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# Criminal Tax Bulletin

Department of Treasury  
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## SUPREME COURT CASES

### **Tactile Manipulation Constitutes An Illegal Search Despite Public Exposure Of Manipulated Items**

In *Bond v. United States*, 120 S. Ct. 1462 (2000), Bond attempted to carry a brick of methamphetamine in his carry-on bag on a Greyhound bus trip from California to Arkansas. While stopped at Sierra Blanca, Texas, border patrol agents performed a routine immigration check of all passengers. After all passengers' immigration documents had been checked, the agent proceeded towards the exit squeezing all soft carry-on bags as he passed. When he detected the brick in Bond's bag, he requested Bond's permission to open it. Bond granted the requested permission and upon opening the bag, the agent confirmed the brick was methamphetamine. Bond was indicted for conspiring to possess and possession with the intent to distribute methamphetamine in violation of 21 U.S.C. § 841. Bond moved to suppress the methamphetamine arguing the agent's search was illegal. Bond's motion was denied and he appealed. The district court found him guilty on both counts and the Fifth Circuit Court of Appeals affirmed.

On appeal, the government argued by exposing his bag to the public, Bond lost his reasonable expectation that his bag would not be physically manipulated. The government cited *California v. Ciraolo*, 476 U.S. 207 (1986) and *Florida v. Riley*, 488 U.S. 445 (1989), which dealt with aerial surveillance, in support of its proposition that matters open to public observation are not protected by the Fourth Amendment. Bond countered, although other passengers

had physical access to his bag, the agent manipulated his bag in a way other passengers would not.

The Court distinguished *Ciraolo* and *Riley* because they involved only visual and not tactile observation. The Court noted physically invasive inspection is more intrusive than visual inspection. Applying Fourth Amendment analysis, the Court found Bond's conduct exhibited a subjective expectation of privacy since Bond used an opaque bag and placed his bag in the bin directly above his seat. Also, the Court agreed Bond's subjective expectation of privacy is one society is prepared to recognize as reasonable since most passengers would not manipulate a bag in the way the agent had. Since the agent's manipulation of Bond's bag constituted a search under the Fourth Amendment analysis and since the search was non-consensual, the Court reversed the lower courts' holdings.

## TITLE 26 AND TITLE 26 RELATED CASES

### **Failure To Report "Ownership Interest" In Subchapter S Corporation Not Sufficient For Criminal Charge**

In *United States v. Pirro*, 212 F.3d 86 (2<sup>nd</sup> Cir. 2000), Pirro and his brother were charged in a 67 count indictment with, *inter alia*, conspiracy to impair the Internal Revenue Service, tax evasion, and filing false personal and corporate income tax returns, in violation of 18 U.S.C. § 371 and 26 U.S.C. §§ 7201 and 7206(1), respectively. All of the charges, except count 67, concerned the defendants' illegal deduction of various personal expenses as business expenses. The final count charged Pirro with violating § 7206(1) by failing to report on the 1992 federal tax return

of Distinctive Properties of Croton (“DPC”), an “S” corporation controlled by Pirro, the “ownership interest” of one of the alleged shareholders in DPC. In response to this count, Pirro filed a pretrial motion, pursuant to FED. R. CRIM. P. 12(b), challenging the legal sufficiency of the charge on grounds the government failed to allege in the indictment that the individual omitted from DPC’s tax return was indeed a shareholder in DPC. Pirro argued the individual was not a shareholder in DPC and, therefore, he did not violate a known legal duty, as required by § 7206(1), to report all of DPC’s shareholders. The district court, determining the issue to be a question of law and not fact, granted Pirro’s motion and ordered the language pertaining to the individual in question and his alleged “ownership interest” in DPC stricken from count 67.

On appeal, the government argued although the indictment failed to specifically allege the individual was a shareholder in DPC, it did allege enough facts to demonstrate the individual possessed an “ownership interest” and, therefore, was a *de facto* shareholder whose name should have been included on the return in question. The government conceded there was no statute or regulation that specifically stated “S” corporations were required to report “ownership interests” on their corporate tax returns. The government, however, urged the court to consider the numerous civil tax cases which have concluded the beneficial or *de facto* ownership of shares in a corporation is the controlling factor for tax purposes.

