup> For now you might ask whether the government simply indicted McGill under the wrong statute(s), or whether, until Congress speaks more clearly than it has, there is something fundamentally wrong with the notion that legal activity which is nondeceptive can support a criminal conviction simply because an actor intended to make the IRS's job more difficult.

Even where some form of deceit or falsity is involved, courts and commentators are concerned about the sweeping breadth of the potential application of the defraud conspiracy simply upon the allegation that there is some attempt to influence some government conduct. Consider the following:

The conspiracy to defraud offense, as advocated by the government on appeal, would allow, for example, the prosecution of bank robbers on a conspiracy to defraud theory if the robbers, by wearing disguises, impeded the FBI's efforts to identify the culprits, or if they proceeded at

---

367. *Id.* at 233-34 (citations omitted). Consider in this regard that even something as innocuous as a hat can meaningfully lower eye witnesses' ability to identify a perpetrator of crime. Richard A. Wise, Nell B. Pawlendo, David Meyer & Martin A. Safer, *A Survey of Defense Attorneys' Knowledge and Beliefs About Eyewitness Testimony*, 31 CHAMPION 18, 19 (Nov. 2007).

368. This concept has overtones of the lenity doctrine which I discuss later in this Article. See *infra* Part VII.

night and without prior announcement so as to avoid detection. We think that imparting such infinite elasticity to the second branch of section 371 flies in the face of rules governing the construction of penal statutes.<sup>369</sup>

*United States v. Murphy* is also illustrative of the courts' concern with the government's expansive claims for the defraud conspiracy.<sup>370</sup> In that case, the defendant orchestrated an offshore money laundering scheme.<sup>371</sup> The defendant deposited \$200,000 currency in a U.S. bank.<sup>372</sup> The defendant completed the CTR, accurately describing the account owner as an offshore corporation.<sup>373</sup> The form did not ask the source of the funds, and, logically, the defendant did not state that the funds were delivered to him by two persons (who were IRS sting agents).<sup>374</sup> The defendant answered the questions honestly that the government's form asked him to answer.<sup>375</sup> The government felt that the defendant's accurate description was not sufficient, should have disclosed the source of the funds and thus, in part here relevant, was a conspiracy to defraud.<sup>376</sup> The court rejected that argument.<sup>377</sup> Even if the limited truth required by the return was itself intended to distract the IRS, the court reasoned, it did not fall within the defraud conspiracy statute:

The intent here may, indeed, have been evil, but the conduct had not yet been denounced as crime. The indictment does not allege a conspiracy to defraud premised upon the defendants' entire laundering operations. It is far more narrowly drawn, stating that defendants conspired to defraud the United States by impeding the IRS in its collection of information with regard to currency transactions. In other words, the conspiracy to defraud charge rests solely on the alleged falsehoods in the CTR Olson filed. We have already noted that Olson truthfully completed the CTR. Therefore, the indictment before us does not properly allege a conspiracy to defraud.<sup>378</sup>

---

369. *United States v. Haga*, 821 F.2d 1036, 1045 n.17 (5th Cir. 1987). Note also in this regard the due process and lenity issue discussed in the text toward the end of this article. See *infra* Part VII.

370. *United States v. Murphy*, 809 F.2d 1427 (9th Cir. 1986).

371. *Id.* at 1429.

372. *Id.*

373. *Id.*

374. *Id.* at 1429, 1431.

375. *Id.*

376. *Murphy*, 809 F.2d at 1429-30.

377. *Id.* at 1430.

378. *Id.* at 1432.

The Ninth Circuit later interpreted *Murphy* and a prior case, *United States v. Varbel*,<sup>379</sup> to mean that a defraud conspiracy “conviction may not be based upon a failure to volunteer information that is not required to be provided to the government, or upon the furnishing of correct information; such acts do not sufficiently impair the functioning of the government to support a criminal conviction.”<sup>380</sup> What I extrapolate from *Murphy* and *Caldwell* is that withholding non-disclosable information and providing correct information cannot be the basis of a defraud conspiracy even if the purpose thereof is to hinder the IRS. This is the reason that, in an earlier example in this Article, the individuals writing the IRS to request that they be removed from the IRS audit activity screen, although blatantly intending to influence IRS audit activity, are not guilty of a defraud conspiracy based on that action alone.

## 2. Government Option - Offense or Defraud Conspiracy or Both?

If you have followed this discussion so far, you know that where two or more persons conspire to commit a tax crime (e.g., I.R.C. §§ 7201, 7206(1)), there will likely exist deceitful conduct that could be construed as impairing or defeating the lawful functions of the IRS. Consequently, the facts could equally support a prosecution for an offense and/or a defraud conspiracy.<sup>381</sup> Which avenue the government chooses to pursue can result in severe consequences for the defendant.

Consider the provision in the conspiracy statute that makes the conspiracy conviction a misdemeanor if the conviction is for an offense conspiracy where the object offense of that conspiracy is a misdemeanor.<sup>382</sup> This provision was added to the conspiracy statute in 1948 to prevent prosecutors from using the offense conspiracy to ratchet up a misdemeanor into a felony.<sup>383</sup> The question arises whether prosecutors can take advantage of the factual overlap between offense and defraud conspiracies to prosecute misdemeanor conduct as a felony defraud conspiracy, thus avoiding the limits on “upward conversion” imposed by the 1948 amendment. Similarly, as previously noted, the conduct that is the object of both tax obstruction and a *Klein* conspiracy are the same,<sup>384</sup> yet by charging a *Klein* conspiracy rather than tax obstruction, the prosecutor can

---

379. 780 F.2d 758 (9th Cir. 1986).

380. *United States v. Tuohey*, 867 F.2d 534, 538 (9th Cir. 1989) (emphasis added).

381. See *United States v. Rosenblatt*, 554 F.2d 36, 40 (2d Cir. 1977) (“These two clauses of the statute overlap when the object of a conspiracy is a fraud on the United States that also violates a specific federal statute.”). See generally Goldstein, *supra* note 277, at 436-40.

382. 18 U.S.C. § 371 (2008) (“If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.”).

383. See *Cole et al.*, *supra* note 321, at 236-37.

384. See *supra* Part II.A.

achieve a maximum five-year sentence rather than a three-year sentence.<sup>385</sup> A related question arises from the willfulness requirement – the intent to violate a known legal duty<sup>386</sup> – for the offense conspiracy: in a situation where the tax offense requiring willfulness was the clear object of the conspiracy, can the government charge the defraud conspiracy and dispatch the defendant without proving willfulness?

In *United States v. Minarik*, the Sixth Circuit was troubled by the prosecutor's choice to charge the defraud conspiracy in order to avoid the misdemeanor limitation of the offense conspiracy.<sup>387</sup> The court held that in an area where the law is as "technical and difficult to discern" as tax law, the existence of "a Congressional statute closely defining those duties takes a conspiracy to avoid them out of the defraud clause and places it in the offense clause."<sup>388</sup> The difference is important for the reason noted by the court (gutting the misdemeanor clause), as well as the fact that the willfulness, in the government's mind, is not required for the defraud conspiracy but is for the offense conspiracy related to tax crimes.<sup>389</sup> Since *Minarik*, the Sixth Circuit has chipped away at the holding without disavowing it altogether, and no other court has embraced it.

In *United States v. Sturman*, the defendants were charged with a defraud conspiracy.<sup>390</sup> Sturman engaged in the pornography business through one-hundred and fifty domestic and five foreign corporations incorporated in tax havens offering secrecy.<sup>391</sup> Although Sturman was the beneficial owner of all of these corporations, the corporate records indicated that other persons – both wholly fictitious persons and real persons who had no knowledge of the matter – were the nominal owners of the corporations.<sup>392</sup> Then, upon the institution of a federal investigation, Sturman began concealing and destroying documents.<sup>393</sup> His tax records contained many other "false statements and inaccuracies."<sup>394</sup> He failed to report his ownership interests in the foreign corporations as well as his signature authority over foreign bank accounts, and he underreported over

---

385. U.S. SENTENCING GUIDELINES MANUAL ch. 5, pt. A (2008).

386. See *United States v. Patridge*, 507 F.3d 1092, 1094 (7th Cir. 2007), *cert. denied*, 128 S. Ct. 1721 (2008) ("An act is willful for the purpose of tax law, the Court concluded, when the taxpayer knows what the Code requires yet sets out to foil the system. Knowledge of the law's demands does not depend on knowing the citation any more than ability to watch a program on TV depends on knowing the frequency on which the signal is broadcast.")

387. 875 F.2d 1186 (6th Cir. 1989).

388. *Id.* at 1196.

389. See *supra* note 33.

390. 951 F.2d 1466 (6th Cir. 1991), *cert. denied*, 504 U.S. 985 (1992).

391. *Id.* at 1471.

392. *Id.*

393. *Id.* at 1472.

394. *Id.*

\$2.7 million in individual income.<sup>395</sup> The court distinguished *Minarik* as follows:

This Court, in *Minarik*, noted that the holding in the case referred to the offense and defraud clauses “as applied to the facts in this case.” The facts in *Minarik* and this case are distinguishable. Reuben Sturman set up a complex system of foreign and domestic organizations, transactions among the corporations, and foreign bank accounts to prevent the IRS from performing its auditing and assessment functions. Evidence shows that he committed a wide variety of income tax violations and engaged in numerous acts to conceal income. This large conspiracy involved many events which were intended to make the IRS impotent. No provision of the Tax Code covers the totality and scope of the conspiracy. This was not a conspiracy to violate specific provisions of the Tax Code but one to prevent the IRS from ever being able to enforce the Code against the defendants. Only the defraud clause can adequately cover all the nuances of a conspiracy of the magnitude this case addresses. As the Supreme Court had held with respect to specific violations within a conspiracy, “the fact that the events include the filing of false statements does not, in and of itself, make the conspiracy-to-defraud clause of § 371 unavailable to the prosecution.” In this case, the prosecution was entitled to indict the defendants under the defraud clause. The broad nature of the conspiracy, and the associated violation of several statutes, distinguishes this case from *Minarik*. In this case, the alleged conduct violates several statutes. A “conspiracy to defraud” charge most clearly covers the conduct when viewed in its entirety.<sup>396</sup>

*Sturman* sounds like a strong endorsement for expansive application of the defraud conspiracy, but an essential element in the court’s analysis is the finding that Sturman was falsifying the audit trail and evading taxes and otherwise violating the tax laws.<sup>397</sup> Despite the breadth of the language, *Sturman* on its facts, like *Haas*, is not authority for the application of the defraud conspiracy in the absence of deceit or dishonesty.

In *United States v. Mohney*, decided just over a month after *Sturman*, the defendants were charged with a defraud conspiracy the gravamen of

---

395. *Id.*

396. *Sturman*, 951 F.2d at 1473-74 (citations omitted).

397. *See id.* (highlighting the nuanced magnitude of conspiracy particular to Sturman’s case and distinguishing it from *Minarik*).

which the district court found to be “a charge that the defendants conspired to conceal Mohnhey’s ownership or control interests by filing tax returns which falsely fail to show such ownership or control.”<sup>398</sup> Because the charge fit neatly within § 7206, the district court dismissed it based on *Minarik*.<sup>399</sup> On appeal, the Sixth Circuit reversed, limiting the implications of *Minarik* by rejecting the idea that simply because the government could have charged a more specific offense, the defraud conspiracy charge is improper.<sup>400</sup> *Mohnhey* does not cite *Sturman* but reaches the same core conclusion: that *Minarik* should be limited to its facts and thus the defraud conspiracy can be charged beyond the facts in *Minarik*.<sup>401</sup> *Mohnhey* does not change the conclusions noted above, however.

In *United States v. Alston*, the defendant, a small scale importer of foreign automobiles, structured cash purchases of bank money orders to purchase the automobiles in amounts so that no single purchase of money orders exceeded the \$10,000 amount that required banks to report the transaction to the IRS.<sup>402</sup> The defendant was charged with two crimes: (i) a defraud conspiracy on the ground that the structuring resulted in the reports not being made, thus impeding the lawful function of the IRS (this is, as the court noted, a classic *Klein* conspiracy); and (ii) the substantive offense of structuring (piece-mealing bank transactions to fit under the \$10,000 threshold).<sup>403</sup> The defendant was convicted of both charges in a non-jury trial.<sup>404</sup> The defendant later filed a motion at the trial court level to set aside the convictions based on an intervening Supreme Court case, *United States v. Ratzlaf*, which had “held that in order to obtain a structuring conviction the government must prove that the defendant knew that structuring itself was illegal.”<sup>405</sup> As a result of the new precedent, the trial court dismissed the substantive offense, but sustained the conviction for the defraud conspiracy.<sup>406</sup> On appeal, the issue was whether the defraud conspiracy could be sustained.<sup>407</sup> Note that the defendant in *Alston* clearly knew about the reporting requirement and intended to avoid it and thereby hide information from the IRS, which under the formulations in the preceding discussion if viewed liberally might support a defraud conspiracy charge.

The court first noted the distinction between the offense conspiracy and the defraud conspiracy, with the former requiring the government to

---

398. 949 F.2d 899, 900 (6th Cir. 1991).

399. *United States v. Mohnhey*, 723 F. Supp. 1197 (E.D. Mich. 1989).

400. *Mohnhey*, 949 F.2d at 900; see also *Sturman*, 951 F.2d 1466 (6th Cir. 1991).

401. *Mohnhey*, 949 F.2d at 903-05.

402. *United States v. Alston*, 77 F.3d 713, 714 (3d Cir. 1996).

403. *Id.* at 715-16.

404. *Id.* at 714.

405. *Id.* at 716.

