

Everything You Wanted to Know About How to Obtain a Prosecutorial Declination of a Federal Tax Case but Were Afraid to Ask

By Nathan J. Hochman

Nathan J. Hochman discusses how to obtain a prosecutorial declination.

Every year, the IRS and the U.S. Department of Justice publicly report on hundreds of taxpayers nationwide that have been prosecuted, convicted and sentenced. Buried in these statistics, however, are the relatively few cases that have worked their way through the system but have gotten declined by a prosecutor prior to criminal tax charges being filed. By the time such a case reaches a prosecutor, whether in the U.S. Department of Justice's Tax Division and/or in a U.S. Attorney's Office, that case has already survived multiple layers of scrutiny at the IRS, had hundreds of hours of investigative time committed to it and most probably features a five-, six- or seven-figure tax loss. How can a defense attorney stop the tremendous momentum behind such a case before his client sees his name after "United States of America vs.?" To accomplish this most difficult and daunting task, a defense attorney must not dwell on how the government chose to investigate his

client in the first place. Instead, the defense counsel must make himself fluent in the mechanics of the decision-making process, in the motivations of the key players, and in the relevant facts and applicable law of the case if he has any hope to succeed.

1. "Why Me?": An Irrelevant Starting Point for a Prosecutorial Declination

Almost every client who finds herself facing an IRS criminal investigation asks her attorney at some point: "Why me?" Why not my competitor down the road who was doing the same thing I was doing or worse? My crooked neighbor? My cheating boss? My unethical banker? My tax-evading gardener? My "wink-wink, nod-nod" accountant? My (fill in the blank) whose tax manipulations make me look like a piker in comparison?

The most honest answer to this question is to tell the client that this question is the wrong one to ask. How the client arrived on the government's radar screen might be useful in trying to determine what the government has learned about the client's conduct, but it is virtually useless in trying to get a prosecutorial declination.

Clients sometimes decry that the government is selectively prosecuting them and believe that this argument is their "get out of jail free" card. For those

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clients, a defense attorney must quickly disabuse them of that argument's chances of success. The defense attorney must candidly inform them that "selective prosecution" in the constitutional sense is a term of art. It is more than just being the unfortunate person that the government selects to the exclusion of most others who may be committing crimes as well. Every prosecution is in some way a "selective prosecution" because the government lacks the resources to prosecute everyone. To establish unconstitutional "selective prosecution" in violation of the Equal Protection Clause justifying a dismissal of the prosecution, the client must prove two things: (i) the client has been singled out and charged for a crime while others similarly situated have not been prosecuted; and (ii) the decision to prosecute was based on an "unjustifiable standard" such as race, religion or other arbitrary classification. This standard has been exceedingly difficult to meet. Only a handful of reported decisions in the last 40 years have found unconstitutional selective prosecution to have occurred, despite the fact that the argument has been raised routinely over the decades. Given the wide latitude that courts have given prosecutors' charging decisions, unless the defense comes into possession of clear-cut evidence of impermissibly-based selection, the energies of the defense counsel are best spent elsewhere.

A prosecutor's stock answer to the "Why-me" question is, "I'll get to others as soon as possible but I have to start somewhere and you are the somewhere." In actuality, however, the prosecutor's bravado masks the stark reality that the federal government has virtually no chance to prosecute its way into tax compliance if simply locking up tax cheats is the measure for success. If one looks at the chances of being criminally prosecuted for tax violations, one would have to conclude that the odds are overwhelmingly in the crooked taxpayer's favor. A simple review of the numbers tells the story:

- Over 130 million taxpayers file over 240 million returns each year.¹
- The IRS estimates three percent of taxpayers (or approximately four million taxpayers) intentionally file fraudulent tax returns every year.²
- The IRS has approximately 2,800 Special Agents to investigate criminal tax violations of approximately four million potential tax evaders.³
- Out of the four million potential cases, approximately 4,000 IRS criminal investigations are initiated every year, with approximately 2,800 of

those resulting in prosecution recommendations to the Department of Justice.⁴

- Over 90 percent of IRS prosecution recommendations are accepted by the Department of Justice.⁵
- Approximately 2,500 indictments/informations are filed each year.⁶
- Approximately 2,100 criminal convictions are obtained each year.⁷

Based on the numbers alone, an average taxpayer has about a 0.003-percent chance of being criminally investigated and a 0.002-percent chance of being convicted. Phrased differently, an average taxpayer has a 99.997-percent chance of not being criminally investigated and a 99.998-percent chance of not being criminally convicted. Even the crooked taxpayer has an over 99-percent chance of not being investigated, prosecuted or convicted.

