US Criminal Prosecution: Tax Evasion & Money Laundering

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US Criminal Prosecution: Tax Evasion & Money Laundering

Tax evasion and money laundering may result in criminal prosecution by the US Department of Justice for both tax crimes and "related sister felonies": wire fraud & mail fraud. When a taxpayer fails to pay taxes due (whether income, estate or gift taxes) and uses the "tax cheating" proceeds (which courts have ruled amount to "profits") to make investments or purchase assets the taxpayer is liable to be criminally prosecuted for multiple felonies:

1. Tax Crimes: Tax Evasion (5 year felony), obstruction of tax collection (3 year felony), file false tax returns (3 year felony);

2. Money Laundering : the use of proceeds from a Specified Unlawful Activity ("SUA"), in this case tax evasion, to purchase assets/investments which "transmutes" the illegal proceeds from tax cheating into new assets (20 year felony);

3. Sister felonies: Mail fraud (the use of the postal system to effectuate a scheme to defraud, 18 USC 1341, a 20 year felony) and wire fraud (the use of the telecommunications facilities to effectuate a scheme to defraud, 18 USC 1343, a 20 year felony). In the 2005 US Supreme Court Case, *Pasquantino* the "wire fraud" which triggered a felony conviction was the use of a telephone to make an inter-state telephone call.

For those US taxpayers who cheat on their taxes and then make investments they face 6 different federal felonies, which subjects them to up to 71 years in jail. If the taxpayer conspired with another party to impede the IRS collection of taxes it is known as a "Klein conspiracy" and under 18 USC 371 both parties face 5 years in jail for conspiracy to commit tax evasion.

Money Laundering

Money laundering may be linked to tax evasion. A violation of the money laundering statutes includes a financial transaction involving the proceeds of a specified unlawful activity (“SUA”) with the intent to either:

1. Promote that activity;

2. Violate IRC Sec. 7201 (which criminalizes willful attempts to evade tax);

3. Violate IRC Sec. 7206 (which criminalizes false and fraudulent statements made to the IRS).

The tax involved in the transaction (and which is avoided) may be any tax: i.e. income, employment, estate, gift and excise taxes (See: U.S. Dept. of Justice, Criminal Tax Manual, Chapter 25, 25.03(2)(a).

Under the money laundering statutes, the IRS is authorized to assess a penalty in an amount equal to the greater of:

1. The financial proceeds received from the fraudulent activity, or

2. $10,000 (under 18 U.S.C. Sec. 1956(b)), the authority is granted by statute to the U.S. not the IRS, and is enforced either by a civil penalty or a civil lawsuit.

Violations of statutes for:

1. Mail fraud;

2. Wire fraud;

3. Money laundering.

- are punishable by monetary penalties, civil and criminal forfeiture. (See 18 U.S.C. Sec. 981 (a)(1)(A) which permits property involved in a transaction that violates 18 U.S.C. Sec. 1956, 1957 and 1960 to be civilly forfeited).

Civil forfeiture statutes include:

1. 18 U.S.C. Sec. 1956, which outlaws the knowing and intentional transportation or transfer of monetary funds derived from specified criminal offenses. For Sec. 1956 violations, there must be an element of promotion, concealment or tax evasion;

2. 18 U.S.C. Sec. 1957, which penalizes spending transactions when the funds are contaminated by a criminal enterprise;

3. 18 U.S.C. Sec. 1960, which penalizes the unlicensed money transmitting business.

Under 18 U.S.C. Sec. 981(b)(2), seizures are made by warrant in the same manner as search warrants. Under 18 U.S.C. Sec. 981(b)(1), the burden of proof is by a preponderance of the evidence. The property may be seized under the authority of the Secretary of the Treasury when a tax crime is involved.

Under 18 U.S.C. Sec. 982(a)(1)(A), if the offense charged is a violation of the Money Laundering Control Act, and the underlying specified unlawful activity is mail or wire fraud, courts may order criminal forfeiture of funds involved in the activity on conviction.

The U.S. Dept. of Justice Tax Division policy requires U.S. attorneys to obtain Tax Division approval before bringing any and all criminal charges against a taxpayer involving a violation of the Internal Revenue Code. Absent specific approval, additional criminal charges for wire fraud, mail fraud and money laundering would not normally be included (U.S. Dept. of Justice Criminal Tax Manual, Chapter 25, 25.01). If the additional criminal charges are approved, the taxpayer risks having the trust assets seized or forfeited.

Regarding asset seizure, the U.S. government may seize assets pursuant to a violation of the money laundering laws. In addition, the IRS has authority for seizure and forfeiture under Title 26. Under IRC Sec. 7321, any property that is subject to forfeiture under any provision of Title 26 may be seized by the IRS.

IRC Sec. 7301 allows for the IRS to seize property that was removed in fraud of the Internal Revenue laws. IRC Sec. 7302 allows the IRS to seize property that was used in violation of the Internal Revenue laws.

Mail/Wire Fraud

If the U.S. taxpayer's tax noncompliance includes: tax evasion and transfer of the "tax evasion proceeds" to purchase assets by wire transfer or U.S. mail, the transfer of funds may be classified by the IRS/U.S. Dept. of Justice as wire fraud or mail fraud, both of which are "specified unlawful activities" under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957), the U.S. taxpayer may be criminally prosecuted for violation of the money laundering statutes.