406. *Id.* at 716-17 (citing *United States v. Ratzlaf*, 510 U.S. 134, 114 S. Ct. 654 (1994)).

407. *Id.* at 714.

“prove whatever level of mens rea is required for conviction of the underlying substantive offense.”<sup>408</sup> The court referred to an earlier precedent where it had vacated both the defraud conspiracy count and the substantive count for violation of the Federal Election Campaign Act which had the same willfulness requirement; relying on this precedent, the court reasoned that this defraud conspiracy conviction could not be sustained in view of the government’s concession that it could not prove knowledge of criminality of structuring to avoid the reporting requirement.<sup>409</sup> Although it dealt with the defraud conspiracy, the court seems to have been troubled by the nexus between the substantive offense and the conspiracy. The court found that the essence of the conduct charged in the indictment was structuring and that the “the government has conceded that its theory against Alston for fraud against the United States is nothing more than structuring.”<sup>410</sup>

The government mounted the same proof for the offense conspiracy as for the defraud conspiracy. The court then turned to the same government argument presented in *Stein* about willfulness:

[T]he government argues that Alston’s “conspiracy to defraud” conviction did not require proof of the “willfulness” required for a structuring conviction. The government contends instead that Alston was guilty of participating in a so-called “*Klein* conspiracy” “to defraud the United States by obstructing or impeding the IRS in its functions and duties under the Bank Secrecy Act to collect, analyze, and disseminate information contained in CTR reports.” Because establishing a true *Klein* conspiracy under the “defraud” clause does not generally require proof of knowledge of illegality, the government contends that its proof that Alston knew of the bank’s CTR filing requirements is a sufficient showing of *mens rea* to sustain his conviction for conspiracy to defraud.

We cannot discern any difference between the government’s “defraud” scenario and the “structuring” scenario of which Alston was acquitted. Both conspiracies involve structuring prior to the 1994 amendment to § 5324. Therefore, given the indictment and the proofs at trial, we conclude that to obtain a conviction under either the “defraud” or “offense” clause of § 371, the government had to prove that Alston knew that his structuring activities were illegal. Although we do not foreclose the possibility of convicting a defendant under § 371’s “defraud” clause

---

408. *Alston*, 77 F.3d at 718.

409. *Id.*

410. *Id.* at 720.



based on charges in *addition to* or *different from* pre-1994 acts of structuring, as we have just discussed, the present indictment, under paragraph 7(a), charged no more or less than a straight-out structuring conspiracy.<sup>411</sup>

....

Because, in the present case, the charge against Alston for “conspiracy to defraud” was nothing more than a charge of conspiracy to structure, we will reverse Alston’s conviction where his conviction was not based on proof that he had “willfully” structured, as required under *Ratzlaf*. Where either Congress or the Supreme Court has spoken on the required level of *mens rea* required to obtain a conviction for structuring, the government may not subvert that mandate by juggling the “defraud” and “offense” clauses of § 371 so as to substitute one for the other.

If the “offense” clause of § 371 specifically covers an act or offense and the indictment charges only that act or offense as having been committed, and the proofs at trial reveal no more than such acts of offense, a defendant not guilty under the “offense” clause cannot alternatively be convicted under the broad “defraud” clause of § 371.<sup>412</sup>

The government does not like *Alston* and grouses as follows:

*[T]he Third Circuit, in United States v. Alston*, found that, although the government had charged the defendant with conspiracy to defraud the United States where he acted in concert with another to avoid the requirement to file currency transaction reports, the conspiracy was, in fact, a “straight-out structuring conspiracy.” The court noted that the government “conceded that its theory against Alston for fraud against the United States is nothing more than structuring.” Because the court found that Alston had been charged with conspiring “to defraud by structuring,” the court held that the government had to prove that the defendant knew that structuring was illegal. Concluding that the government had failed to prove the defendant’s knowledge of the illegality of structuring, the court reversed his conviction.

The *Alston* court also rejected the government’s argument that because Alston was charged with conspiracy to defraud, the government did not have to prove

---

411. *Id.* at 720-21.

412. *Id.* at 721.

willfulness. *Alston* stands in stark contrast to decisions holding that in order to establish a conspiracy to defraud, the government need only establish an intent to defraud and not the intent necessary to commit some other substantive offense.<sup>413</sup>

Assuming the government can choose which conspiracy to charge, it will have an incentive to choose the one which imposes lesser burdens on the facts at hand. The *Alston* court was not the first to express alarm at this and, as noted above, the perceived relaxed burdens for the defraud conspiracy are troubling indeed. Thus, long ago, the Second Circuit expressed its concern as follows:

When the government proceeds under the conspiracy-to-defraud clause, in cases that could as easily have been brought under the “offense” clause, the courts must be alert to subtle attempts to broaden the already pervasive and wide-sweeping nets of conspiracy prosecutions. The terms “conspiracy” and “defraud,” when used together, have a peculiar susceptibility to a kind of tactical manipulation which shields from view very real infringements on basic values of our criminal law.<sup>414</sup> Accordingly, conspiracy-to-defraud prosecutions are “scrutinized carefully.”<sup>415</sup>

In *United States v. Kahlife*, decided shortly after *Alston*, the Sixth Circuit continued to chip away at *Minarik*.<sup>416</sup> Counts 1 and 2 of the multi-count indictment in *Kahlife* charged conspiracy.<sup>417</sup> From the opinion, Count 1 appears to have been an offense conspiracy.<sup>418</sup> Count 2 was a defraud conspiracy.<sup>419</sup> Only Count 2 was involved on the appeal. Count 2 alleged a defraud conspiracy by multiple deposits of cash of less than \$10,000 in three bank accounts, and the aggregate amount involved was over \$12 million.<sup>420</sup> The government did not charge structuring because it

---

413. CTM, *supra* note 104, § 23.07[3] (some citations omitted). In *United States v. McKee*, 506 F.3d 225, 243 n.14 (3d Cir. 2007), the same court declined to determine whether *Alston* had added an additional element of willfulness to a *Klein* conspiracy because the evidence in the case was sufficient to establish willfulness. 506 F.3d 225, 243 n.14 (3d Cir. 2007).

414. See Goldstein, *supra* note 277, at 409.

415. *United States v. Rosenblatt*, 554 F.2d 36, 40 (2d Cir. 1977) (citation omitted).

416. *United States v. Kahlife*, 106 F.3d 1300, 1303-07 (6th Cir. 1997), *cert. denied*, 522 U.S. 1045 (1998).

417. *Id.* at 1301.

418. The court of appeals summarized: “Count 1 charged the defendants with conspiracy to cause the concealment of material facts in violation of 18 U.S.C. §§ 371, 2(b), and 1001;” the court thereafter said: “Count 1 charged the defendants under the ‘offense’ clause of § 371.” *Kahlife*, 106 F.3d at 1301.

419. The court of appeals summarizes: “Count 2 charged the defendants with conspiracy to defraud the United States in violation of 18 U.S.C. § 371;” the court thereafter said: “Count 2 charged an offense under the ‘defraud’ clause of § 371.” *Kahlife*, 106 F.3d at 1301.

420. *Kahlife*, 106 F.3d at 1301.

could not prove that the defendants knew structuring was illegal as *Ratzlaf* required.<sup>421</sup> The government sought solace in the defraud conspiracy charge because it “did not require proof that the defendants knew their conduct was illegal.”<sup>422</sup> The district court bought that government claim but dismissed based on *Minarik*.<sup>423</sup>

The court of appeals reversed the district court’s dismissal.<sup>424</sup> The court first discussed the *mens rea* required for the defraud conspiracy.<sup>425</sup> The issue was whether the government must prove the defendants’ knowledge of the illegality of their venture.<sup>426</sup> The court ultimately held:

The government presents the better argument, which is also in harmony with this court’s holding in *United States v. Collins*. In *Collins*, this court held as follows in the context of a § 371 conspiracy to defraud the IRS: “The intent element of § 371 does not require the government to prove that the conspirators were aware of the criminality of their objective, but it does require the government to show that they knew of the liability for federal taxes.” Thus, under *Collins*, the district court and the government are correct in concluding that *Ratzlaf* intent does not apply to a § 371 conspiracy to defraud.<sup>427</sup>

The authority quoted, *Collins*, is largely unfocused on the distinction addressed in this portion of this article, but the case does in fact say what the Court of Appeals quoted it as saying, i.e., that the defraud conspiracy at issue requires the government to show the defendant knew of the liability for taxes.

The court then concluded:

Finally, the defendants’ duty not to conceal transactions over \$10,000 from the IRS does not seem to be as “technical and difficult to discern” as the precise timing of the defendant’s duty in *Minarik* (noting that, under Internal Revenue Code provision, duty of non-concealment arises only at time of notice of assessment for back tax). Because the *Minarik* requirement of mutual exclusivity is *dicta*, and because we have subsequently confined *Minarik* to its facts, we conclude that the law in this circuit does not require, in circumstances such as these, that the conspiracy

---

421. *Id.* at 1302.

422. *Id.*

423. *Id.*

424. *Id.*

425. *Id.* at 1302-03.

426. *Kahlife*, 106 F.3d at 1303.

427. *Id.* (citations omitted).

be charged only under the “offense” clause of § 371. Therefore, we AFFIRM the district court’s determination that *Ratzlaf* intent does not apply to a § 371 conspiracy to defraud, but we REVERSE the dismissal of Count 2 and REMAND this case to the district court for further proceedings consistent with this decision.<sup>428</sup>

### 3. Final Thoughts on the Defraud Conspiracy

Professor Goldstein summarized the state of the law almost 50 years ago:

In combination, “conspiracy” and “defraud” have assumed such broad and imprecise proportions as to trench not only on the act requirement [the requirement that crimes in our jurisprudence require evil acts and not just evil intent] but also on the standards of fair trial and on constitutional prohibitions against vagueness and double jeopardy.<sup>429</sup>

Fortunately, at least in the reported cases, Professor Goldstein’s fears for the defraud conspiracy have not materialized principally because the courts have recognized the danger and applied *Hammerschmidt*’s deceit element strictly to require more than just an evil intent coupled with an otherwise illegal act. That is all Judge Kozinski did in a common sense way in *Caldwell*.<sup>430</sup> Professor Goldstein states the *Hammerschmidt* requirement more pithily: “first, there must be a falsehood, a lie; second, the lie must be purposive in nature.”<sup>431</sup>

Returning to the audit avoidance context addressed in this Article, the rule is that a deceit element is required. However, this invites the question: what is deceit? Judge Kozinski tells us that deceit is not merely making the IRS’s job more difficult. Professor Goldstein’s formulation of “a falsehood, a lie,” is basically the *Hammerschmidt* standard and makes a deceit recognizable to anyone, for the “falsehood,” the “lie,” is a known quantity in the law and a standard to which citizens generally and taxpayers specifically are routinely held.<sup>432</sup> This is a standard that easily passes constitutional muster. More specifically, this is a standard required to imbue the defraud conspiracy with its defraud moorings.

Despite the fact that courts have generally discussed the broader formulation in cases where it was not the primary issue and have insisted on *Hammerschmidt*’s focal deceit requirement where it does matter, that

---

428. *Id.* at 1306, *cert. denied*, 522 U.S. 1045 (1998) (quotation marks and citations omitted).

429. Goldstein, *supra* note 277, at 409.

430. *United States v. Caldwell*, 989 F.2d 1056, 1059 (9th Cir. 1993).

431. Goldstein, *supra* note 277, at 455.

432. For example, citizens may not perjure themselves (18 U.S.C. § 1621 (2007)) or make false statements to government agents (18 U.S.C. § 1001(a)(2)), or lie on their tax returns (I.R.C. § 7206(1)).

broad language can take a toll in the resolution of off-the-books cases not reflected in reported decisions. For example, the possibility that defendants have been motivated to plead guilty to a defraud conspiracy count for audit avoidance conduct (or its counterpart with respect to other government agencies) cannot be discounted because of concern as to the sweeping *Haas*-like statements<sup>433</sup> that continue to be made in the court opinions, particularly if the government sweetens the deal by dropping other counts.<sup>434</sup> Additionally, there may have been countless instances in which someone has been convicted on the basis of wrongful instructions, but the case was not appealed. Finally, in those cases for which the government might not have brought charges at all, without the false crux of the broad language and scope of the defraud conspiracy, there may have been instances in which defendants have been found innocent.

## VI. ANY MORE EXPANSIVE CLAIM IS CONTEXTUALLY UNACCEPTABLE

### A. *Courts, Including the Supreme Court, Have Not Thought Audit Avoidance was Criminal*

In *Ratzlaf v. United States*,<sup>435</sup> the Supreme Court held that the statute criminalizing “willfully” structuring transactions to avoid the currency transaction reporting requirement<sup>436</sup> required that the government prove the defendant acted with knowledge that the conduct was illegal. The currency transaction reporting provisions are designed principally to provide the government information in its war on organized crime and drug trafficking.<sup>437</sup> In reaching the holding, the Court indicated specifically that it did not view audit avoidance per se as illegal:

Undoubtedly there are bad men who attempt to elude official reporting requirements in order to hide from government inspectors such criminal activity as laundering drug money or tax evasion. But currency structuring is not inevitably nefarious. Consider, for example, the small business operator who knows that reports filed under 31 U.S.C. § 5313(a) are available to the Internal Revenue Service. To reduce the risk of an IRS audit, she brings \$9,500 in cash to the bank twice each week, in lieu of transporting over \$10,000 once each week. That person, if

---

433. See *Hass v. Henkle*, 216 U.S. 462, 479-80, 30 S. Ct. 249, 253-54 (1910); see also *supra* text accompanying note 277.

434. For a possible instance of this phenomenon, see *United States v. Looney*, 532 F.3d 392 (5th Cir. 2008).

435. 510 U.S. 135 (1994).