2. Top Three Prosecutorial Motivations for Tax Crimes: Deterrence, Deterrence, Deterrence

Given the enormous odds against anyone being criminally prosecuted and convicted, the very few cases the federal government elects to prosecute have to achieve the greatest deterrence possible for the country's voluntary self-assessment system to work. Prosecutors have to make each of the approximately 2,500 charged criminal tax cases count in order to convince the tens of millions of taxpayers that there really are dire consequences for committing tax offenses. Sending tax scofflaws to prison, seizing their assets and exacting huge fines and penalties—and doing so in the most public manner possible to achieve maximum deterrence with each case—is the main agenda for tax prosecutions. Leveraging each case so that not only the defendant, his family and his friends are specifically deterred, but also the overall taxpaying community "gets the message" is among the prime missions of every tax prosecution.

This directive reverberates in the Tax Division's Criminal Tax Manual, the U.S. Attorney's Manual, the IRS Manual, and the U.S. Sentencing Guidelines. For instance, the Introductory Commentary to *Part T—Offenses Involving Taxation of the Sentencing Guidelines* states in pertinent part: "Because of the limited number of criminal tax prosecutions relative to the estimated incidence of such violations, deter-

ring others from violating the tax laws is a primary consideration underlying these guidelines.”

Prosecutors view deterrence as a synonym for imprisonment. To expend the huge effort necessary to investigate, prosecute, convict and sentence a typical tax offender, a prosecutor will generally not view deterrence as being achieved unless the defendant goes to prison. Prosecutors wholeheartedly agree with the sentiments expressed recently by the Eleventh Circuit in *United States v. Livesay*⁸ in reversing the probationary sentence of a fraudster. The court stated: “If a would-be white-collar criminal could steal millions of dollars, place the money in an off-shore bank account, serve his probationary sentence, and then be free to start a new life with his newly acquired fortune, this court sees little incentive for that person to think twice before concocting such a scheme ... The threat of spending time on probation simply does not, and cannot, provide the same level of deterrence as can the threat of incarceration in a federal penitentiary for a meaningful period of time.”

As shown below, knowing that deterrence and incarceration lay at the heart of a prosecutor’s decision-making matrix provides a defense attorney with key ammunition in framing a declination argument.

3. How Did My Client’s Case End up on the Prosecutorial Radar Screen?

From the over four million annual potential criminal cases, the IRS initiates only approximately 4,000 investigations each year. How does the IRS choose which ones to pursue? The leads for these investigations span the gamut from whistleblowers and “ex’s” (e.g., ex-spouse, ex-partner, ex-employee, ex-computer programmer) to Revenue Agents conducting audits, Revenue Officers involved in collections, Fraud Referral Specialists, the Lead Development Centers, other federal or state agencies or even referrals coming out of family and bankruptcy courts. More recently, many referrals have emanated from international sources like the Joint International Tax Shelter Information Center (JITSIC), tax information sharing agreements, and foreign financial institutions.

Once the IRS determines it has a valid lead, the IRS can choose to open (or “number”) its investigation administratively or through a grand jury. If the IRS elects the administrative path, then its strict disclosure provisions in place for the last 30 years prevent it even

from sharing information during that stage with the Department of Justice. Only once a referral is made for prosecution or a grand jury investigation does the Department of Justice have decision-making authority over the criminal tax case. Finding out if the client’s case started administratively is important because while the IRS will have invested a lot of time into it during the administrative investigation, a prosecutor will most likely have never even heard about the case during that time.

Over 25 percent of the 4,000 criminal investigations initiated by the IRS on an annual basis do not result in prosecution recommendations by the IRS to the Tax Division. For the approximately 2,800 out of 4,000 cases that are referred, these cases are the products of a tremendous amount of time and resources by the lead IRS Special Agent assigned the case, that agent’s Supervisory Special Agent, the Assistant Special Agent in Charge, the Special Agent in Charge and IRS Criminal Tax Counsel, all of whom review the investigation. A detailed Special Agent Report will have been prepared, reviewed, edited and approved by multiple levels at the IRS before it reaches the Tax Division. Once the referral is made to the Tax Division, the case will either be kept by a Tax Division attorney who will run the prosecution from that point on or the case will be sent out to the local U.S. Attorney’s Office for prosecution or grand jury investigation.