In affirming the district court’s dismissal of the allegations from the indictment, the Second Circuit agreed with the lower court’s finding that the applicable statutes and regulations, as well as the forms to be filed thereunder, refer only to shareholders and stock. Moreover, the statutes and regulations specifically relating to S corporations refer only to shareholders and to holding stock in “S” corporations. The court found nothing requiring the “ownership interest” of an individual in an S corporation to be reported. Accordingly, Pirro could not have violated a known legal duty by failing to report the individual’s alleged ownership interest on DPC’s corporate tax return.

### **Twice Convicted Individual Ineligible to Participate in Electronic Filing Program**

In *Sabat v. Internal Revenue Service*, 99-1715, 2000 U.S. Dist. LEXIS 3974 (W.D. Pa. Mar. 16, 2000), Sabat appealed the Service’s denial of his application to participate in the Service’s Form 1040 Electronic Filing Program for individual income tax returns. Sabat was arrested numerous times between 1982 and 1993, was convicted of rape and recklessly endangering another person

and he had served ten and one half years in state prison. The Service denied his application based on information received when conducting a routine suitability check which indicted conduct of a disreputable nature reflected by Sabat’s arrest record. Sabat appealed the denial of his application to all levels within the Service prior to seeking judicial relief. In all of his appeals, Sabat argued an arrest record does not establish disreputable conduct and challenged the manner in which the procedures for making a suitability determination were applied to him.

In response to Sabat’s judicial complaint, the Service filed a motion to dismiss under FED. R. CIV. P. 12(b)(6) arguing Sabat’s prior arrests and convictions reflect on his integrity. Further, the Service argued its determination was based on the fact Sabat’s arrest record is conduct of a disreputable nature and such conduct would reflect adversely on the Electronic Filing Program. The court concluded, under the circumstances, the Service’s determination was not arbitrary or capricious and, therefore, did not require Service reconsideration. Consequently, the court granted the Service’s motion to dismiss.

### **The Term “Tax Deficiency” Does Not Include Interest And Penalties For Purposes Of Section 7201**

In *United States v. Wright*, 211 F.3d 233 (5<sup>th</sup> Cir. 2000), Wright had an outstanding tax liability of \$419,000, not including penalties and interest, for tax years 1986-1988. In 1992, he submitted an offer in compromise and began paying \$5,000 a month until December 1994. During the pendency of the offer in compromise, Wright and his wife, with the assistance of their attorney and a friend, purchased a new home in the name of the friend. The Wrights gave their friend \$150,000 in cash for the purchase of a house. An amended offer in compromise was filed stating the Wrights sold their home because they could not afford the payments and were now renting. The new house was not listed in the amended offer and, ultimately, the offer was rejected because it failed to provide required additional information. Through seizures and voluntary payments, Wright paid \$490,000 toward his tax liability. The Wrights, their attorney and friend were convicted of conspiracy to defraud the Service pursuant to 18 U.S.C. § 371. Wright was also convicted of violating 26 U.S.C. § 7201 and his attorney was convicted of making false statements in violation of 18 U.S.C. § 1001.

On appeal, the defendants argued there was no underlying tax deficiency on which to predicate the conspiracy and evasion convictions. They contended Wright only owed interest and penalties and had paid off the \$419,000 tax

liability. The Fifth Circuit agreed § 7201 requires a tax deficiency and that interest and penalties are excluded from tax liability for purposes of § 7201. While § 7201 does not define “tax deficiency,” the court relied on its definition elsewhere in the Code -- as the amount by which the tax exceeds the tax reported on the return plus the amounts previously assessed. *See*, 26 U.S.C. § 6211. The court relied on the Sentencing Guidelines exclusion of interest and penalties in assessing the penalty for tax evasion to bolster its interpretation that interest and penalties are not part of a tax deficiency for § 7201 purposes. The court, however, concluded Wright failed to prove he owed no tax. Although his total payments exceeded the tax owed, the Service collected a substantial portion of the payments through seizure. The Service applied the seized amounts according to its normal procedure, which is to first extinguish the taxpayer's total tax, interest and penalties for the earliest years owed. Since the seized amounts were not first applied to his tax liability, Wright did have a tax deficiency. Consequently, the convictions were affirmed.

### **Case Republished**

The opinion previously reported as *United States v. Rivera*, 196 F.3d 144 (2<sup>nd</sup> Cir. 1999), which appeared in the March 2000, *Criminal Tax Bulletin*, has been withdrawn from the Bound Volume and republished at 201 F.3d 99.