436. 31 U.S.C. § 5322(a).

437. *Ratzlaf*, 510 U.S. at 144 n.11 (citing the legislative history).

the United States is right, has committed a criminal offense, because she structured cash transactions “for the specific purpose of depriving the government of the information that Section 5313(a) is designed to obtain.”<sup>438</sup>

Although the Supreme Court was not considering the potential application of § 7212’s tax obstruction crime or the defraud conspiracy<sup>439</sup> to such conduct, it seems clear contextually that the Court, while not necessarily condoning audit avoidance, certainly did not think it was criminal. This CTR criminal provision was subsequently amended to eliminate the requirement that the defendant act “willfully,” so that all the defendant need know is that he or she is avoiding the reporting requirement whether or not he or she acted willfully. Certainly one must ask why specific criminalization of avoiding a CTR requirement is even necessary if § 7212 and the defraud conspiracy were so construed.

This construction of *Ratzlaf* has been echoed in other cases. In *United States v. Daughtry*,<sup>440</sup> the Fourth Circuit said: “Further, the [*Ratzlaf*] Court pointed out, structuring a transaction in order to avoid reporting requirements ‘is not inevitably nefarious,’ but rather is the type of activity that might be engaged in for innocent reasons (for example, to reduce the risk of an audit by the Internal Revenue Service).”<sup>441</sup> Similarly, in *In re Stiller*,<sup>442</sup> the D.C. Circuit stated that: “one might engage in currency structuring out of a desire for privacy, or to reduce the chance of a burdensome audit by the IRS, even if one had nothing to hide.”<sup>443</sup>

### B. *The Willfulness Requirement*

As noted earlier, and as the Supreme Court has recognized,<sup>444</sup> the willfulness requirement for tax crimes is perhaps the critical feature of the criminal tax landscape. This requirement limits tax crimes to intentional violations of the law. Willfulness is not a textual element of the *Klein* conspiracy<sup>445</sup> or § 7212,<sup>446</sup> although as interpreted some courts have come close to formulations of the elements of those crimes that approach or equal willfulness. Still, it is interesting to contemplate what could happen to the

---

438. Brief for the United States, 28-29, *Ratzlaf v. United States*, 510 U.S. 135 (1994).

439. I used the term defraud conspiracy here rather than the narrow tax application of the *Klein* conspiracy because CTR information may be used by government agencies other than those focused on tax administration.

440. 48 F.3d 829, 831 (4th Cir. 1995).

441. *Id.*

442. 725 A.2d 533 (D.C. Cir. 1999).

443. *Id.* at 538. Cf. *First Heights Bank v. United States*, 422 F.3d 1311 (Fed. Cir. 2005).

444. *See Cheek v. United States*, 498 U.S. 192, 205, 111 S. Ct. 604, 612 (1991); *see also supra* note 46.

445. *See United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), *cert. denied*, 355 U.S. 924 (1958).

446. *See I.R.C.* § 7212.

willfulness element normally associated with tax crimes if, indeed, a limited interpretation is not given to the *Klein* conspiracy and § 7212.

The *Klein* conspiracy or § 7212 could thus apply to:

- Any *Spies* affirmative act of evasion under § 7201;<sup>447</sup>
- Any tax perjury conduct defined in § 7206(1);<sup>448</sup>
- Any conduct aiding or assisting defined in § 7206(2);<sup>449</sup> and
- Any failure to file under § 7203, a misdemeanor.<sup>450</sup>

---

447. The landmark case of *Spies v. United States*, 317 U.S. 492, 63 S. Ct. 364 (1943), requires an affirmative act of evasion. A legal act will suffice if coupled with the required willfulness – intent to violate a known and knowable law – and tax due and owing. *Id.* at 499. However, under the government’s imagination of both the defraud conspiracy and the § 7212 crime, the same act, if coupled with merely an intent to make the IRS’s job more difficult, will suffice to make the conduct criminal, regardless of whether the actor intended to violate any law. *Id.* at 494-95. Indeed, tax evasion requires a tax due and owing, so by charging defraud conspiracy or § 7212, the government imagines it can convict where it could not establish tax evasion. *Id.* at 499.

448. The statute provides that “[a]ny person who . . . [w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter” has committed a “[d]eclaration under penalties of perjury” felony. I.R.C. § 7206(1). Although there is no tax due and owing element to this crime, there is a willfulness element requiring that the taxpayer violate a known and knowable legal duty. The government imagines, however, that it can charge defraud conspiracy or § 7212 where it could not establish willfulness.

449. The statute provides that

[a]ny person who . . . [w]illfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document . . .

has committed an “[a]id or assistance” felony. *Id.* § 7206(2). The government’s claims will permit it to avoid the willfulness element simply by charging defraud conspiracy or § 7212.

450. See *id.* § 7203. A failure to file almost by definition makes the IRS’s job more difficult. The crime of failure to file requires willfulness. However, the government imagines it can charge defraud conspiracy or § 7212 even when it cannot prove willfulness.

And so forth. It depends upon how the government wants to charge.<sup>451</sup> Willfulness as the key feature of tax crimes could disappear. Alternatively, it could give the government a charging choice, which could be avoided at whim because of the fact that the *Klein* conspiracy or § 7212 is easier to prove. Why bother with the more difficult requirement of willfulness, an inherently uncertain concept that requires circumstantial proof of what was in the defendant's mind?

Another effect of the expansive scope of § 7212 could be that of transforming conduct which has been traditionally characterized as a misdemeanor failure to file under § 7203 into a felony under § 7212 or a defraud conspiracy. A "willful" failure to file is per se an attempt to defeat the lawful functions of the IRS. Moreover, it is not even certain that a defendant charged under either § 7212 or for a defraud conspiracy could get a lesser included offense instruction under § 7203 in order to have the jury rein in the government's expansive charging decision.<sup>452</sup>

Finally, broad interpretation of the rule could have other dramatic implications. For example, § 6673 imposes a penalty for Tax Court proceedings instituted for purposes of delay or for asserting positions in Tax Court proceedings that are frivolous. Since the effect of Tax Court proceedings is to prevent the IRS from assessing and collecting a deficiency,<sup>453</sup> certainly instituting such proceedings for purposes of delaying assessment or collection would violate § 7212 under a broad construction.<sup>454</sup> Yet, although the § 6673 penalty is meted out often, there is not a single assertion by the government that garden-variety delay action is criminalized under § 7212 or, in analogous circumstances, the general obstruction statutes. A more common context occurs when a taxpayer, knowing that the IRS has correctly determined a tax deficiency, declines to sign a Form 870, thus forcing the IRS to issue a notice of deficiency, solely

---

451. Although the Sentencing Guidelines took much of the abuse out of charging decisions, potential for abuse still remains. *See, e.g., United States v. Looney*, 532 F.3d 392 (5th Cir. 2008) (involving the stringing of minimum mandatory sentences to achieve a life sentence for a first offense). The court was constrained to affirm the sentence but not without lamenting the prosecutors' charging decisions that appeared abusive in the case and that, if not restrained, could give a prosecutor in future cases enormous power to force the innocent (or at least those deserving of trial) to plead to avoid the risk of an exceptionally long sentence. *Id.* at 397-98. Although these comments were made in the context of large, mandatory minimum sentences, it seems to have occurred in the *Stein* case where potential *Pinkerton* liability for tax evasion counts and the quantum of tax loss involved in the overall conspiracy would have created the risk of a Guidelines sentence exceeding twenty years. *See generally United States v. Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007); *Pinkerton v. United States*, 328 U.S. 640, 66 S. Ct. 1180 (1946). This gives the government enormous power to force a defendant to a one-count guilty plea with a maximum of five years, rather than risk twenty years or more. In addition, in order to obtain a five-year cap, the defendant may have to take truly imaginative views of what he can offer the government by way of "cooperation," thus subtly and negatively influencing the truth-finding process.

452. *See, e.g., Sansone v. United States*, 380 U.S. 343, 353, 85 S. Ct. 1004, 1011 (1965) (holding that the petitioner was not entitled to a lesser-included offense based on § 7207 because, on the facts of the case, "§§ 7201 and 7207 'covered precisely the same ground'").

453. *See* I.R.C. § 6213(a).

454. It would also likely violate 18 U.S.C. § 1503 (judicial proceeding obstruction).



because the taxpayer desires to delay the assessment of the tax as long as possible.

In short, any broader interpretation of the *Klein* conspiracy and § 7212 could dramatically change the criminal tax landscape, directly contradicting the congressionally-approved scheme, as well as the Court's interpretation of the willfulness requirement as the common feature of tax crimes.

## VII. MITIGATING THE EFFECT OF OVERBROAD CONSTRUCTIONS - LENITY AND RELATED CONCEPTS

Courts and commentators alike have expressed concern about expansive application of the defraud conspiracy and § 7212, as well as its Title 18 obstruction counterparts. Various stated, the concern is that without some limitation, the statutory text does not give the citizen fair notice of the crime nor the courts or the public any assurance that Congress intended to criminalize the conduct before the court. Moreover, the prosecutor who has considerable discretion to charge has no real standard other than his or her own instinct in choosing targets to investigate and charge. However it is expressed, these concerns are the basis for the rule of lenity and related concepts.

The Supreme Court recently summarized the rule of lenity and its basis as follows:

The rule of lenity<sup>455</sup> requires ambiguous criminal laws to be interpreted in favor of the defendants subjected to them.<sup>456</sup> This venerable rule not only vindicates the fundamental principle that no citizen should be held accountable for a violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed. It also places the weight of inertia upon the party that can best induce Congress to speak more clearly and keeps courts from making criminal law in Congress's stead.<sup>457</sup>

---

455. For a good, recent general discussion of the rule of lenity, see *The New Rule of Lenity*, *supra* note 135, at 2432.

456. For purposes of conceptual analysis in the larger landscape of executive branch interpretation of ambiguous statutory text after *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778 (1984), the rule of lenity and the related avoidance canon may be described as an "anti-deference" regime "which invokes a presumption against the agency interpretation in criminal cases." William N. Eskridge & Lauren N. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretations from Chevron to Hamdan*, 96 GEO. L. J. 1083, 1098, 1115-17, 1166 (2008). The avoidance canon is "the presumption or rule that, when a statute is ambiguous and one interpretation would present serious constitutional difficulties, the Court should avoid those difficulties by choosing the clearly constitutional alternative interpretation." *Id.* at 1115.

457. *United States v. Santos*, 128 S. Ct. 2020, 2025 (2008) (citations omitted).

A related, but more subtle theme, justifying the rule of lenity is the interface of overbroad statutes and courts' traditional deference to so-called prosecutorial discretion. Although not in this particular context, Justice Jackson wisely observed:

[O]ne of the greatest difficulties of the position of prosecutor is that he must pick his cases, because no prosecutor can ever investigate all of the cases in which he receives complaints. . . . If the prosecutor is obliged to choose his case, it follows that he can choose his defendants. Therein is the most dangerous power of the prosecutor: that he will pick people that he thinks he should get, rather than cases that need to be prosecuted. With the law books filled with a great assortment of crimes, a prosecutor stands a fair chance of finding at least a technical violation of some act on the part of almost anyone. In such a case, it is not a question of discovering the commission of a crime and then looking for the man who has committed it, it is a question of picking the man and then searching the law books, or putting investigators to work, to pin some offense on him.<sup>458</sup>

The evil that lurks in overbroad criminal statutes may not really surface when the prosecutor only charges the really egregious cases. That, of course, is simply prosecutorial discretion that keeps the problem of overbreadth and uncertainty below the surface. But once courts dealing with egregious cases start make pronouncements broader than the case at hand (*Haas v. Henkel* and *United States v. Popkin* being classic examples), the prosecutors can then ratchet those statements into situations that give the citizen no notice that he is committing a crime and give courts no assurance that Congress intended to criminalize the conduct.<sup>459</sup> This is

---

458. *Morrison v. Olson*, 487 U.S. 654, 727-28, 108 S. Ct. 2597, 2638 (1988) (Scalia, J., dissenting) (quoting Attorney General Robert H. Jackson, Address Delivered at the Second Annual Conference of United States Attorneys (Apr. 1, 1940)).

459. This general concern of inadequate statutory standards that permit unprincipled prosecutorial discretion is a core concern that is addressed in this Article. This issue has long been raised in the context of the defraud conspiracy. Goldstein, *supra* note 277, at 134. Courts with similar visceral reactions often state the concern as one of unbounded prosecutorial discretion and have drawn lines, either statutory or common sense, to rein, accordingly, in what they perceive as prosecutorial indiscretion. See *Hammerschmidt v. United States*, 265 U.S. 182, 189, 44 S. Ct. 511, 512 (1924); see also, e.g., John Shepard Wiley, Jr., *Not Guilty by Reason of Blamelessness: Culpability in Federal Criminal Interpretation*, 85 VA. L. REV. 1021, 1041 (1999) (asserting that the Supreme Court's opinion in *Ratzlaf v. United States*, 510 U.S. 135, 114 S. Ct. 655 (1994) took a hard line against unchecked prosecutorial discretion: "[b]y demanding that the statute reach only conduct that is 'inevitably' or 'invariably' 'nefarious,' the *Ratzlaf* opinion effectively placed no trust in free-ranging prosecutorial discretion."); see also, Kristin E. Hickman, *Of Lenity, Chevron, and KPMG*, 26 VA. TAX REV. 905, 940-41 (2007) (citing *Wiley, supra*, at 1058-65). Dean Schizer of Columbia Law School has commented on the phenomenon that "criminal statutes . . . cover more conduct than is really culpable

prosecutorial discretion at its worst. Zealous prosecutors imagine crimes where they should not exist; the author does not feel comforted with the exercise of prosecutorial discretion that could easily become prosecutorial indiscretion.