The Tax Division has approximately 100 criminal tax prosecutors broken into three enforcement sections: Northern, Southern and Western. These Tax Division attorneys are trained to analyze and prosecute tax crimes; are very familiar with the relevant tax law, elements of the tax crimes and defenses; and spend their days exclusively working in the criminal tax world. By comparison, the 94 U.S. Attorneys’ Offices nationwide have thousands of prosecutors, some of whom have significant criminal tax experience and most of whom do not. Getting as much “intel” or background on the prosecutor assigned to the case—e.g., her criminal tax experience level, her trial record, her work ethic, her willingness to listen to defense counsel’s arguments, her proclivity to plead a case rather than try it—is indispensable information to crafting the proper declination argument.

Given their greater numbers, the bulk of criminal tax cases will be primarily prosecuted by Assistant U.S. Attorneys. By law, all criminal tax charges (with very few exceptions) must ultimately be approved by the Tax Division. Consequently, a local U.S. At-

torney's Office does not have unilateral discretion to decline a case, change a charge from a felony to a misdemeanor or enter into a disposition for other than the "major count" (*i.e.*, usually the tax year with the greatest tax loss) without running that decision by the Tax Division first. If a U.S. Attorney's Office chooses to decline a case and the Tax Division disagrees, the Tax Division has the ability to take over the prosecution of the case. On the other hand, if the Tax Division elects to decline a case, then that case cannot be prosecuted regardless of the position taken by the U.S. Attorney's Office.

The impact of a prosecutorial declination on the various stakeholders cannot be understated. A declination effectively nullifies the scores or hundreds of hours of IRS time (and prosecutorial time) devoted to the criminal case, even if a civil case can be salvaged to recover the tax, interest and civil penalties. If the case was the only or primary case being investigated by the lead Special Agent and occupied one to three years of that agent's time, a declination will presumably not have positive consequences for that agent's career. A declination will not endear a prosecutor to the IRS, whose agents he might be working with on other cases now or in the future. While a prosecutor will rarely, if ever, admit that his declination decision weighed these collateral consequences, a defense counsel must be conscious of such consequences, particularly in a lengthy investigation.

4. How to Convince the Prosecutor to Decline the Case

With so much momentum generated toward filing charges once the charges have cleared the IRS' multi-layered review and landed on a prosecutor's desk, how can a defense counsel possibly convince the prosecutor to forego an indictment?

In order to be assured that a defense counsel will have the opportunity to meet with the Tax Division lawyer or Assistant U.S. Attorney, defense counsel must make a written request for a pre-indictment conference well prior to any charging decision being made. That request should be directed to the Criminal Enforcement Section Chief for the region in which the case has been investigated or the taxpayer resides (Western, Southern or Northern) and should include the taxpayer's name and identification number (*e.g.*, Social Security Number). If the case has already been sent to a U.S. Attorney's Office, then a copy of the request should be sent to the Assistant U.S. Attorney

assigned to the case and the Chief of the Criminal Division as well.

While there is no legal right to have a pre-indictment conference with the prosecutor, such conferences are routinely given and sanctioned by the Tax Division's Criminal Tax Manual and U.S. Attorney's Manual. The conference will be more a monologue by the defense counsel than a dialogue with the government attorney. During the conference, the Tax Division attorney will normally advise defense counsel of the proposed charges, the method of proof (*e.g.*, bank deposits, indirect method), and the income and tax computations the IRS has recommended. The conference will not be a vehicle to discover or explore the government's evidence. Instead, defense counsel has the opportunity to present whatever arguments she wishes to convince the prosecutor to decline the case. This exercise can be likened at times to trying to hit a moving target because the prosecutor can adjust his theory to meet the defense counsel's arguments without necessarily giving the defense counsel a chance to respond to the modified theory. The attorney's statements on her client's behalf are not to be used by the government in general court proceedings as vicarious admissions of the client.

The arguments that resonate best with a prosecutor are ones that demonstrate how the prosecutor will lose in court if he brings the proposed charges. Framing one's attack in terms of "litigation risk" is crucial because the prosecutor's central mission of deterrence will fail miserably if the case is dismissed by a judge or the taxpayer receives a verdict of acquittal. Indeed, such a failure, if anything, may embolden the tax evading community who view the government's inability to convict an alleged tax violator as a sign that even in the unlikely event they get caught, they may prevail at trial. Such a failure will make plea deals more difficult because tax defendants will not look at the government's winning ratio at trial of over 90 percent but focus on its most recent defeat. Moreover, such a failure will have wasted enormous amounts of prosecutorial and investigative time and resources that could have been devoted to other more meritorious cases.