## **PROCEDURE**

### **Thirty Day Filing Limitation Under The Hyde Amendment**

In *United States v. Ranger Electronic Communications, Inc.*, 210 F.3d 627 (6<sup>th</sup> Cir. 2000), Ranger was a foreign manufacturer of radio equipment indicted for importing banned radio equipment. The case was dismissed with prejudice after trial had begun. Four months after the dismissal, Ranger moved for attorney's fees under the Hyde Amendment -- allowing courts to award attorney's fees to prevailing criminal defendants where the government's litigating position is found to be vexatious, frivolous or in bad faith. The motion contended the government acted in bad faith by concealing *Brady* material, but that discovery of the government's failure to disclose this information did not occur until after the case was dismissed. The district court ultimately granted an award of \$40,106.74. *See*, *Criminal Tax Bulletin*, December 1998.

Under the Hyde Amendment, requests for attorney's fees are subject to the procedures and limitations used by civil litigants under the Equal Access to Justice Act (EAJA).

There are two provisions under the EAJA on which to base such an award -- subsections 2412(b) and 2412(d). Subsection (b) does not contain a filing deadline or other procedural requirements and subsection (d) contains numerous procedural requirements, including a requirement that applications be made within 30 days of final judgment. District courts have reached conflicting decisions as to how to give effect to the Hyde Amendment's incorporation of the procedures and limitations of the EAJA. *Compare, e.g., United States v. Gardner*, 23 F. Supp. 2d 1283, 1289 (N.D. Okla. 1998) and *United States v. Holland*, 34 F. Supp. 2d 346, 358-59 (E.D. Va. 1999). Here, the district court relied on *Holland* to make its award of attorney's fees in this case.

On appeal, a majority of the Sixth Circuit held the correct interpretation of the Hyde Amendment's incorporation of EAJA procedures and limitations requires application of those found in subsection (d). The court criticized the *Holland* court's interpretation because it did not give effect to the plain meaning of the Hyde Amendment or the policy behind it. Since the only procedural requirements in the EAJA are found in subsection (d), the court reasoned there is no basis to believe Congress did not intend such requirements to apply in criminal cases via the Amendment. Applying its interpretation to this case, the majority ruled the 30 day filing limitation in subsection (d) barred the defendant's claim for an award. Since the district court lacked jurisdiction over the application, the court reversed the district court's award.

### **Hyde Amendment**

In *United States v. Truesdale*, 211 F.3d 898 (5<sup>th</sup> Cir. 2000), the Fifth Circuit held the standard of proof under the Hyde Amendment, which authorizes an award of attorneys' fees and costs to a successful criminal defendant where the court finds the government's position was “vexatious, frivolous, or in bad faith,” is tougher than the standard adopted for fee awards in civil cases under the Equal Access to Justice Act (EAJA). A movant under the Hyde Amendment must prove more than the government's position was not substantially justified. In the instant case, Truesdale and his accomplice's federal gambling convictions were overturned in an earlier appeal on the basis the proof presented at trial did not support the specific charges alleged in the indictment. The defendants then moved for an award under the Hyde Amendment. This appeal stems from the district court's denial of their claim.

As a preliminary issue, the court also had to decide whether the defendants had timely filed their notice of appeal. The question which arose was whether appeals from Hyde Amendment rulings were governed by the 30 day deadline that applies in a civil case under FED. R. APP. P. 4(a) or

instead, by the 10 day deadline which applies in a criminal case under FED. R. APP. P. 4(b). The Fifth Circuit concluded a motion for attorneys' fees does not implicate the liberty interest of the accused. Instead, the interest it implicates is identical to those implicated by a motion for attorneys' fees under the EAJA. In each case, the movant is seeking an award of attorneys' fees based upon a litigating strategy that conflicts with notions of fair play. It, therefore, makes little sense that the time period for filing a notice of appeal should differ depending upon whether the cases was civil or criminal. Accordingly, the court held Rule 4(a)'s 30 day deadline was applicable to motions brought under the Hyde Amendment.