The rule of lenity operates as a check, albeit an imperfect one, on this type of abuse by interpreting criminal statutes more narrowly so as to limit the dangers of prosecutorial indiscretion, while at the same time providing clear guides to the various constituencies that need to know when a criminal line has been crossed. Specifically with respect to the obstruction statutes, the Supreme Court applied the rule of lenity in *United States v. Aguilar*.<sup>460</sup> The application of the rule of lenity was critical to the Court's limitation on the potential reach of the obstruction statute.<sup>461</sup>

Again, in the context of an obstruction statute, in *Andersen*, the Supreme Court invoked the rule:

We have traditionally exercised restraint in assessing the reach of a federal criminal statute, both out of deference to the prerogatives of Congress, and out of concern that a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed.<sup>462</sup>

The application of the rule of lenity should constrain statutes where, as in the contexts discussed here, there is no consciousness of wrongdoing.<sup>463</sup> The fraud area generally is ripe for this type of analysis,<sup>464</sup> and certainly any of the various interpretations of the defraud conspiracy

---

and leave it to prosecutorial discretion to determine who is prosecuted." David M. Schizer, *Enlisting the Tax Bar*, 59 TAX L. REV. 331, 338 (2006).

460. *United States v. Aguilar*, 515 U.S. 593, 612, 115 S. Ct. 2357, 2368 (1995).

461. The majority opinion does not refer to the first sentence of this quotation as reflecting the rule of lenity, but, of course, that is what it is. See *The New Rule of Lenity*, *supra* note 135, at 2432 (citing *Ratzlaf*, another case related to the criminal tax arena also dealing with the requirement of willfulness). Justice Scalia's dissent in *Aguilar*, in which he was joined by Justices Kennedy and Thomas, asserts that this is an application of the rule of lenity. *Aguilar*, 515 U.S. at 612 (Scalia, J., dissenting). Further, there is no indication that this label was disputed by any of the justices. *Id.* Referring to *Aguilar* and *Ratzlaf*, it was recently noted that "[t]hese examples suggest that the rule led to readings that would not have been reached through ordinary statutory interpretation." *The New Rule of Lenity*, *supra* note 135, at 2435.

462. *Arthur Anderson L.L.P. v. U.S.*, 544 U.S. 698, 703, 125 S. Ct. 2129, 2134 (2005) (citing to *Aguilar*, 515 U.S. at 600)(citations and quotations omitted).

463. *The New Rule of Lenity*, *supra* note 135, at 2436; see also, Hickman, *supra* note 459, at 912-13.

464. Buell, *supra* note 304, at 2043 (concluding that the law of fraud generally, which certainly encompasses the defraud conspiracy and, by extension, obstruction, has managed these tensions by insisting upon a consciousness of wrongdoing as evidence by an "actor's observable awareness of wrongfulness in her actions"). With respect to the KPMG superseding indictment in particular, Professor Buell concluded that it is the government's claim, which is not expressly stated, that "defendants displayed a consciousness of wrongdoing . . . [that] belies any assertion that the defendants believed they were creatively but permissibly engineering around the tax code." *Id.* at 2003.

should connote conduct where there is a consciousness of wrongdoing. The obstruction context is also a classic instance where otherwise innocent conduct may be included, and, as in *Andersen*, consciousness of wrongdoing creates the appropriate boundary.

In addition to these concerns, there is the related concern that the crime being punished is really an intent crime. This concern was raised by Professor Goldstein in his seminal article on the defraud conspiracy. I quote the article extensively, because he says it so eloquently:

It has long been our boast that we class as crimes only those acts that are recognizably dangerous to the community. Never, the maxim has it, do we punish an evil intent alone. Though much of contemporary theory would strip “act” of any significance beyond that of “muscular contraction” and would focus instead upon the state of mind of the accused, the traditional conception of “act” continues its hold upon the imagination of men and upon legal doctrine. It expresses today, as it did three centuries ago, the feeling that the individual thinking evil thoughts must be protected from a state which may class him as a threat to its security. Rooted in skepticism about the ability either to know what passes through the minds of men or to predict whether antisocial behavior will follow from antisocial thoughts, the act requirement serves a number of closely-related objectives: it seeks to assure that the evil intent of the man branded a criminal has been expressed in a manner signifying harm to society; that there is no longer any substantial likelihood that he will be deterred by the threat of sanction; and that there has been an identifiable occurrence so that multiple prosecution and punishment may be minimized.

More than any other important crime, conspiracy impinges on the act requirement. It does so in ways significantly different from the other inchoate crimes. The law of attempts, for example, searches for the point at which criminal intent has proceeded beyond “preparatory” action and has reached the “commencement of the consummation” of the crime. The law of solicitations may substitute for this careful plotting of the line between intent and act a context which indicates the probability that aggressive statement will be transformed into harmful action. In contrast, conspiracy doctrine comes closest to making a state of mind the occasion for preventive action against those who threaten society but who have come nowhere near carrying out the threat. No effort is made to

find the point at which criminal intent is transformed into the beginnings of action dangerous to the community. Instead, the mystique of numbers, of combination, becomes the measure of danger. Even when a statute requires an overt act "to effect the object of the conspiracy," as in federal law, it may be a completely innocent one which indicates little or nothing of the kind of injury to society which the conspiracy seeks to bring about. The agreement to accomplish the prohibited purpose furnishes, without more, the basis for criminal liability.

If the prohibited purpose is clearly set forth in the conspiracy statute, the difficulties are solely those involved in applying the concept of an agreement. When, however, unlawful purpose is vaguely stated, the contours of "conspiracy" become ever more vague, and the dividing line between intent, now designated "purpose," and act, now termed "agreement," tends to disappear. Added to the problems inherent in a concept created to deal with potential antisocial action are new ones which arise when it is not at all clear what kind of antisocial action is threatened.

The federal conspiracy statute brings the problem into sharp relief. Though it purports to specify the purposes which transform mere agreements into crime — prohibiting conspiracy either "to commit any offense against the United States, or to defraud the United States" or any agency thereof in any manner or for any purpose' — it introduces through the phrase "defraud the United States" a concept every bit as shadowy as common law conspiracy. In combination, "conspiracy" and "defraud" have assumed such broad and imprecise proportions as to trench not only on the act requirement but also on the standards of fair trial and on constitutional prohibitions against vagueness and double jeopardy. Yet the difficulties of "conspiracy to defraud the United States" have gone virtually unrecognized by commentators and courts. The federal cases leave the impression that the large problems of defining the crime have long been resolved, with only procedural and tactical minutiae remaining for discussion. Nothing could be further from the truth. An examination first of "conspiracy" and then of "defraud the United States" will demonstrate their peculiar susceptibility to a kind of tactical manipulation which

shields from view very real infringements of basic values of our criminal law.<sup>465</sup>

These same concerns have also been raised with respect to the obstruction crimes, including § 7212,<sup>466</sup> for basically the same reasons. One author, after traversing basically the same ground as Professor Goldstein, concludes that the “corruptly” element has, in effect, been corrupted:

How can it be that Congress has invited judges and juries to delve into the defendant’s psychology to determine his motive and to apply their own notions of what is “evil” or “improper” to judge his actions? How can it be that judges have decided that an “evil” or “improper” motive can convert an otherwise blameless act into something that warrants jail time? How can it be that courts are unable to arrive at a uniform and reasonably specific meaning for the word “corruptly” in § 1503 given that this one word separates entirely legal conduct from conduct that could send one away for ten years? . . . . My belief is that there are no satisfactory answers to these questions, and that the American public deserves better.<sup>467</sup>

In short, in the context here presented, audit avoidance, the questions of fair notice of criminality with resulting consciousness of wrongdoing and clear statement of the congressional will in the sparse and uninformative statutory terms raise substantial constitutional questions. Those questions can be mitigated – but not eliminated altogether – by strict requirement of the dishonesty element imposed on the defraud conspiracy by the Supreme Court in *Hammerschmidt*<sup>468</sup> and the parallel requirements of the obstruction statute. Only then will the citizen be put on fair notice and have the requisite consciousness of wrongdoing and courts will be comfortable that there is sufficient certainty of cognizable societal misbehavior of the types that can comfortably fit the text in the criminal statutes. Better still, it seems to me, the courts could impose the equivalent of a willfulness requirement – at least in terms of consciousness of violating the law – as some courts already seem to do when they are focused on the dangers of a broader reading of the defraud conspiracy and obstruction provisions.

In addition, other methods are available and have been used to mitigate the potential that conduct never intended to be criminalized is swept up in the net of these overbroad statements as to the scope of the

---

465. Goldstein, *supra* note 277, at 405-09.

466. I.R.C. § 7212 (2006).

467. O’Sullivan, *supra* note 105, at 702 (discussing the “corruptly” requirement of § 1503).

468. *Hammerschmidt*, *supra* note 119.

obstruction provisions. *Aguilar* is a classic example. The Court and the court of appeals whose nexus requirement it approved were patently concerned about the scope of the focal obstruction statute, § 1503. In my view, the Court did not strain the purpose of the statute to impose a nexus requirement, but it did strain to find that there was no nexus.<sup>469</sup> Although there appears to have been a failure of proof on the issue, the FBI agents likely were assisting the attorney in the grand jury investigation under Rule 6(e)(3)(B). Such investigative assistants often participate in the basic investigative legwork and then appear before the grand jury to present at least the prosecuting attorney's view of the disparate strains of evidence that were developed in the investigation. The investigating assistant's presentation will and certainly could be influenced by the various evidence he or she has gathered, including any false statements any witness, such as Aguilar, has made. I think it is myopic to think that a knowledgeable witness – including Aguilar, a U.S. district judge who certainly had the knowledge as to how grand juries work – would not have known this and, had he known the FBI agents were assisting the prosecutor for the grand jury, the requisite nexus is inescapable. But, the decision is silent as to the role the FBI agents were serving, and that perhaps is the key the understanding the case. If failure of proof as to the FBI agents' role is not the explanation, then it appears that the majority strained mightily to avoid even a natural reading of the obstruction statute. The point I make here is that in adopting the nexus requirement and applying it stringently, the Court sought, in its words, to put protective “metes and bounds on the very broad language of the catchall provision [the Omnibus Clause].”<sup>470</sup>

A similar role could be served by a materiality limitation on all of the obstruction statutes. Materiality is the stuff of everyday life whereby mere trifles in context should not affect important decisions. The criminal statutes and the obstruction statutes are a hodge podge of statutes, only some of which explicitly impose a materiality requirement and others of which are interpreted to include a materiality requirement.<sup>471</sup>

---

469. U.S. v. Aguilar, 515 U.S. 593, 600, 115 S. Ct. 2357, 2362 (1995).

470. *Id.* at 599.

471. Podgor, *supra* note 108, at 597. In the tax arena, where a tax due and owing is an element of the crime (§ 7201, evasion) or where necessary to prove the crime (*e.g.*, § 7206(1) or tax perjury (*see* Boulware v. United States, 128 S. Ct. 1168, 1178 & n.9 (2008))), an unresolved question is whether the tax due and owing must be material (or substantial, which means the same in this context). *Compare* United States v. Helmsley, 941 F.2d 71, 83-84 (1991) (“We have also required a showing that the deficiency was substantial.”), *with* United States v. Daniels, 387 F.3d 636, 639-41 (7th Cir. 2004) (holding otherwise, and discussing other interpretations). Of course, materiality or substantiality in the tax due and owing plays a very practical role in curbing overbroad applications of the tax crimes. Unless a lot of tax is involved, juries may not convict and the government will be unable to obtain a significant incarceration sentence, which is important to its prosecution priorities for tax crimes. In the latter regard, even with the advisory use of the Sentencing Guidelines in this post-*Booker* world, the Guidelines will practically set the cap on what a court will do, because sentencing in tax cases rarely exceeds the Guidelines ranges, and the Guidelines with no or little tax due will not indicate incarceration as a reasonable sentence.

Some have argued for a materiality requirement for the obstruction statutes as a proper limit of its otherwise broad, even too broad, application.<sup>472</sup> I think such a requirement may already be there, although not expressly articulated. *Aguilar's* nexus requirement arguably is at least related to a materiality requirement, although I recognize that it is conceptually different. More directly on point, however, is *Aguilar's* express reaffirmation that, “as in *Pettibone*, if the defendant lacks knowledge that his actions are likely to affect the judicial proceeding, he lacks the requisite intent to obstruct.”<sup>473</sup> The defendant must have “knowledge” of a likely effect on the judicial proceeding. Now, knowledge can mean different things in different contexts and sometimes includes reason to know (including deliberate ignorance). However, given the context of *Aguilar*, where he was knowledgeable of the process even if it was not proven that he knew precisely which investigation the FBI agents were conducting, perhaps reason to know is not enough.<sup>474</sup> The government must prove there was an actual intent to obstruct a known proceeding, which is the classic way of describing *Aguilar* and its predecessor, *Pettibone*.<sup>475</sup>

#### VIII. CONCLUSION

Trying to bring rationality to the topic is difficult, which is the problem. Criminal statutes are supposed to guide the citizen in conforming his or her behavior to the law's commands, constrain the government in selecting subjects and targets to investigate and prosecute so that prosecutorial discretion has recognizable boundaries, and guide judges and juries in applying the law to specific facts. At a minimum, that guidance should be articulable to all of these constituencies and provide the critical societal function of weeding the criminal from the noncriminal.

