Practitioners - Beware the Trojan Horse: The Government Unsheathes an Old Weapon to Target Practitioners for Criminal Tax Offenses

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PRACTITIONERS - BEWARE THE TROJAN HORSE:
THE GOVERNMENT UNSHEATHES AN OLD WEAPON TO TARGET
PRACTITIONERS FOR CRIMINAL TAX OFFENSES

by

DANTE MARRAZZO *

I. INTRODUCTION

Nestled within the many criminal sanctions of the Internal Revenue Code is a little known, less understood, and, until recently, seldom used statute proscribing attempts to interfere with administration of the Internal Revenue laws. This article will discuss the exponential increase in use of that provision, section 7212(a) of the Internal Revenue Code, in the last decade to seek prosecution of tax scofflaws, particularly practitioners, who might have otherwise escaped criminal sanctions. This article will call attention to some perils for the practitioner relating to representing a client on tax matters. Those perils include possible criminal prosecution of an attorney for her advice to a client.

II. CRIMINAL SANCTIONS UNDER THE INTERNAL REVENUE CODE

1. Background

Prior to the enactment of the Sixteenth Amendment to the Constitution of the United States on February 25, 1913, the principal sources of revenue for the Federal government were customs duties and excise or other indirect taxes. The first income tax law enacted pursuant to the Sixteenth Amendment was the Revenue Act of 1913, which imposed a normal tax of 1% on the net incomes of individuals, estates, trusts and corporations. A graduated surtax of 1% to 6% was imposed on incomes in excess of $20,000.

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2. U.S. CONST. amend. XVI.
5. Id.
The most recent comprehensive enactment of the Internal Revenue Code ("Code") was in 1954. Criminal sanctions for violations of the tax laws were incorporated in that enactment by sections 7201 through 7215 of the Code.

2. General Criminal Provisions

When the government has sought criminal prosecution for violation of the Code, it has predominantly used three criminal provisions. Probably the most familiar criminal tax statute is "tax evasion." Additional tax due and owing is an element of this most frequently charged offense, hence, the Internal Revenue Service ("IRS") must establish the corrected tax liability, often a difficult task in complicated criminal cases. Conviction for violation of section 7201 is a felony.

As an alternative to proving tax due and owing under section 7201, the IRS has recommended prosecution for filing a false tax return. This sanction is mostly used when the tax due cannot be determined with any degree of certainty. Conviction for violation of section 7206(1) is a felony.

In cases where a tax return has intentionally not been filed, the most applicable provision is the willful failure to file a tax return. This statute is used in cases where the IRS cannot prove sufficient overt acts to support a tax evasion recommendation. Conviction for violation of section 7203 is a misdemeanor.

3. Section 7212(a)

Section 7212(a) provides, in part:

Whoever corruptly or by force or threats of force . . . endeavors to intimidate or impede any officer . . . acting in an official capacity under this title, or in any other way corruptly or by force or threats of force . . . obstructs or impedes, or endeavors to obstruct or impede,
the due administration of this title, shall, upon conviction thereof. . . . The term "threats of force," as used in this subsection, means threats of bodily harm to the officer or employee of the United States or to a member of his family.17

Conviction for violation of section 7212(a) is a felony.18

III. LEGISLATIVE HISTORY OF THE STATUTE - SECTION 7212(A)

Section 7212(a) has its earliest roots in the thirty-seventh Congress in 1862. As originally enacted, this section provided:

That if any person shall forcibly obstruct or hinder a collector or deputy collector in the execution of this act, or of any power and authority hereby vested in him, or shall forcibly rescue, or cause to be rescued, any property, articles, or objects, after the same shall have been seized by him, or shall attempt or endeavor so to do, the person so offending shall, for every such offence, forfeit and pay the sum of five hundred dollars.19

As enacted, the statute forbade only the forceful interference with employees in the performance of their duties or the rescue of seized property and provided a penalty of $500.20

In 1863, the statute was amended to include imprisonment for up to two years as part of the sanctions for violating the statute.21 In 1864, the statute was re-enacted to add assessors, revenue agents, and inspectors as persons protected.22 Later that same year, the Internal Revenue Service Act of 1864 was codified to include the same sanctions against forceful interference with covered employees or the rescue of seized property.23

In the 1939 codification of the Internal Revenue laws, the Act separated the provisions against forcible interference against an employee and forcible rescue of seized property.24 With respect to forcible interference, the Act provided

17. Id. § 7212(a) (emphasis added to identify what has been commonly referred to as the "omnibus clause").
18. Id.
20. Id.
for fines or imprisonment for any person who might "[f]orcibly obstruct or hinder any collector, deputy collector, internal revenue agent, or inspector, in the execution of any power and authority vested in him by law . . . ". 25

The modern version of section 7212(a) was enacted as part of the Internal Revenue Code of 1954. 26 The section was modified from its lineage to include the language pertaining to "corruptly or by force . . . " and the obstruction of "the due administration of this title . . . ". 27

The House of Representatives purported that the current version of section 7212(a) was "similar" to 18 U.S.C. § 111, which proscribed assaults of federal employees engaged in the performance of their duties, but also "amplified" the protection afforded Internal Revenue Service employees by covering "all cases where the officer is intimidated or injured; that is, where corruptly, by force or threat of force, directly or by communication, an attempt is made to impede the administration of the internal revenue laws. " 28

The Senate version of this section indicated that it would correspond to that of the House bill except for applicable penalties. 29 The Senate version also indicated that the section was "broader" than 18 U.S.C. § 111 "in that it covers threats of force (including any threatening letter or communication) or corrupt solicitation." 30

Differences between the House and Senate versions were resolved by the Conference Committee in favor of the Senate (and current) version of the statute. 31

Hence, the legislative history of section 7212(a) fails to reveal any express intent behind the statute other than the protection of government employees against assaults or threats while in the performance of their duties.