The Fifth Circuit then turned to the burden of proof and standard of proof which it again analyzed by reference to the EAJA. Under the EAJA, the burden of proof is on the government to prove its position was "substantially justified." In *Pierce v. Underwood*, 487 U.S. 552 (1988), the Supreme Court defined a "substantially justified" litigation position as one which is "justified to a degree that could satisfy a reasonable person," or one which has a "reasonable basis in law and fact." The Fifth Circuit concluded the Hyde Amendment intended to change not only the identity of the party who bears the burden of proof, but also the standard of proof. The court pointed out the Hyde Amendment, as originally introduced in Congress, contained the EAJA's substantially justified language but, Congress' eventual change of the language to "vexatious, frivolous or in bad faith" signaled its desire to limit the scope of the Hyde Amendment. Although the district court erroneously applied the substantially justified standard, the defendants were still unable to satisfy this lower standard and the Fifth Circuit affirmed the district court's holding.

Finally, the court rejected the defendants' claim that a district court must grant an evidentiary hearing and discovery on every action under the Hyde Amendment, as a matter of right.

## **EVIDENCE**

### **Admissibility Of Codefendant's Confession Determined Without Regard To Other Evidence Introduced At Trial**

In *United States v. Logan*, 210 F.3d 820 (8<sup>th</sup> Cir. 2000), Logan and a codefendant were tried for a number of charges including armed robbery, in violation of 18 U.S.C. § 1951, and using a firearm in a crime of violence in violation of 18 U.S.C. § 924. At trial, a detective testified for the government regarding a confession made by Logan's codefendant who did not testify. Despite the prohibition in

*Bruton v. United States*, 391 U.S. 123 (1968) against admission of confessions of a codefendant which implicate the defendant where the defendant can not confront the codefendant about his confession, the court allowed admission of the detective's testimony. The court allowed admission because the detective had redacted the codefendant's confession by testifying the codefendant had confessed to planning and committing the robbery with "another individual." Despite the court's admission of the detective's testimony, the court instructed the jury not to use the confession as evidence of Logan's involvement in the crime. Logan was convicted and appealed his conviction on the ground the confession should not have been admitted since the jury instruction was insufficient to protect his Sixth Amendment right of confrontation.

On appeal, Logan argued because he had testified he was present at the robbery but his actions were coerced, the confession took on added evidentiary significance branding him a voluntary participant despite the redaction of his name. In support of his argument, Logan cited *Gray v. Maryland*, 523 U.S. 185 (1998) which reversed a conviction based on the admission of a nontestifying codefendant's redacted confession which was admitted in written and oral form. The court distinguished *Gray* noting the confession in *Gray* had obviously been redacted by substituting a blank or the word "deleted" for the defendant's name in four separate places. The confession in the instant case was less obviously redacted since the detective's substitution of "another individual" for Logan's name could have appeared to the jury to be the codefendant's own words.

Also, the court, citing *Richardson v. Marsh*, 481 U.S. 200 (1987), refused to determine the admissibility of the codefendant's confession by assessing it in light of the evidence introduced at trial. Rather, confessions must be assessed in isolation from other evidence admitted at trial. In the instant case, viewing the codefendant's confession in isolation from Logan's testimony to being present during the crime, the court found it had no unease about the efficacy of a jury instruction to protect Logan's Sixth Amendment rights since the confession neither facially implicated Logan, nor was obviously redacted.

## **FORFEITURE**

### **Innocent Owner Defense**

In *United States v. Wetterer*, 210 F.3d 96 (2<sup>nd</sup> Cir. 2000), the Second Circuit reversed and remanded the district court's order of forfeiture of three bank accounts belonging to a not for profit Association in which Wetterer was the former president. Wetterer was indicted for mail fraud on

the theory he engaged in a pattern of abuse of boys entrusted to his care by the Association and that the Association's fund raising campaign concealed that material facts from donors. The government's theory of forfeiture was that the funds mailed to Wetterer as contributions were the proceeds of the mail fraud and upon being deposited into the various accounts, resulted in an act of money laundering.

The Association filed a claim for the funds as an innocent owner under the forfeiture statutes. The district court rejected this claim finding the association was Wetterer's alter ego and, therefore, could not assert the innocent owner defense. On appeal, the Association argued the district court erred when it applied New York corporate law to find the association had not observed proper corporate formalities and was Wetterer's alter ego.