In the U.S. "wire fraud" is governed under 18 U.S.C. Sec. 1343 which provides: "whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation affects a financial institution, such person shall be fined not more than $1M or imprisoned not more than 30 years, or both."

The wire fraud statute (18 U.S.C. 1343) forbids schemes to obtain "money or property" by fraud. If no property or money is involved, the statute does not reach the conduct in question.

The U.S. "Fraud Enforcement and Recovery Act" (S. 386), 94 DTR G-3, codified the definition of the term "proceeds" in the money laundering statute to make clear that the proceeds of specified unlawful activity includes the gross receipts of the illegal activity, not just the profits of the activity. The "Fraud Enforcement and Recovery Act" overruled the U.S. Supreme Court ruling in the *Santos* case (128 S.Ct. 2020 (2008)), defining proceeds as "net proceeds" (not gross proceeds, which Supreme Court decision limited the reach of money laundering statutes to "profitable crimes"), which was also held by the 11th Circuit in *Khahani,* 502 F.3d 1281, 1296-97 (CA-11, 2007) which stated: "proceeds does not contemplate profits or revenue indirectly derived from labor or from the failure to remit taxes".

The 3rd Circuit in *Yusuf* (536 F.3d 178 (CA-3, 2008) held that the government could use the mail fraud statute in support of an international money laundering charge. The *Yusuf* case dealt with a scheme to defraud the U.S. Virgin Islands out of a gross receipts tax. The tax at issue in this case was not an income tax, but a tax on a straight percentage of sales. In addition to holding that the retained taxes were the proceeds of mail fraud, the 3rd Circuit further held that the retained taxes amounted to profits.

The IRS and the U.S. Dept. of Justice have significant legal authority to treat domestic tax evasion as a predicate offense to money laundering.

<u>On 10/29/04, the Dept. of Justice Tax Division amended Tax Division Directive 128 so that domestic tax offenses may be charged as mail or wire fraud</u> (emphasis added). Tax offenses are predicate offenses for a money laundering violation include: state, federal or foreign taxes.

For example, a taxpayer who mails a false state income tax return may be a subject to both mail fraud (and tax evasion). See: <u>Helmsley</u>, 941 F.2d 71, 68 AFTR 2d 91-5272 (CA-2, 1991), <u>cert</u>. <u>den</u>. 502 U.S. 1091 (1992).

Tax Division Directive No. 128 permits the Dept. of Justice to bring mail fraud or wire fraud charges in tax-related schemes if:

1. There is a large loss related to fraud;

2. There is a significant benefit to bringing such charges.

Tax Division Directive No. 128 does not apply in routine tax prosecutions but does apply to fraud charges. If there is "significant benefit", fraud charges will be considered:

1. At the charging order stage to ensure that there is support for forfeiture of the proceeds of a scheme to defraud;

2. At trial, all relevant evidence will be admitted;

3. At sentencing, to ensure full restitution, promoters of tax schemes are particularly targeted [See USAM G-4.210].

The U.S. Dept. of Justice, Tax Division policy will not authorize prosecution for money laundering "where the effect would merely be to convert routine tax prosecutions into money laundering prosecutions, as the statute was not intended to provide a substitute for traditional Title 18 and Title 26 charges related to tax evasion, filing of false returns or tax fraud conspiracy" (U.S. Dept. of Justice Criminal Tax Manual, Ch. 25, 25.01). The U.S. government may seize taxpayer assets under either tax evasion or money laundering charges.

In Ianniello, 98 TC 165 (1992) taxpayers were convicted of mail fraud and tax evasion for $666,667 in restaurant profits that had been illegally skimmed. The IRS assessed a fraud penalty for failure to include skimmed profits in taxable income.

The taxpayers' defense was that the skimmed receipts were not income because they were forfeited to the government. The court held that the receipts were income: "A taxpayer obtains possession, custody and control of proceeds he acquires unlawfully, despite a statutory forfeiture provision that tests legal title to the proceeds in the United States, on the date he acquires such proceeds (See: Wood, 863 F.2d 417), 63 AFTR 2d 89-709 (CA-5, 1985); Gambino, 91 TC 826 (1988); Holt 69 TC 75 (1977); Bailey, TCM 1989-674, aff'd 929 F.2d 700 (CA-6, 1991).

The U.S. Supreme Court held: ("IRC Sec. 61 provides that gross income means all income from whatever source derived"). "Gross income includes all accessions to wealth, clearly realized and over which the taxpayers have complete dominion (James v. U.S. 213, 7 AFTR 2d 1361 (1961), quoting Glenshaw Glass Co., 348 U.S. 426, 47 AFTR 162 (1955).)

Tax evasion may expose U.S. taxpayers to additional crimes: money laundering, mail fraud and wire fraud, which can expose the taxpayer to violations of U.S. criminal law, forfeiture of assets, and exposure of counsel to violations of U.S./state criminal laws, IRS Circular 230 and claims for malpractice, when a client's assets are seized or forfeited.