To demonstrate "litigation risk," a defense counsel must appreciate the fairly unique and very difficult burdens a prosecutor faces in bringing criminal tax charges. Unlike in a civil case where the burden of proof is preponderance of the evidence or clear and convincing evidence, the burden of proof in a criminal tax case is the highest in our courts—beyond a

reasonable doubt. The fact finder in almost all cases is not a judge, but a jury. In contrast to a civil jury which may be composed of six members, a criminal jury is composed of 12 members and their verdict must be unanimous. With respect to the *mens rea* or mental state required for a criminal tax charge, the prosecutor faces the highest standard in the law—willfulness—the intentional violation of a known legal duty. In addition, the prosecutor must prove a negative, namely, that the taxpayer did not have a subjective good faith belief in the legitimacy of her tax position (“the *Cheek* defense”), in order to obtain a conviction.

On top of all these hurdles, the prosecutor knows that prosecuting tax crimes requires him to wade into the waters of one of the most complicated set of laws ever devised. Many tax cases will require the prosecutor to educate the jury about how the Internal Revenue Code, its regulations, its revenue procedures and its case law intersect with the line items on the tax returns at issue. Making the case simple is the prosecutor’s mission; making it as complicated as possible is the defense counsel’s objective. Since most jurors dread filling out their own tax returns, the prosecutor has to overcome an initial, unspoken juror presumption that the tax code is too complicated for anyone to willfully violate it. Since some of the key prosecution witnesses will be IRS agents, the prosecutor will also have to prevail over some jurors’ latent antipathy toward the IRS. On the other hand, defense counsel has to recognize that while jurors may not like the IRS or paying their own taxes, they really dislike someone else not paying their fair share.

While a defense counsel can present “litigation risk” arguments to the IRS during the investigation, these arguments may receive a more favorable audience with a prosecutor. In many ways, a prosecutor will be more sensitive to “litigation risk” because the prosecutor will be the one in charge of the trial, figuring out how to admit evidence, examining and cross-examining witnesses, dealing with the judge’s rulings, and assessing how the case will play in front of a jury. For instance, while the IRS may use information from a “dirty” informant with a criminal record to build its case, the prosecutor may be more sensitized as to how a judge and a jury will consider the evidence, particularly in light of the jury instructions that will be given to question it more carefully. Similarly, if the prosecutor will not be able to properly authenticate foreign records and such records are necessary to prove the taxpayer’s guilty mental

state, then the mere fact that the IRS obtained the documents during its investigation is of little solace to the prosecutor.

In fashioning “litigation risk” arguments, a savvy defense counsel will have performed essentially a mirror investigation of the IRS’ investigation, interviewing as many of the witnesses the IRS has interviewed as possible, accumulating all the documentary evidence gathered by the IRS, and trying to stay one step ahead of the IRS on the information curve about the case. If the investigation started administratively, defense counsel will try to keep track of the investigation through the IRS summonses issued and witnesses interviewed. If the investigation is in the “secret” grand jury phase, defense counsel can attempt to monitor the investigation by trying to interview any witnesses called to testify before the grand jury and discovering not only the testimony given but the questions asked. In many respects, the questions asked are as important as the answers given because they will alert defense counsel to the focus of the criminal tax investigation.

There is no substitute for knowing the facts and applicable law of the case as well or better than the prosecutor in trying to convince the prosecutor to decline the case based on “litigation risk.” For instance, if the IRS operated under the assumption that the cash found in a client’s safety deposit box came from his business when the defense counsel has ironclad proof it came from a nontaxable source like an inheritance, then a prosecutor may perceive the problems with his case as insurmountable and decline to proceed. Other examples of “litigation risk” might include establishing unreported deductions that fully offset unreported income in a tax evasion case; providing legal or accounting opinions that the client relied on to justify her good faith position taken on her returns; highlighting Fourth Amendment problems embedded in the search warrants used to obtain key evidence; or demonstrating the lack of credibility of crucial government witnesses (e.g., financial incentives, personal vendettas, past acts of dishonesty). “Litigation risk” factors can also encompass potential government intrusions into privileged material, difficulties in bringing witnesses to court, particularly overseas ones, and significant impediments in bringing the client to court, particularly if the client is not a U.S. citizen and is living abroad.

In addition to demonstrating as much “litigation risk” as possible, a defense counsel should be prepared to argue in the right case how similarly

situated taxpayers were not prosecuted criminally, but resolved their matters civilly. The Tax Division's mantra is "broad, balanced and uniform criminal tax enforcement." While a selective prosecution argument will almost always fail as a matter of law, as a matter of policy it resonates at a different level and should be used if available. If similarly situated taxpayers in the same or other jurisdictions did not get indicted, then uniformity demands an equal result in the client's case. Obtaining this information is easier said than done since there is no publicly available database showing what cases have received criminal declinations. In large-scale, multi-defendant cases, one can attempt to track which defendants have and have not been offered civil-only resolutions. For other types of cases, obtaining this information on a district or circuit basis will require significant networking with other defense counsel and research on the Internet.