The Second Circuit agreed the district court erred when it applied New York law rather than the law of the place of incorporation, Guatemala, in determining the alter ego issue. Applying Guatemala law, the court concluded the Association's board was independent of its president and not its alter ego. Upon finding the Association was not Wetterer's alter ego, it then considered whether the Association's innocent owner claim was meritorious. The court noted the Association followed corporate formalities and took appropriate action to investigate the allegations against Wetterer to determine whether action to remove Wetterer as president was required. The court found an investigation conducted in Guatemala exonerated Wetterer of the allegations and, thus, the fact the Association took no action to remove Wetterer as president was appropriate. The court, therefore, held the Association was the innocent owner of the three accounts and forfeiture of those accounts was inappropriate.

## **MONEY LAUNDERING**

### **Bankruptcy Fraud Is Complete At Point Of Concealment, Not Point Of Use Of Funds**

In *United States v. Butler*, 211 F.3d 826 (4<sup>th</sup> Cir. 2000), Butler received two checks totaling \$350,000 and did not report his receipt of these funds to the bankruptcy trustee or to his creditors. He used the first \$100,000 check for personal expenses and gave the second \$150,000 check to a friend of his, a priest, to hold. The priest held these funds for over a year until September 1992, when Butler directed the priest to use the funds to purchase four cashier's checks payable to an associate of Butler. Butler was convicted of

bankruptcy fraud in violation of 18 U.S.C. § 152 and money laundering, in violation of 18 U.S.C. §1957.

On appeal, Butler argued these transactions failed to support a money laundering conviction since the underlying "specified unlawful activity," bankruptcy fraud, had not been completed when the transactions occurred. The Fourth Circuit found the intent of Congress in enacting the money laundering statute was to target transactions involving the proceeds of a completed crime but rejected Butler's argument that his bankruptcy fraud was not completed when the transactions occurred. The court found Butler had engaged in concealment of the \$150,000 check from the bankruptcy trustee almost as soon as he obtained it and, at the latest, Butler engaged in concealment when he gave the check to the priest to hold. Thus, by September 1992, when Butler began directing the priest to purchase the cashier's checks, the underlying specified unlawful activity, bankruptcy fraud, was already complete. And because Butler was engaging in a transaction with the proceeds of a completed crime when he directed the purchase of the cashier's checks, the evidence supported a money laundering conviction.

## **INVESTIGATIVE TECHNIQUES**

### **Oral Communication Intercepted In Police Car**

In *United States v. Turner*, 209 F.3d 1198 (10<sup>th</sup> Cir. 2000), the Tenth Circuit held the interception of Turner's conversation by a concealed tape recorder in a police cruiser did not violate Title III of the Omnibus Crime Control and Streets Acts of 1968, 18 U.S.C. §§ 2510-2522. A police officer obtained Turner's consent to search his (Turner's) car after a routine traffic stop. After expressing concerns about Turner's safety, the officer asked Turner and his passenger to sit in the back of his patrol car. Unbeknownst to Turner, the officer had activated a tape recorder in his patrol car. After the officer's search of the vehicle, he replayed the tape of Turner's conversation which revealed the presence of firearms which Turner, as a parolee, was prohibited from possessing. A later search of Turner's car revealed four firearms and a small quantity of marijuana.

Turner appealed the district court's denial of his motion to suppress his recorded conversation on grounds the recording was made in violation of Title III. Title III protects oral communications uttered by a person exhibiting an expectation that such communications are not subject to interception under circumstances justifying such expectation. The legislative history of Title III shows Congress intended this definition to parallel the "reasonable

expectation test” articulated by the Supreme Court in *Katz v. United States*, 389 U.S. 347 (1967). For Title III to apply, the court must conclude: (1) the defendant had an actual, subjective expectation of privacy; and (2) the defendant’s expectation was one society would view as objectively reasonable under the circumstances. Accordingly, Turner asserted he had a reasonable expectation of privacy in the patrol car.

Because the government stipulated Turner had a subjective expectation of privacy, the court only had to consider whether society would consider Turner’s expectation of privacy “reasonable.” The Tenth Circuit concluded, on these facts, society is not prepared to recognize an expectation that communications in a patrol car are not subject to interception. The court disregarded Turner’s contention that his expectation of privacy was reasonable since he was not in custody or being threatened with arrest. The Tenth Circuit agreed with the Eleventh Circuit in *United States v. McKinnon*, 985 F.2d 525 (11<sup>th</sup> Cir. 1993), whether an individual is in custody does not materially affect an expectation of privacy in a police car. Furthermore, the practical realities of the situation should have been apparent to the occupants. Patrol cars are equipped with electronics, including microphones to the dispatcher, possible video recording with audio pickup, and other electronic and recording devices.