I have presented in the online appendix to this Article a series of examples, each of which includes some intent to lower the audit profile and thereby affect how the IRS might conduct its business with respect to the transaction, where the actual conduct is otherwise legal and there are no dishonest statements or actions and, certainly, on the faces of the examples, no consciousness of wrongdoing. Some of the examples are garden variety tax practice as to which, I think, no citizen (whether taxpayer or tax advisor), no reasonable prosecutor<sup>476</sup> and no reasonable court or jury would deem appropriate for criminal sanction, whether under the tax obstruction

---

472. See Podgor, *supra* note 108, at 598.

473. *United States v. Aguilar*, 515 U.S. 593, 599, 115 S. Ct. 2357, 2362 (1995); see also *id.* at 601-02 (commenting that its interpretation “makes conduct punishable where the defendant acts with an intent to obstruct justice, and in a manner that is likely to obstruct justice, but is foiled in some way”).

474. *Id.* at 596.

475. *Id.* at 599; *Pettibone v. United States*, 148 U.S. 197, 205-06, 13 S.Ct. 542, 546 (1893).

476. This is not an oxymoron. Some do exist.



statute or the defraud conspiracy statute or any other the other myriad of potentially overlapping criminal statutes. Some of the examples are more extreme – they just hit the gut with more force than those less extreme which may not hit the gut at all. I have presented one of the more extreme examples which has hit the government's gut in *Stein*.<sup>477</sup> The problem is that there is no articulable basis for distinguishing among these examples. Hitting someone's gut is not an articulable standard.

In the audit avoidance context specifically, (1) most taxpayers perceive it as their right and most practitioners as their duty to advise the taxpayer that the law does not require them to waive red flags before the IRS saying "Audit Me", and (2) most taxpayers and tax practitioners think that they can take some action that may lower the audit profile, so long as they did not do it in an illegal or dishonest way. How in any principled way can taxpayers and practitioners who daily and easily conform their conduct to avoid the shoals of willfulness for tax crimes similarly discern where the line is drawn for proper and improper audit avoidance?

The key, I think, is to interpret these statutes to require consciousness of wrongdoing and, at a minimum in the context addressed here, dishonest conduct of the type that would give fair notice to all constituencies that there is a line that can be articulated and intentionally crossed. Every actor is conscious of wrongdoing in the lie that affects or potentially affects tax administration, just as the lie that affects or potentially affects the actions of other executive branches, the judicial branch, and the legislative branch has crossed the line. The lie is the minimum standard expressly announced for the defraud conspiracy in *Hammerschmidt* and at the core of the obstruction cases, even when not articulated expressly. In the language I quoted earlier, the tax obstruction case must be about "lying, cheating or stealing," or, in the language of the Enron prosecutor, the case must be about "lies and choices."<sup>478</sup>

---

477. See *United States v. Stein*, 440 F. Supp. 2d 315, 319 (S.D.N.Y. 2006).

478. Hueston, *supra* note 27, at 207 (emphasis added) (quotations omitted).

# TAX OBSTRUCTION CRIMES: IS MAKING THE IRS’S JOB HARDER ENOUGH?

## ONLINE APPENDIX\*

*By John A. Townsend*

I.	EXAMPLE 1: CHOOSING THE STANDARD DEDUCTION WHEN ITEMIZED DEDUCTIONS ARE LARGER. ....	A-2
II.	EXAMPLE 2: CLAIMING FEWER DEDUCTIONS THAN OTHERWISE AVAILABLE. ....	A-2
III.	EXAMPLE 3: VARIATION: CLAIMING FEWER CHARITABLE DEDUCTIONS. ....	A-3
IV.	EXAMPLE 4: MAKING THE AMOUNT OF CHARITABLE DEDUCTIONS BASED ON AUDIT FACTORS. ....	A-3
V.	EXAMPLE 5: CONFORMING DEDUCTIONS TO IRS AUDIT MODELS. ....	A-4
VI.	EXAMPLE 6: FOLLOW THE FORMS STRATEGY. ....	A-4
VII.	EXAMPLE 7: PLANNING RETURN POSITIONS BASED ON THE TAXPAYER CIVIL PENALTY RULES. ....	A-4
VIII.	EXAMPLE 8: SAME EXAMPLE WITH PREPARER PENALTY RULES IN PLAY. ....	A-5
IX.	EXAMPLE 9: FAILURE TO DISCLOSE WHERE EVEN A CIVIL PENALTY WOULD NOT APPLY. ....	A-5
X.	EXAMPLE 10: DRAFTING RETURN DISCLOSURE TO LOWER THE AUDIT PROFILE. ....	A-6
XI.	EXAMPLE 11: FILING A PAPER RETURN TO EXPLOIT IRS INEFFICIENCIES. ....	A-7
XII.	EXAMPLE 12: INCORPORATING. ....	A-7
XIII.	EXAMPLE 13: FILING A RETURN ON EXTENSION. ....	A-7
XIV.	EXAMPLE 14: FILING A RETURN THAT INCORRECTLY STATES THE ECONOMIC POSITION OF THE TAXPAYER. ....	A-8
XV.	EXAMPLE 15: RESISTING IN AN AUDIT. ....	A-10
XVI.	EXAMPLE 16: NONCOMPLIANCE WITH SUMMONS. ....	A-10
XVII.	EXAMPLE 17: NONCOMPLIANCE WITH SUMMONS (PART 2). ....	A-11
XVIII.	EXAMPLE 18: VARIATION ON RESISTING AN AUDIT. ....	A-11

---

\* This Appendix is an unpublished, online supplement referenced extensively in the following article: John A. Townsend, *Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough?*, 9 HOUS. BUS. & TAX. L.J. \_\_ (2009).

XIX. EXAMPLE 19: STRUCTURING TRANSACTIONS FOR LESS VISIBILITY ON AUDIT.....	A-12
XX. EXAMPLE 20: ACTION TO DELAY VIA U.S. BANK. ....	A-13
XXI. EXAMPLE 21: ACTION TO DELAY VIA FOREIGN BANK. ....	A-14
XXII. EXAMPLE 22: TAKING A DEDUCTION AS SCHEDULE C RATHER THAN SCHEDULE A. ....	A-15
XXIII. EXAMPLE 23: TAKING AN NOL CARRYOVER TO A LATER YEAR. ....	A-15
XXIV. EXAMPLE 24: DECLINING TO AMEND A TAX RETURN. ....	A-16
XXV. EXAMPLE 25: MANIPULATING THE SYSTEM.....	A-17
XXVI. EXAMPLE 26: STAGING A VOLUNTARY DISCLOSURE.....	A-18
XXVII. CONCLUSION. ....	A-20

These examples illustrate anecdotally the range of audit avoidance conduct – i.e., the intent to lower the audit profile coupled with some legal – even morally neutral objective – conduct.

#### I. EXAMPLE 1: CHOOSING THE STANDARD DEDUCTION WHEN ITEMIZED DEDUCTIONS ARE LARGER.

A taxpayer is advised by his return preparer that returns with itemized deductions are more likely to be audited than returns claiming the standard deduction. Knowing that his client has had a bad experience with a “no-change” audit<sup>1</sup> that was a hassle and expensive, the preparer recommends that the taxpayer consider electing the standard deduction. Preferring to avoid an audit or at least lower the chances of an audit, the taxpayer accepts the recommendation and directs his return preparer to elect the standard deduction even though his deductions, if itemized, would produce a lesser tax liability. The return is prepared and filed with the standard deduction.

#### II. EXAMPLE 2: CLAIMING FEWER DEDUCTIONS THAN OTHERWISE AVAILABLE.

A taxpayer with large Schedules A and C deductions is advised by the return preparer that the amount of the deductions being relatively large and aberrational will almost certainly flag the return for audit. The return preparer advises that the IRS has a computer model called the Discriminate Index Function (“DIF”) used to test for aberrational patterns that might justify an audit. The return preparer does not have the model behind the DIF but imagines that it would pick up this return because of the aberrational deductions which he thinks are proper, but an audit would be costly and distracting for this taxpayer. They accordingly cut back the

---

1. A no change audit is one that results in the IRS making no changes to the return.

quantum of the deductions in order to minimize the audit risk.<sup>2</sup> The return preparer finalizes and the taxpayer files the return with the reduced deductions.

### III. EXAMPLE 3: VARIATION: CLAIMING FEWER CHARITABLE DEDUCTIONS.

This is a variation on Examples 1 and 2 of foregoing deductions. You are a business man – a generous business man – who prefers to do your own return. You made substantial charitable contributions during the year, all of which are deductible. You buy TurboTax. When you input your tax data into the TurboTax program, it raises an “audit flag” and provides data regarding averages which cautions that your contributions are substantially above the average for taxpayers with a comparable tax profile. TurboTax designs its audit flags and averages to caution taxpayers that they may be increasing their audit profile by claiming benefits in excess of the averages.<sup>3</sup> You also review the Turbo Tax publisher’s web site on avoiding audits.<sup>4</sup> Indeed, in the 2007 iteration of TurboTax, the IRS has a feature called “Audit Risk Meter” advertised to “Help you reduce risk of audit.”<sup>5</sup> Based on these various TurboTax offerings, you scale back your claims of charitable contributions.

### IV. EXAMPLE 4: MAKING THE AMOUNT OF CHARITABLE DEDUCTIONS BASED ON AUDIT FACTORS.

Same facts as Example 3, but the taxpayer decides next year that he will make charitable contributions that are lower than TurboTax’s flags and averages showed in preparing his return for last year. He clearly shapes his actions – less charitable contributions – and resulting return reporting position to lower his audit profile.

---

2. This example is inspired by James Edward Maule, *No Thanks, Uncle Sam, You Can Keep Your Tax Break*, 31 SETON HALL LEGIS. J. 81 (2006). The author explores the issue of whether the taxpayer can decline to take deductions the taxpayer is otherwise entitled to take on several grounds, including the perception that more deductions than claimed would higher the audit profile.

3. For similar mass distributed techniques to play the audit lottery by avoiding audit, one need only Google “avoid audit tax” or some such iteration of the key words. The results are a number of claims by tax whackos and marginally credible sources, but some are by recognized publications and tax experts. See e.g., Tom Herman, *How to Avoid Getting Audited: IRS Ramps Up Scrutiny Of High-Income Groups; Red-Flag Deductions*, WALL ST. J., Apr. 7, 2007, (<http://online.wsj.com/article/SB117589697192162590-search.html?KEYWORDS=avoid+audit&COLLECTION=wsjie/6month>). Are they recommending criminal conduct, and more directly in point do they and the target persons who engage in audit avoidance engage in tax obstruction or a *Klein* conspiracy?

4. See <http://www.quicken.com/cms/viewers/article/taxes/6206> (last visited Apr. 7, 2007).

5. See <http://turbotax.intuit.com/personal-taxes/online/compare.jsp> (last visited July 7, 2008).

## V. EXAMPLE 5: CONFORMING DEDUCTIONS TO IRS AUDIT MODELS.

Professor Amir D. Aczel is a statistician with an intense interest in taxes as a result of suffering, he feels, an audit from hell. He built a statistical model that emulates the IRS's computer modeling score – referred to in the IRS and tax aficionados as the “DIF score” (or some variation) and has published a book about it titled Amir D. Aczel, *How to Beat the I.R.S. at Its Own Game: Strategies to Avoid - And Fight - An Audit* (Four Walls Eight Windows 1995).<sup>6</sup> And his statistical technique has been widely described – e.g. in the New York Times.<sup>7</sup> The book and the articles the book or the author has generated tell the author's techniques for avoiding audits. Some readers have shaped their planning and return reporting around the information provided by Dr. Aczel.

## VI. EXAMPLE 6: FOLLOW THE FORMS STRATEGY.

The Wall Street Journal “Wealth Report” for January 30, 2008 published some simple strategies designed to help “a rich person duck an audit.”<sup>8</sup> These, of course, are all facially legal strategies designed to lessen the risk of an audit. The strategies include (1) keep the tax landscape of artificial entities (S Corps, trusts and partnerships) relatively simple; complexity invites scrutiny; (2) avoid radical year to year changes which also invite scrutiny; and (3) “follow the forms” meaning that, even if you receive a Form 1099 or K1 that you “think may be wrong,” just “suck it up” and report consistently rather than creating a ruckus that might invite broader scrutiny.<sup>9</sup>

## VII. EXAMPLE 7: PLANNING RETURN POSITIONS BASED ON THE TAXPAYER CIVIL PENALTY RULES.

The taxpayer engaged in a transaction that is not a tax shelter. The tax preparer advises the taxpayer that the favorable return reporting position the taxpayer desires to take in reporting the transaction (i) has substantial authority<sup>10</sup> but and (ii) is not more likely than not to prevail. The preparer

---

6. On Amazon at [www.amazon.com/Beat-I-R-S-Game-Avoid-Fight/dp/1568580487](http://www.amazon.com/Beat-I-R-S-Game-Avoid-Fight/dp/1568580487). Professor Aczel may have an ax to grind because of his perception of inappropriate behavior from an IRS agent, but he is a credible statistician. See [http://en.wikipedia.org/wiki/Amir\\_Aczel](http://en.wikipedia.org/wiki/Amir_Aczel).

7. David Cay Johnston, *Your Taxes: Some New Tricks to Help Filers Avoid an Old Audit Trap*, N.Y. TIMES (Feb. 25, 1996) (Apr. 7, 2009, <http://query.nytimes.com/gst/fullpage.html?res=9500E1D71039F936A15751C0A960958260>).

8. See <http://blogs.wsj.com/wealth/2008/01/30/the-taxman-targets-the-rich> (last visited July 7, 2008),

9. Query whether this is consistent with the taxpayer's signing on the return that it is true, complete and correct even when, as posited, the taxpayer thinks the 1099 or K-1 is wrong. Does it matter whether the taxpayer thinks the error, if reported consistently, generates less tax?