To the extent that a client paid off the outstanding tax liability at issue during the investigation or is in a position to do so along with significant civil penalties, a defense counsel should trumpet these "lack of tax loss" and "making the government whole" arguments as additional factors militating in favor of a civil disposition. These type of arguments have to be raised carefully since the government will always react negatively to the insinuation that some defendant was able to buy his way out of criminal charges.

Defense counsel should also be prepared to humanize their client as much as possible. If a prosecutor is on the fence as to how to proceed, establishing that one's client is a good person or a good corporate citizen who made a mistake rather than a bad person or company who got caught may tip the balance toward a declination. For an individual client, defense counsel must be able to effectively present the positive highlights from the client's life story including charitable and communal commitment, the lack of any significant criminal record, a high degree of tax compliance and taxes paid outside the years at issue, any serious medical conditions, and any extraordinary family responsibilities. In addition, defense counsel in the proper case should detail the draconian collateral consequences of a criminal charge ranging from loss of employment and deportation for a non-U.S. citizen to revocation and debarment for clients with professional licenses. For a corporate client, defense counsel should focus on many of the same criteria emphasized by the Sentencing Guidelines including prior civil or criminal history, effective compliance

and ethics programs, self-reporting, cooperation and collateral consequences to the organization.

5. When Should a Defense Counsel Go for a Declination?

The decision of whether to lay out some or all of one's cards to a prosecutor to try to obtain a declination is one of the hardest and most important decisions a defense counsel will make. A defense counsel must factor into the decision the strength of the arguments and evidence to be presented, the level of trust in the prosecutor's judgment and ability to view the presentation objectively, and the repercussions to the client of getting indicted at all versus prevailing at trial at a much later stage. The stronger the arguments and evidence, the greater the trust, and the more significant the repercussions of an indictment, the more likely a defense counsel will decide in favor of full disclosure to obtain a declination. If a defense counsel has a legal or factual defense that is irrefutable and effectively decimates the prosecutor's case, then playing all the cards of such a defense with a reasonable prosecutor may make tactical sense. If the ramifications of the mere filing of an indictment are too profound, *e.g.*, irreversible reputational or financial damage, then a defense counsel may have no choice other than to disclose the complete defense to stave off an indictment.

On the other hand, if a client can survive an indictment but wants to best position themselves for a victory at trial and if the problems pointed out in the prosecutor's case can be fixed prior to indictment or trial or do not completely eviscerate the case, then the wisest course of action may be to lay down no cards or only a few cards.

If a complete declination is not in the cards, then a defense counsel must consider whether to go for "Plan B." Plan B in this case constitutes a full disclosure of the defense with lesser objectives in mind, *i.e.*, getting a different type of charge (*i.e.*, a misdemeanor instead of a felony), a lower tax loss, a fewer number of counts, a declination against proceeding against others potentially involved in the case (*e.g.*, relatives) and/or the most favorable sentencing recommendation possible. If the client cannot suffer any conviction at all, understands the harsh sentencing consequences if found guilty after trial and will not authorize Plan B, then the best course of action may be no action at all.

Given its rarity, obtaining a prosecutorial declination may appear to pose too lofty a goal to strive for

in most cases. The shroud of mystery over the process should not deter the savvy defense counsel from pursuing this elusive prize. Knowing how the system operates, which motivations drive which stakehold-

ers, and which factual and legal arguments have the best chance of success with the assigned prosecutors allows defense counsel to maximize their chances for success. Forewarned is forearmed.

ENDNOTES

¹ Internal Revenue Service Data Book 4 (2007) available at www.whitehouse.gov/omb/budget/fy2008/summary_tables.aspx.

² "Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance" available at www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf.

³ "Criminal Investigation (CI) At-A-Glance," available at www.irs.gov/irs/article/0.id=98398.00.html.

⁴ "Enforcement Statistics--Criminal Investigation (CI) Enforcement Strategy" available at www.irs.gov/compliance/enforcement/article/0.id=108792.00.html.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *United States v. Livesay*, 2009 U.S. App. LEXIS 25118 (11th Cir. Ala. Nov. 16, 2009).

⁹ *J.L. Cheek*, S Ct, 91-1 US TC ¶50,012, 498 US 192, 111 S Ct 604.

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