### **Anti-Gratuity Statute**

In *United States v. Harris*, 209 F.3d 165 (3<sup>rd</sup> Cir. 2000), the Third Circuit held the government does not violate 18 U.S.C. § 201(c)(2), the federal anti-gratuity statute by paying confidential informants who testify at trial. The significance of the paid informant’s testimony was to identify whether Harris, who admitted having once been a drug dealer, had withdrawn from his illegal activities by the first date the government could use under the statute of limitations. The first of the government’s informants who placed Harris in drug dealing activity received payments of \$250, \$350, and \$1,500 from the government and received an eight year reduction in his own sentence. The government’s second informant received \$20 a month for several months and received a ten year reduction in his sentence. Harris argued a third witness was never indicted despite some apparent involvement with illegal drugs. After hearing the informants’ testimony and having full knowledge of the money and other benefits they received, the jury convicted Harris.

On appeal, Harris contended when the government paid several confidential informants to gather information and later testify at trial, the government violated the anti-gratuity

statute. The statute prohibits “whoever” from giving “anything of value to any person, for or because of the testimony under oath . . . by such person as a witness upon a trial . . . .” The Third Circuit previously held in *United States v. Hunte*, 193 F.3d 173 (3<sup>rd</sup> Cir. 1999), promises of leniency do not violate the anti-gratuity statute. Accordingly, the sentence reductions the first two informants received were not prohibited by the statute. Similarly, the decision not to prosecute the third witness is by implication another type of leniency not prohibited by the statute. The central question raised in this appeal was whether the government violated the statute when it paid the informants before trial to collect information while expecting the informant to later testify at trial.

The Third Circuit agreed with decisions of the Fourth, Fifth and Eighth Circuits which held the use of a paid informant’s testimony does not violate the anti-gratuity statute. In reaching this conclusion, the court stressed a defendant’s right to be appraised of the government’s compensation arrangement and to inquire about it on cross examination must be protected. The method of payment is a matter for the jury to consider in weighing the credibility of the informant. The court cited its conclusion in *Hunte* that “whoever” in the statute does not include the government and referred to the Fourth Circuit’s decision in *United States v. Anty*, 203 F.3d 305 (4<sup>th</sup> Cir. 2000), that many statutes allow payments to government witnesses. The court believed Congress which authorized the payment of rewards for information, assistance, and services in the enforcement of criminal statutes surely must have contemplated payments to informants for assisting both in investigations and by testifying. The court reserved the issue whether the anti-gratuity statute allows the government to pay a witness solely or essentially for favorable testimony, as distinct from paying a witness for collecting evidence and testifying about what was found.

## **SENTENCING**

### **Court Must Resolve Disputed Fact**

In *United States v. Standard*, 207 F.3d 1136 (9<sup>th</sup> Cir. 2000), Standard was convicted of bankruptcy fraud and of subscribing to a false return in violation of 26 U.S.C. § 7206(1). In the 1988 tax year, Standard made referral payments for solicited as well as unsolicited referrals which he deducted on his income tax return. In 1988, in California, payments for unsolicited referrals were not illegal, therefore, those payments could have been properly deducted as business expenses. At sentencing, Standard challenged the district court’s computation of the base offense level for his tax conviction, arguing the presentence report, on which the district court relied, improperly

included the total amount of referral fees as non-deductible illegal referral fees which were not deductible. Standard was sentenced without the court resolving this disputed issue of fact.

The court found the district court had not resolved this controverted matter in accordance with FED. R. CRIM. P. 32(c)(1). In addition, U.S.S.G. § 6A1.3(b) specifically requires the court to resolve disputed sentencing factors at the sentencing hearing in accordance with Rule 32(c)(1). The court noted when a defendant specifically objects to an item during sentencing, the district court is required to specifically address the item. Merely accepting the probation officer's calculations to be valid and correct and agreeing with the findings of facts and conclusions of law proposed by the government does not satisfy the requirements of Rule 32(c)(1). The court could find no statement within their prior opinions which specifically dealt with the tax loss argument. Consequently, the Ninth Circuit remanded the case so the district court could specifically address Standard's tax loss argument.