10. Substantial authority is tax jargon from the civil accuracy related penalty rules. This and related jargon are the concepts that tell if return reporting positions are subject to civil penalties. The gradation of opinions has been described as: “non-frivolous = 10 percent or better; reasonable basis =

advises that the combination of these phenomena permit the taxpayer, in effect, to play a congressionally approved version of the audit lottery without disclosure and without penalty other than having to pay the tax and interest if the return is audited, if the agent spots the position, if the agent understands the position, if the agent is not dissuaded from making an adjustment, and if the taxpayer does not prevail in appeals or in litigation. After discussion of the risks and potential rewards, the taxpayer directs the tax preparer not to disclose the position, for Congress has directed that there be no penalty even if he does not increase the chance of audit by disclosing.

#### VIII. EXAMPLE 8: SAME EXAMPLE WITH PREPARER PENALTY RULES IN PLAY.

Use the same example, but now consider the preparer penalty in Section 6694(a), as amended in 2007,<sup>11</sup> which imposes a relatively light civil penalty (the greater of \$1,000 or 50% of the income with respect to the return) for a preparer who prepares a return with a return reporting position that would impose the accuracy related penalty on the taxpayer. Since the penalties are parallel in their application, the promoter will not even be subject to this relatively light promoter penalty even though the taxpayer at the preparer's direction intended to and did play the audit lottery and certainly intended to impede the IRS's ability to detect the aggressive return reporting position. Yet, Congress did not even impose the relatively light civil penalty upon either the taxpayer or the preparer; it is incomprehensible that Congress intended a far more draconian criminal penalty to apply.

#### IX. EXAMPLE 9: FAILURE TO DISCLOSE WHERE EVEN A CIVIL PENALTY WOULD NOT APPLY.

A taxpayer consults with his tax lawyer and his tax accountant regarding how to report a non tax-shelter transaction on his return. They both advise the taxpayer that it is more likely than not (i.e., over a 50%

---

20 to 25 percent; realistic possibility of success = 33 1/3 percent; substantial authority = something more than realistic possibility, perhaps 35 to 40 percent; more likely than not = something more than 50 percent; probable = 70 to 80 percent.” Burgess J.W. Raby and William L. Raby, *Painting the Accounting Practitioner Into a Tax Practice Corner*, 2005 TNT 178-4 (citation omitted); see generally Jasper L. Cummings, Jr. *The Range of Legal Tax Opinions with Emphasis on the “Should” Opinion*, 98 TAX NOTES 1125 (2003). Tax crimes require the intentional violation of a known legal duty, so that, by analogy, a non-frivolous or stronger position (i.e., at least reasonable basis) should be relegated solely to the civil penalty regime.

11. The amendment has an effective date for returns filed after May 25, 2007, but because of administrative concerns, the IRS has granted transitional relief so that the less onerous prior version of § 6694(a) applies through 2007. Notice 2007-54, 2007-27 I.R.B. 1. Prior to the amendment, the statute imposed a \$250 penalty for positions that had no realistic possibility of success and was either not disclosed or was frivolous.

chance) that the taxpayer will be taxed on the transaction and that there is not even substantial authority for that position. But, they both advise, there is a reasonable basis but nonfraudulent position that the taxpayer will not be taxed on the transaction. The tax lawyer and tax accountant advise further that, under the accuracy related penalty rules, the taxpayer would be subject to the substantial understatement accuracy penalty unless he discloses the transaction on his return. They advise the taxpayer that the penalty would be 20% if there is an audit and the position discovered and challenged. The taxpayer then asks what his chances of being audited are if he does not disclose. The tax lawyer and tax accountant advise that that is hard to quantify, but they believe the statistics indicate the audit rate is less than 1% overall and that almost certainly for his profile it is less than 2%. (The tax lawyer and the tax accountant did not take the audit rate into consideration in making their more likely than not and reasonable basis determinations.) The taxpayer then decides to forego disclosing the position, viewing his remote risk of having to pay a penalty as acceptable because of the substantial benefit if an audit is avoided. This decision not to disclose is solely a decision to influence the audit profile which they all imagine is increased if he discloses. With the blessings of the professionals, the tax accountant prepares the return, and the taxpayer signs it and files it. This type of conduct is not uncommon.<sup>12</sup> The implication from the fact that only a civil accuracy related penalty (and not a civil fraud penalty) would apply to this conduct is that the conduct itself is not fraudulent.

X. EXAMPLE 10: DRAFTING RETURN DISCLOSURE TO LOWER THE AUDIT PROFILE.

Same example, except that the taxpayer decides he is not willing to risk the penalty and therefore will make the disclosure. The tax lawyer then drafts the disclosure in a way that is not false but spins disclosure with the intent of lowering the risk that the IRS would audit the return. The spin is in effect a one-sided brief stating the case in the best light for the taxpayer and is intended to affect the audit profile. The tax accountant prepares the return (including the disclosure which incorporates the tax lawyer's "brief-type" disclosure on the issue). This type of conduct is not uncommon.<sup>13</sup>

---

12. I dare say most practitioners have done some variation of this theme. Cf. *Richard C. Stark, A Principled Approach To Collection And Accuracy-Related Penalties*, 91 TAX NOTES 115, 122 (Apr. 2, 2001) ("There are taxpayers, and probably every tax practitioner has encountered them and most of us have represented them, who deliberately take advantage of ambiguities in the code and who carefully do their penalty algebra in evaluating whether to disclose positions and how aggressively they should act.").

13. See *supra* note 12.

## XI. EXAMPLE 11: FILING A PAPER RETURN TO EXPLOIT IRS INEFFICIENCIES.

A tax preparer believes that the IRS is less capable of managing paper returns as efficiently as e-filed returns.<sup>14</sup> Accordingly, the preparer routinely recommends to his clients that they file paper returns rather than e-filed returns. All of his clients like the idea of using this technique to slow down or stop the IRS's ability to deal with their returns in any context, audit or otherwise.

## XII. EXAMPLE 12: INCORPORATING.

What if a taxpayer prefers, if possible, to avoid an audit for his business activities? He or she consults with his tax adviser who advises that, based on his understanding of Government statistics and his own anecdotal experience, the IRS audits Form 1040 Schedule C business operations more than they audit C Corporation business activities at the activity level of the taxpayer's business. The taxpayer then decides to incorporate to achieve what he thinks will be a lower audit profile, and the tax adviser then implements the incorporation (e.g., by preparing and filing articles of incorporation, making the necessary tax elections, etc.).<sup>15</sup> They certainly are guilty of no substantive tax offense because this example has no tax that is underpaid.<sup>16</sup>

## XIII. EXAMPLE 13: FILING A RETURN ON EXTENSION.

You and your tax return preparer have suffered through an expensive and time and energy consuming IRS audit of the taxpayer's year 1 return that resulted in "no change." The taxpayer and you believe the agent was inefficient and even abusive. The tax preparer has substantially completed your year 4 return for your signature on April 1 of year 5 and advises that, from the publications she has read as to the IRS's mechanisms for classifying returns for audit, she believes that taxpayers with your return

---

14. There is some indication that this belief would be consistent with the facts, but for purposes of this paper it does not matter whether the preparer's belief is true. It just matters that he believes it is true. However, for a GAO study consistent with the truth of this hypothetical belief, see GAO Report GAO-07-1160 titled *The Internal Revenue Service Can Improve Its Management of Paper Case Files* (September 2007).

15. One web site touts this audit avoidance technique as follows: If you are self-employed and file a Schedule C you automatically increase your audit chances. If you are self-employed the best way to avoid scrutiny from the IRS is to Incorporate or form a Limited Liability Company. Corporations and LLCs are audited far less frequently than individuals. It's also a good idea to be incorporated to help protect your personal assets in the event of a lawsuit. Another benefit is the fact that corporations are allowed more deductions with fewer limitations, and officers of the corporation can borrow money as well as take a salary - the borrowed money being tax free to the officer until converted into salary. See <http://www.totaltaxsolutions.com/avoid-audit.htm> (last visited Apr. 9, 2007).

16. Ah, but you say, what about § 7212 which has similar language ("impedes, or endeavors to obstruct or impede, the due administration of this title")? I discuss that section in the text below.



profile are more likely to be audited if the return is filed timely than if the return is filed during the 6 month extension period that can be routinely obtained by filing a Form 4868.<sup>17</sup> The preparer recommends that, although you could file a substantially complete and accurate return on time, there are some things that will not be available by that time to make it more complete and accurate, so that you could obtain the extension and then file the return on September 1 of year 2, which she thinks is close to the “sweet spot” for lowering your audit profile. You ask the preparer if it is legal, for, although you are an aggressive sort, you certainly don’t want to break the law. The preparer assures you it is legal – taxpayers are entitled to obtain an extension and are not required under the current form to state a reason for the extension. Preferring to lower the risk of audit any way you can legally, you direct the preparer to complete the return on September 1 of year 2 and you will come by her office to sign it on that date and have her mail it to the IRS. The return is then prepared, signed by both and mailed in on September 1 as planned. Can they be charged with tax obstruction or *Klein* conspiracy? Would it make any difference if a key deduction claimed on the return was an SEP deduction which may be claimed for SEP payments made prior to the filing of the return and you say that, although you are prepared to make the payment on April 1 if you were to file on April 1 you will just maintain the funds in an interest bearing account and make the SEP payment August 25, just before the return is prepared, signed and mailed to the IRS? If the preparer additionally advised you that she is giving her other important (translated high income, high fee) clients the same advice and most are following her advice, would that make you a co-conspirator with all the others who follow her advice?

#### XIV. EXAMPLE 14: FILING A RETURN THAT INCORRECTLY STATES THE ECONOMIC POSITION OF THE TAXPAYER.

This example is “inspired by” (in Hollywood language designed to alert you to the fact that it is not exactly the same as, but it close enough) a famous Supreme Court case where the Supreme Court famously asserted that form trumps economic substance for tax purposes. The case is *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978). There a bank obtained its corporate headquarters building by complex financing arrangement in which the bank appeared nominally as a tenant for a period of time, a corporation (the Frank Lyon Co.) owned by one of the bank’s directors

---

17. One web site explains this audit avoidance technique:

Due to budget constraints there is a limit to the number of returns selected for examination. Most returns are selected by the end of the summer, so file on the last extension possible (October 15th). By then it’s likely that the IRS has already reached its yearly quota of audited returns so your chances of an audit is reduced.

See <http://www.totaltaxsolutions.com/avoid-audit.htm> (last visited Apr. 9, 2007).

(Frank Lyon) appeared nominally as the owner for a period of time, and a financial institution appeared as the lender (the financial institution's role was not nominal) which looked, for all practical purposes solely to the bank to repay the loan. As is common in complex financial arrangements, however, the nominal positions of some of the parties were not their real economic positions. In economic substance, although nominally a tenant, the bank had the material economic attributes of ownership and the Frank Lyon Co. had the material economic attributes of a lender (in this case a second mortgage lender, because the financing institution was in the first mortgage position and Frank Lyon Co. ultimately only got his advance money returned with an interest factor). Yet, because of how the parties and their counsel papered the transaction, Frank Lyon Co. reported the transaction as if it were the owner of the building, thus achieving depreciation deductions for depreciation Frank Lyon Co. would never suffer – achieving a tax shelter effect by deferring income sheltered by the depreciation and converting it ultimately to capital gains when the bank took nominal title to the building which it was entitled to do simply by paying Frank Lyon Co. its principal and interest thereon. This was tax shelter nirvana, if it worked. The Eighth Circuit easily saw through the paper fog, but, amazingly, the Supreme Court said the complicated tax engineering by financial wizards and papersmiths worked for artificial reasons, giving hope to even the most brazen of tax shelter promoters ever since.<sup>18</sup> But, let's say for analysis purposes that Supreme Court had not rendered from Mount Olympus the flawed *Frank Lyon* decision and the Government wanted to pursue the players in that case, including their respective professionals, who papered Frank Lyon Co. as owner when he was in fact a lender and reported the transaction that way. Could the Government charge tax obstruction or *Klein* conspiracy on the theory that the nominal ownership position was an intent to deceive the IRS into believing Frank Lyon Co. was really the owner in substance?<sup>19</sup> Or even if the parties could dodge the bullet on that point because, under the facts, the bank regulators required the bank not appear as owner (even though it really was), could the Government say that tax obstruction or *Klein* conspiracy is still present because, even though the bank regulators required the charade for its purposes, there was no requirement that the charade encouraged or even blessed by the bank regulators be carried

---

18. There are a number of scholarly publications discussing this case, so I cite here only a few: Charles I. Kingson, *How Tax Thinks*, 37 SUFFOLK U. L. REV. 1031 (2004); Bernard Wolfman, *The Supreme Court in the Lyon's Den: A Failure of Judicial Process*, 66 CORNELL L. REV. 1075 (1981) (discussed in Kingson's article).

19. Just for fun, I plugged in the *Frank Lyon* facts into the major allegations of the *Stein* indictment. Fit like a charm. Except, of course, the Supreme Court blessed the deal. For those interested, the result of this fun exercise can be downloaded from my web site at: [www.tjtaxlaw.com/franklyon.pdf](http://www.tjtaxlaw.com/franklyon.pdf). Remember in reviewing the draft indictment that I am not alleging that anybody committed a crime; rather, what I am suggesting is that, given the Government's imagination, almost anybody can be charged with a crime.

forward into the tax return where, after all, substance and not form is said to prevail (sometimes)?<sup>20</sup> At least in this example, there is something false and deceptive really being done – papering Frank Lyon Co. or presenting Frank Lyon Co. on the return as owner when it is really a lender. But the Supreme Court blessed that false return presentation on the merits, so presumably the Government could not make any type of crime out of it unless tax obstruction or the *Klein* conspiracy is so expansive as to criminalize the mere intent to influence an audit with some act in furtherance thereof.

#### XV. EXAMPLE 15: RESISTING IN AN AUDIT.

A taxpayer is undergoing an audit. The taxpayer is represented by a lawyer. The IRS requests documents from the lawyer. The lawyer says that he does not respond to oral requests, hoping thereby to deflect the oral inquiry. (In the lawyer’s experience, sometimes agents will not bother to follow through with a written request.) The agent thinks about it off and on for a couple of weeks and issues an Information Document Request (Form 4564) (“IDR”) for the documents, asking that they be produced in 10 days. The lawyer advises the taxpayer that the IDR is not compulsory and that he need not respond. They agree to not respond, thinking that the agent might not pursue it further. The agent stewes for a few days after the 10<sup>th</sup> day when the documents are not produced, consults with his division attorney. After careful attention to needs of the audit, the agent and attorney draft and issue a comprehensive summons. Now, the lawyer advises the taxpayer that they have what he views might be compulsory process and must respond. You will note that the taxpayer’s and practitioner’s inaction to the first two steps – refusing the oral request and not complying with the IDR – had as their purpose the intent to impede the agent in the audit.

#### XVI. EXAMPLE 16: NONCOMPLIANCE WITH SUMMONS.

Take the same example (Example 14) except that the taxpayer, with the advice of the lawyer, then do not comply with the summons. The taxpayer and the lawyer live in Manhattan where the IRS audit is being conducted (the venue for the *Stein* case). Your attorney is aware of a truly remarkable decision in the Second Circuit – *Schulz v. I.R.S.*, 395 F.3d 463 (2d Cir. 2005), revised opinion 413 F.3d 297, 298-299 (2d Cir. 2005) – holding that you need not even comply with the summons unless ordered to do so in a subsequent summons enforcement proceeding in district court initiated by the Government. The lawyer advises the taxpayer that, based on his experience, the IRS often does not do the extra work to engage DOJ to file such a proceeding, but that in any event the filing and obtaining of a

---

20. Cf. *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979) (financial accounting, even if demanded for regulatory purposes, does not control tax accounting and reporting.

court order would take several months. The taxpayer desires to at least delay, and thus, he and the lawyer agree that there will be no production pursuant to the summons.

#### XVII.EXAMPLE 17: NONCOMPLIANCE WITH SUMMONS (PART 2).

Assume that the taxpayer is in a Circuit that does not buy into the *Schulz* position that the summons itself is not compulsory without a court order. The summons itself is viewed as a compulsory process even without a subsequent judicial order to comply. The taxpayer nevertheless resists the summons, requiring the IRS to pursue a summons enforcement proceeding in the district court. Or, the taxpayer files a motion to quash the summons in the district court. In either case, as is typically the case in such judicial contests to IRS summonses, the taxpayer has no possibility of avoiding the summons under the familiar *Powell*<sup>21</sup> standards and thus has no legitimate purpose in not originally complying with the summons. By failing to comply originally, the taxpayer has delayed the IRS audit and caused the institution of unnecessary judicial proceedings.

#### XVIII.EXAMPLE 18: VARIATION ON RESISTING AN AUDIT.

This example, a variation of the same theme, is from Professor Goldstein's seminal article:

Another class of problem is illustrated by A's direction to a bank official to keep A's bank records from an internal revenue agent who is trying to ascertain whether A owes additional taxes. Arguably, everyone has the right to keep his affairs private unless an affirmative duty of disclosure has been imposed through a valid exercise of governmental power. On the other hand, the tax authorities unquestionably are authorized to conduct investigations looking to the ascertainment of tax liability. If the "conspiracy to defraud" statute is said to guard that authority, the problem arises of how to draw a line between the area in which one may act with complete impunity in personal affairs and the area in which impunity ends and an obligation to act "honestly" begins. Is there "dishonest interference" with an internal revenue agent investigating tax liability when an individual refuses to make his bank records available to the agent? The response of one sensitive to a tradition that crimes must be clearly defined by the legislature in terms comprehensible to men of common intelligence is that such an act can constitute

---

21. *United States v. Powell*, 379 U.S. 48 (1964).

“dishonest interference” only if a statute or a properly promulgated regulation imposes an obligation to disclose to the revenue agent. The existence of an elaborate investigative machinery, provided by statute and empowering the agent to obtain a subpoena, would seem to negate by implication the obligation to make disclosure outside the formal setting.<sup>22</sup>

In other words, merely because a taxpayer and his lawyer decline to produce documents in which the IRS on audit is interested in order to slow down the audit or, if the agent does not follow through with a summons, impede it altogether, that does not make them guilty of a *Klein* conspiracy because the law did not impose an obligation that the taxpayer and his lawyer produce without the compulsion of a summons.<sup>23</sup>

#### XIX. EXAMPLE 19: STRUCTURING TRANSACTIONS FOR LESS VISIBILITY ON AUDIT.

This example is “inspired by” fact patterns in *Stein*, a *Klein* conspiracy case. An accounting firm introduces taxpayers with large capital gains to a strategy where the taxpayers will obtain offsetting losses which are not real economic losses. The strategy is, in common tax parlance, a tax shelter. The economic cost to the taxpayer will be an amount that, although temporarily invested, will ultimately be used for fees to the accounting and law firm that will give the taxpayers written opinions that the tax benefits will more likely than not prevail and to an investment firm that will make the temporary investments purportedly supporting the strategy. A key assumption in this “inspired by” example as I posit it is that the opinions are given and received in good faith – the accounting firm and law firm, as well as the taxpayer (after getting independent advice), believe that the tax benefits will more likely than not be sustained. (In the real case, the Government contests this assumption, but make the assumption for purposes of this analysis.) The accounting firm also advises the taxpayers that they can implement the strategy either at their individual level or through a grantor trust where the tax law requires that the results be reported by the taxpayers on their personal returns. The accounting firm advises the taxpayers that the accounting firm believes that the risks of audit are less if the grantor trust alternative is used. The accounting firm and the taxpayers specifically discuss the benefits of the lower audit profile – (1) even though they both believe in good faith that the claimed benefits will more likely than not be sustained if audited, they know that there is

---

22. Goldstein, *Conspiracy*, p. 432.

23. Indeed, it is unclear whether the mere issuance of a summons alone – without the enforcement of the summons – is itself a compulsory event. See *Schulz v. I.R.S.*, 395 F.3d 463 (2d Cir. 2005), clarified *Schulz v. IRS*, 413 F.3d 297, 298-299 (2d Cir. 2005).

some risk that the benefits will not be sustained if audited, so a lower audit profile gives them greater opportunity to sustain the benefits (the IRS would say that this gives them greater opportunity to play the audit lottery); and (2) even if ultimately sustained after audit and any resulting litigation, the transaction costs of responding to audit and litigation would be great and hence it is better to avoid such costs if possible. Based on this advice and with the intent to lower the audit profile, the taxpayers elect the grantor trust alternative. The taxpayers, with the assistance of the accounting firm, implement the grantor trust alternative and prepare and file trust and individual returns reporting the claimed results.

How is this fact pattern materially different from a prior one (Example 12) involving the incorporation to lower the audit profile? Have the accounting firm and taxpayers engaged in deceitful conduct within the intention of the defraud clause? At one level, they did take actions, otherwise clearly legal, which in their minds would lower the audit profile. Is it deceitful per se to take an action otherwise legal and not misleading if the parties intend thereby to lower the audit profile by exploiting the IRS's audit rates or audit priorities for varying types of taxpayers (in this case entities)?

In *Klein*, for example, the court catalogued acts of deceit including alteration of documents, false descriptions in accounting records as to the nature of payments, false statements on the income tax returns and the on and on.<sup>24</sup> The element of deceit was clearly present. But, it seems to me that in this Example 18 deceit is missing because the actions are legal, are reflected in clear and simple paper trail (not one needlessly complex to create a virtual fog via complexity alone), and there is no deceptive description of the legal steps taken. Should that be criminal? Does the *Klein* conspiracy fit?

#### XX. EXAMPLE 20: ACTION TO DELAY VIA U.S. BANK.

The taxpayer has an assessed unpaid tax liability. The taxpayer has given the IRS a financial statement identifying his two bank accounts. The taxpayer's accountant has advised that the IRS is likely to levy on those accounts. The taxpayer says that he will receive in a week a \$10,000 check from a customer, which he needs for other purposes and does not want it to be seized by IRS levy. The accountant advises that the taxpayer can set up a new account that the IRS will not know about (until it asks) and use it without fear of levy at least for the time being. The taxpayer, with the accountant's assistance, sets up the account at the accountant's bank which is across the street from the accountant's office. The account is set up in the taxpayer's name and with his social security number, but the taxpayer chooses a non-interest bearing account so that, he and the accountant

---

24. *Klein* catalogs these at p. 915.

believe, 1099s will not be sent to him and the account reported to the IRS with his SSN. Let's assume that the facts are clear that both the taxpayer and the accountant fully intend to identify this account if the IRS ever asks about it; they just don't want to volunteer the information. They thus realize that the account is just an interim measure to avoid a levy until the IRS asks. The court in *United States v. McGill*, 964 F.2d 222 (3d Cir. 1992), cert. denied 500 U.S. 1023 (1992), held that these bare facts would not constitute an affirmative act of evasion of payment to allow prosecution under § 7201. Under *Spies*,<sup>25</sup> an act otherwise legal can constitute the required affirmative act for tax evasion if it is deceptive. But, *McGill* held that setting up an account in the taxpayer's own name with no deception is not the required *Spies* affirmative act of evasion.<sup>26</sup> Can the Government do through the *Klein* conspiracy (or § 7212) that which the *McGill* court denied under § 7201?

#### XXI. EXAMPLE 21: ACTION TO DELAY VIA FOREIGN BANK.

Take the same facts as Example 20 except that the bank rather than being in the U.S. is in a foreign, tax haven jurisdiction. At the time the account is established, the facts are clear that the taxpayer intends to put the account beyond the IRS's ability to levy. Assume that the taxpayer intends to identify and properly report the account for all purposes, including the foreign bank account question on Schedule B of his 1040, the FBAR report, and any question or financial statement with the IRS. He is not hiding the account; he just imagines it is beyond the IRS's ability to levy. He has thus no reason to disguise the ownership of the bank account, so he puts in his own name and provides the foreign bank for its associated records his U.S. TIN (SSN) and passport number. Nothing about the titling or existence of the bank account is deceptive. It is, however, outside the U.S. jurisdiction so that the IRS is impaired in its ability to identify easily (short of asking the taxpayer) and levying the account. Would that be sufficient to support a *Klein* conspiracy? I think it would, both as to evasion and conspiracy. Keep in mind that, unlike *McGill*, the taxpayer has not put the asset beyond the IRS's ability to levy and thus enforce collection. Even without deception, an offshore deposit would still be evasion of payment and conspiracy to defeat the lawful functioning if done with the purpose of preventing the IRS practical ability to collect the tax

---

25. *Spies v. United States*, 317 U.S. 492 (1943).

26. Despite the thrust of the holding in *McGill*, a recent indictment in the Northern District of Texas charges tax evasion with one of the *Spies* required affirmative acts of evasion as "directing a person known to the Grand Jury not to deposit money into one of Hill's bank accounts because the deposited monies would be seized by the IRS." Indictment in *United States v. Hill, et al.* (N.D. TX - No. 3:07CR289-R (filed Sept. 27, 2007), at Count 26, subparagraph d. It is not clear from the allegation quoted whether the deposit was directed away from one account into another, so it is not clear that this indictment deals with the *McGill* situation. However, just reading the bare fact alleged, there is nothing to distinguish it from *McGill*.

due. The key difference is, of course, that it has been put beyond the power of the IRS. Perhaps this analysis would explain the bond iteration in the *Klein* litany discussed above (so that, if, in *Klein*, the conspirators had just moved the bonds from New York to Cleveland rather than to Canada, it would not be considered conspiracy).

#### XXII.EXAMPLE 22: TAKING A DEDUCTION AS SCHEDULE C RATHER THAN SCHEDULE A.

The taxpayer, a criminal defense lawyer, is a generous person. He regularly makes contributions to public charities equaling 10% of his substantial income. In year 5, however, he made public charity contributions equaling 40% of his income, 25% of which was a special contribution to his law school to help fund a criminal defense institute that will be named after the lawyer. In making the decision to contribute, the taxpayer was motivated both by his charitable instincts and by the public recognition that will permit his practice to grow and his hourly rate and nonrefundable retainer rate to grow. His accountant, who prepares his return, advises him that claiming a charitable deduction of 40% of his income will likely result in an audit, because as he understands the IRS computer based review, it will kick out such a large and statistically aberrational charitable contribution. The accountant advises that they can put a special disclosure on the return and the disclosure may give the IRS enough information to forego a full audit. But, he is not sure that will work. The accountant then advises that, given the relationship of that contribution to the taxpayer's business, the taxpayer can claim the deduction as a business expense, thus, while not exactly burying it among other large expenses on his Schedule C, still giving it less surface visibility in the IRS scoring models. In short, the accountant says that that return position, totally legal, will result in a lower audit profile. The taxpayer agrees, the accountant prepares the return accordingly, and the taxpayer signs and mails it in. Are they guilty of a *Klein* conspiracy?