### **Criminal Responsibility Of Employees Must Be Found For Enhancement Under § 3B1.1(a)**

In *United States v. Maloof*, 205 F.3d 819 (5<sup>th</sup> Cir. 2000), Maloof was convicted of conspiracy to restrain trade in violation of the Sherman Act, 15 U.S.C. § 1, and conspiracy to commit wire fraud, violation of 18 U.S.C. § 371. Maloof was the southern regional sales manager for Bay Industries, Inc., a manufacturer of metal building insulation. One of the major components of metal building insulation is fiberglass. In 1993, fiberglass manufactures announced a price increase and reduction in supply of fiberglass insulation. As a result, Bay prepared a new price sheet outlining its pricing scheme for its sales representatives. Early in 1994, Maloof began to contact the sales managers of Bay's competitors in an attempt to create a uniform set of prices for metal building insulation. Maloof was successful over the course of the next two years in causing several companies to fix their prices in accordance with Bay's, thereby stifling competition in the industry. Finally, a Bay employee reported Maloof's activities to the FBI. Maloof refused a government offer of immunity and was subsequently indicted, convicted and sentenced to 30 months imprisonment.

On appeal, Maloof challenged, *inter alia*, the trial court's four level sentence enhancement under U.S.S.G. § 3B1.1(a), which provides a defendant's offense level shall be increased by four levels if he was "an organizer or leader of a criminal activity that involved five or more participants or

was otherwise extensive." Maloof argued the conspiracy to restrain trade did not involve "five or more participants" and he was not an organizer or leader.

The Fifth Circuit agreed with Maloof determining the district court erred in concluding the involvement of three Bay employees and two executives from other insulation companies satisfied the five person requirement of the guidelines. Although the Bay employees may have followed Maloof's instructions in perpetrating the fraud, the district court made no finding as to whether they were criminally responsible for commission of an offense. "Willful participation is an essential element of the crime of conspiracy; mere knowledge of a conspiracy does not itself make a person a conspirator." *United States v. Mann*, 161 F.3d 840, 867 (5<sup>th</sup> Cir. 1998). Accordingly, Maloof's sentence was vacated and the case remanded for re-sentencing.

### **Downward Departure Based On Due Process Claim**

In *United States v. Tenzer*, No. 99-1123, 2000 U.S. App. LEXIS 8078 (2<sup>nd</sup> Cir. Apr. 26, 2000), Tenzer pleaded guilty to four counts of wilful failure to file income tax returns in violation of 26 U.S.C. § 7203. Tenzer's plea followed the Second Circuit's remand of the case based on its decision in *United States v. Tenzer*, 127 F.3d 222 (2<sup>nd</sup> Cir. 1997) ("*Tenzer I*") that Tenzer's prosecution was not barred because he failed to bring himself within the Service's voluntary disclosure policy and could not claim the benefits of any protection it might afford. On remand, the district court sentenced him to a year and a day incarceration which was at the lower end of the applicable guidelines range of 12 to 18 months, but declined to depart downward. Tenzer had moved for a downward departure on various grounds which he argued took this case outside the heartland of the sentencing guidelines – the most notable of which was his claim that his prosecution was unfair and in violation of his due process rights.

At sentencing, the district judge stated, "the entire prosecution here is essentially unfair and contrary to policies adopted and publicized by the IRS," but ruled such issues did not provide a reasonable basis for a downward departure. The judge further stated, "[w]hile courts have considerable power in connection with the fashioning of a sentence, a court must honor the mandates and decisions of the Court of Appeals, even when they're totally wrong." The judge concluded a sentencing court should not "engage in nullification by departure" merely because of its view "the Court of Appeals panel opinion in this case was unfair or wrong" or because "generalized fairness" requires a departure to rectify an unfair appellate decision.

On appeal, Tenzer argued the district court did not fully understand its authority to downwardly depart in the case. A majority of the Second Circuit agreed, concluding the district court mistakenly believed it lacked the authority to grant a departure. The majority found the statements of the district judge at sentencing and in his prior opinions in the case clearly indicated his belief that certain elements present in Tenzer's case were unusual but he was precluded from considering them as a basis for departure based on the

mandate of *Tenzer I*. Based on this perceived misapprehension, the court remanded the case for reconsideration of the sentence. The court was careful to explain its ruling did not decide whether any of the factors cited by Tenzer in support of his claim for departure, taken individually or together, constitute an appropriate basis for departure; rather, it was simply holding consideration of these factors had not been ruled out by the mandate in *Tenzer I*.



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**JUNE 2000**

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