#### XXIII.EXAMPLE 23: TAKING AN NOL CARRYOVER TO A LATER YEAR.

With his lawyer's and his CPA practitioner's advice, the taxpayer takes an aggressive position on the return. The position results in a net operating loss ("NOL") from the taxpayer's Schedule C activity. The taxpayer is a sophisticated businessman and has learned from his regular reading of the Wall Street Journal tax column that IRS audit rates are low. The taxpayer thus believes that the odds of an audit are low and confirms that with his lawyer and CPA, both of whom cautioned him that he should not consider the audit odds in taking the position and specifically advise him that the audit odds had not entered into their advice to take the position resulting in a net operating loss. The lawyer and the CPA do, however, then proceed to advise the taxpayer that he can take the NOL to an earlier



year, which would require a refund claim for the earlier year or carry it forward to a later year. Upon the taxpayer's request to be advised as to the risks of audit in each alternative, the lawyer and CPA advise that, although they do not know for sure, they believe that carrying the NOL back and the filing of a claim for refund is substantially more likely to generate an audit than carrying it forward and claiming a deduction on future original returns. They therefore recommend that the NOL be carried forward. Based on this advice, the taxpayer decides to carry the NOL forward and, pursuant to that decision, the lawyer directs the CPA to elect to carry the NOL forward.

#### XXIV.EXAMPLE 24: DECLINING TO AMEND A TAX RETURN.

The taxpayer has filed a nonfraudulent original year 1 return on April 15 of year 2 reporting \$500,000 gross income and tax of \$100,000. Among the gross income reported was \$9,500 of rental income. On February 1 of year 3, the taxpayer advises his return preparer that he omitted rental income of \$500 from the return, explaining that he recently discovered that this rental income has been improperly totaled because he had failed to cash one of the rent checks and was \$10,000 rather than \$9,500. The tax preparer dutifully prepares an amended return which reports that additional tax due with respect to the omitted income is about \$190. From an abundance of caution, the tax preparer advises the taxpayer that, although he is only generally aware of practitioner shop talk as to the IRS's scoring techniques for deciding whether to audit, he does believe that the IRS generally is more likely to audit amended returns than original returns. The taxpayer has not taken positions on the return other than this \$500 rental item that are, in the final analysis, subject to any adjustment, but the taxpayer does have audit phobia. The taxpayer therefore asks whether he is required to file the amended return. The tax preparer advises correctly that the Code and interpretations of the Code, including the Regulations, do not require an amended return. Often an amended return might be advisable to invoke the voluntary disclosure policy, but under the facts indicated the policy is irrelevant because there is no fraud and no likelihood that the IRS would even consider conducting a fraud investigation. The tax preparer therefore suggests the taxpayer not file an amended return since (1) he is not required to and (2) the audit exposure is increased if he does. The taxpayer then decides that he will not file an amended return and instructs his preparer to destroy the draft amended return. Are the taxpayer and the preparer guilty of the *Klein* conspiracy? (Set aside in answering the question whether there is an overt act of the conspiracy; focus just on whether they have the prohibited agreement.)

## XXV. EXAMPLE 25: MANIPULATING THE SYSTEM.

This example is a variation of this theme of manipulating the system to impair the IRS's ability to deal effectively with aggressive tax positions. The facts are taken from a recent case.<sup>27</sup> A decedent's estate had taken an extremely aggressive valuation position for a minority interest in a closely held corporation on an estate tax return. The estate's return position was that the value was \$1.75 million; the Tax Court ultimately found a value of \$13.5 million and the finding was sustained on appeal. The true valuation, thus determined, was almost 8 times what the estate reported on the return; stated another way, the estate reported a value of around 13% of the correct value as determined by the Tax Court. In originally filing the return, the estate clearly knew that the valuation position was aggressive, and took steps that it believed would make the position less visible to the IRS upon audit. The center of gravity for the estate and the corporation were in the New York City metropolitan area – the corporation was headquartered there, the estate was probated there, the executors lived there. Notwithstanding that center of gravity, the estate engaged a lawyer and an accountant, both living and practicing in Alaska, to value the company and to represent the estate for filing and for audit. The lawyer and accountant were marginally qualified, if qualified at all, to render a valuation on the corporation. The sole purpose of the estate's engagement of the Alaska lawyer and accountant was to try to smoke the marginal valuation past the IRS by moving the audit to the IRS Alaska office, having far less experience in such valuations than the IRS New York office. Although, as noted, the estate reported a value of about 13% of the correct value as determined by the Tax Court, the Tax Court nevertheless rejected the IRS attempt to apply the valuation misstatement penalty,<sup>28</sup> which imposes a penalty if the reported value is 25% or less of the correct value unless due to reasonable cause and good faith. The Second Circuit reversed the Tax Court on both aspects. First, the Court of Appeals remanded for a correction of a double counting issue in reaching the valuation. The IRS estimated that correcting the valuation calculation for the double counting would require a downward adjustment to value of \$1.2 million, so that the correct value after recalculation would be \$12.3 million. On that basis, the estate's initial reporting was about 14% of the corrected value. Second, since, even with a revaluation on remand, the value reported would still be less than 25% of the correct value, the Court of Appeals remanded for the Tax Court to determine specifically whether the estate reasonably and in good faith relied upon the Alaska lawyer and accountant for the valuation. Technically, although the manipulation of the audit process does not relate to the valuation itself, the Court of Appeals recited it prominently in

---

27. *Estate of Thompson v. Commissioner*, 499 F.3d 129 (2d Cir. 2007).

28. § 6662(a), g(1), (h)(1), (h)(2)(C) (2006).

determining to remand for reconsideration of the reasonableness and good faith issue. What is clear from this recitation of the facts is that the estate's executors and the lawyer attempted to manipulate the processing of the audit to achieve a result for an aggressive position that they might not otherwise have been able to obtain. They never stated a false fact (except as one might infer that such an aggressive valuation position is false, a step that neither court was asked to take); all they did was attempt to manipulate the system through a type of administrative arbitrage to move the audit to a more favorable forum within the IRS.<sup>29</sup> It is relevant that neither the Tax Court nor the Court of Appeals indicated any perception of illegality in the conduct, however much both of them disliked it. Nevertheless, was this a *Klein* conspiracy simply because, through the commonly agreed gambit, they attempted to impede or impair the normal functioning of the IRS?

#### XXVI.EXAMPLE 26: STAGING A VOLUNTARY DISCLOSURE.

The taxpayer filed fraudulent original returns for years 1, 2, 3 and 4 understating gross receipts and overstating deductions for his schedule C business. The IRS has not begun any audit or investigation of the returns. Unprompted by any external influence, he develops pangs of conscience and comes to you on January 15 of year 6 to help him clean up the mess. His principal concern is that he could go to jail. You confirm that, indeed, he could go to jail and advise that the criminal statute of limitations is 6 years, so that each of the years is still in play for criminal purposes.<sup>30</sup> You reach into your bag of tricks and come up with the venerable voluntary disclosure policy. The voluntary disclosure policy, generally, says that, if the taxpayer makes a voluntary disclosure the taxpayer will not be prosecuted.<sup>31</sup> Voluntary disclosure is usually made by filing nonfraudulent amended returns.<sup>32</sup> You advise him to file nonfraudulent amended returns

---

29. Practitioners use variations of this theme of forum shopping within the IRS and then in resulting litigation as routine components of the bag of tricks used to produce value for clients and thus fees for themselves.

30. Whether the Government could, in fact, charge 6 years is a different issue. The normal lead time it needs for the investigation of a tax crime might cause one or more of the early years to be barred by the statute of limitations.

31. The IRS policy is set forth in IRM 9.5.3.3.1.2.1 which has been recently revised and will be discussed later in this section. A good recent discussion of the policy may be found in Allen D. Madison, *An Analysis of the IRS's Voluntary Disclosure Policy*, 54 TAX LAW. 729 (2001). DOJ Tax has a parallel voluntary disclosure policy at CTM 2.00 (2001 ed.), quoting memorandum titled "Tax Division Voluntary Disclosure Policy," dated Feb. 17, 1993.

32. In the case of returns that have not been timely filed, the voluntary disclosure is often made by filing nonfraudulent delinquent returns.

Voluntary disclosure is sometimes pursued by first having a discussion with IRS's Criminal Investigation ("CI") to determine whether, if the facts presented (with taxpayer identity anonymous) are as disclosed, the IRS will treat the disclosure under the voluntary disclosure policy. There might be circumstances where this avenue is pursued but, in most cases that I have observed, voluntary disclosure is pursued by filing nonfraudulent amended or delinquent returns.

for the years 1, 2, 3 and 4.<sup>33</sup> You advise that this policy solves only the criminal issue; the taxpayer could still be subject to a civil penalty. The two relevant civil penalties are the 75% civil fraud penalty and the 20% accuracy related penalty. The additional principal tax dollars and any penalty applied will bear interest from the date of the return. So, the “cost” of coming clean is going to be significant. However, you advise that a civil penalty parallel to the voluntary disclosure policy might avoid the civil tax penalties. That civil penalty parallel is the qualified amended return.<sup>34</sup> That concept, you advise, is not applicable with respect to fraudulent original returns.<sup>35</sup> Of course, the qualified amended return relief would not technically apply here because the original returns were in fact fraudulent.<sup>36</sup> However, you know that the Code is clear that the taxpayer does not self-assess any of the civil penalties; further, your experience is that, in qualifying for the voluntary disclosure policy, the taxpayer need do no more than file a true, correct and complete amended return without red-flagging to the IRS that it should assert the civil fraud penalty with respect to the return and be prepared to cooperate fully by opening the kimono in any resulting IRS audit or investigation. Your experience tells you, however, that the IRS is unlikely to follow through with any audit or investigation. The taxpayer decides to pursue voluntary disclosure by filing amended returns for these years. You then advise the taxpayer that some practitioners believe that, if the amended returns are not filed at one time, but the filings are spread out over some period (such as, say, one

---

33. Some practitioners might advise filing less than 4 years amended returns. The advice is related to the normal lead time required for criminal tax investigations. I won't get into the factors that enter such advice here, but just note it in case the reader wants to follow through on that thread outside this article. I will say, however, that the Government lawyer who claims that, while a ranking official with the IRS, he authorized the *Stein* indictments also stated earlier while he was in private practice that he rarely recommended going beyond three past years, because the IRS will not be inclined to go back further either for civil or criminal purposes. That lawyer is a friend – at least I count him as a friend. Let me see how I can state this delicately – could an attorney making that type of advice and participating in its implementation be guilty of a *Klein* conspiracy or § 7212 and perhaps even an offense conspiracy? I see no principled basis for saying that this conduct is noncriminal but the other conduct discussed in the outline is. The conclusion I draw obviously is that none of this conduct is criminal, simply because it is not false or deceptive, although clearly the goal is to influence in the taxpayer's favor how the IRS goes about its business.

34. This concept is a creature of the Regulations. Treas. Reg. § 1.6664-2(c)(2) & (3). The taxpayer-friendly concept although not in the Code is likely the law under *Chevron* concepts (*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)) or, as a fallback, estoppel. The IRS is unlikely to disavow its own regulations. And, as with the voluntary disclosure policy, is unlikely to apply it too strictly because the qualified amended return is an overall net winner, so applying it too strictly would be self-defeating.

35. Treas. Reg. § 1.6664-2(c)(2).

36. For this reason, it would be inadvisable to do anything that would affirmatively claim that the taxpayer is entitled to qualified amended return treatment. The Regulations do not appear to require anything other than an amended return. So, on the return, the taxpayer does not have to waive the fraud red-flag and, in any ensuing investigation, the taxpayer and the practitioner have to be careful that any claims of the absence of fraud are consistent within tolerable ranges as to the truth, as permitted to be claimed in an adversarial context.

every week), the amended returns are less likely to draw service center attention and thus less likely (1) to generate an audit or investigation and (2) to generate assessment of a penalty (the thinking is that, since the return appears on its face to be a qualified amended return, the IRS will not assert a fraud penalty or an accuracy related penalty because it will be unlikely to expend resources auditing a return of that nature.<sup>37</sup> Obviously, the second leg (number 2) is dependent upon there not being an audit. So the planning to send in the amended returns is designed to affect the audit profile – at least in the imagination of the tax community – and lower the risk of the IRS asserting the civil fraud penalty that is otherwise due. You advise the taxpayer that this last gambit of stretching out the filing of returns is a bit troubling to you, but that it seems so prevalent in the tax community that you feel you must offer it as an option. He decides to do that. You therefore direct the accountant engaged to prepare the amended returns to complete the returns one year at a time one week apart and deliver each year's returns immediately upon completion so that it can be executed and filed.

## XXVII.CONCLUSION.

These examples illustrate the dangers of the Government's expansive imagination of the tax obstruction crimes in § 7212 and the *Klein* conspiracy. Most practitioners have engaged in some patterns of conduct that would be deemed not dissimilar to many of the examples. While as among the examples, there are differences in nuance, there is no principled difference between or among them that would provide guidance as to which of the transactions should be subject to a Government *Klein* conspiracy or tax obstruction charge and which ones would not. I hope that those of you who are in the trenches in the real world of tax practice will instinctively recoil at the notion that the legal conduct of the type described, even where the tax rules are clearly manipulated without falsity or misrepresentation, could be criminalized. But, more importantly for all of us, I hope also that the courts will recoil when the prosecutors exercise indiscretion in this area.

---

37. One practitioner advises that he advises clients to send in the amended returns in separate envelopes, even if filed the same day, because of experiences he has had where multiple returns sent in a single envelope got stapled together or even the bottom returns got thrown out by service center personnel not handling the enclosures properly. His concern is that, because of sloppy service center processing, the voluntary disclosure policy might not apply or, at a minimum a criminal investigation might kick in that gets diverted after the error is established. So, he thinks he assures better processing by separate envelopes for the returns. And, he did add that, oh, by the way, he imagines it is less likely that the IRS will put together the returns filed in separate envelopes than if they were in a single envelope, so there might be some favorable by-product of separate filing in that respect.