IV. HISTORICAL APPLICATION OF THE STATUTE

For approximately twenty five years following its enactment in 1954, section 7212(a) was used exclusively to prosecute those persons who, by force or

25. Id. § 3601(c)(1).
27. Id. (emphasis added).
30. Id.
threats of force, interfered with IRS employees in the performance of their official duties. In a 1982 annotation, the author collected a series of historical cases prosecuted under section 7212(a). The annotation highlights that force or threats of force against IRS employees was a key ingredient in these cases. The statutory language pertaining to “force or threats of force” was deemed to be the operative provision of the statute. The annotation includes only one case (in 1981) prosecuted under circumstances other than acts directed at IRS employees or their enforcement activities.

As late as 1974, twenty years after codification of section 7212(a), the government argued in a tax fraud case that it could not charge the defendant under section 7212(a) since “that section ‘apparently applies only to acts or threats of physical violence . . . ’”

V. A CHANGING TREND IN THE APPLICATION OF THE STATUTE

As tax fraud schemes became more complicated, more difficult to detect, and increasingly difficult to prosecute under the more familiar statutes, the government had to seek innovative approaches to combat tax scofflaws. Rather than seek new criminal sanctions through legislation, beginning in at least 1981, the government sought to expand interpretation of section 7212(a) by arguing that there were two independent provisions of the statute.

The first provision related to the more familiar use of threats or force against IRS employees. The second provision was broader and proscribed conduct tending to impede the administration of the Code. The operative language of the second provision, a so-called “omnibus” clause, provides, “Whoever corruptly . . . obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title . . . .” An “omnibus bill” is defined as a legislative bill which includes various separate and distinct matters.

32. Elaine K. Zipp, Annotation, Corrupt or Forcible Interference With Administration of Internal Revenue Laws, Under 26 USCS § 7212(a), 60 A.L.R. FED. 776 (1982).
33. Id. at 778-80.
34. Id. at 777. See also United States v. Varani, 435 F.2d 758, 761-62 (6th Cir. 1970) (holding that “[t]he criminal intent involved in this statute is that of intentionally employing a threat of force in order to obstruct or impede an IRS employee in the lawful discharge of his duties”).
35. Zipp, supra note 32, at 780 (citing United States v. Williams, 644 F.2d 696 (8th Cir. 1981)).
37. See, e.g., United States v. Williams, 644 F.2d 696 (8th Cir. 1981).
Whereas section 7212(a) had been used for more than twenty five years since its enactment to prosecute cases involving force or threats, starting in 1981, the government sought to apply the statute in tax fraud cases. The government now looks to section 7212(a) in virtually every tax case.

VI. REACTION BY THE COURTS

Perhaps the first case of record came before the court in 1981 where the government sought to expand the use of section 7212(a) beyond threats or use of force cases. The defendants in the case promoted a tax fraud scheme to others for profit where they instructed participants to file exempt tax withholding certificates (IRS Forms W-4) to defeat the payment of income taxes. The court observed that there were no other cases of record in which the government attempted to apply the “omnibus” clause in cases not involving actions directed at IRS employees or their activities. The court further noted that it was an issue of first impression and that it should proceed with caution “where for over 25 years the Government has feared to tread.” The court acknowledged that the legislative history of the statute was “wholly silent of § 7212’s omnibus clause.” Yet, the court ultimately agreed with the government that the “broad language of section 7212’s omnibus clause demands a correspondingly broad construction.”

Also in 1981, the government asserted violation of section 7212(a) in a case where a defendant retook his files, which had just been taken by an IRS agent from the defendant in an investigation of a third party. The court extensively analyzed the history of the statute in holding that it proscribed conduct beyond threats of force. Even after the government’s successes in expanding application of the statute in the early 1980’s, its use in the statute in cases where force or threats of force against IRS employees was not involved was infrequent and its expansion was gradual.

40. Zipp, supra note 32.
42. Id.
43. United States v. Williams, 644 F.2d 696 (8th Cir. 1981).
44. Id.
45. Id. at 699.
46. Id.
47. Id. at n.13.
48. Williams, 644 F. 2d at 700.
50. Id. at 302-07.
In 1984, the court addressed the scope of the language of section 7212(a) where a defendant filed false complaints with the IRS in order to discredit the IRS auditor and hinder the investigation. The court concluded that neither the legislative history nor its language limited its broad terms and analogized the statute to other broad obstruction of justice statutes. The pivotal statutory clause for the court was the "corrupt endeavor" language, which the court held would include the filing of a false complaint against an IRS employee.

VII. THE GOVERNMENT ESTABLISHES POLICY FOR SECTION 7212(a)

In 1989, the United States Department of Justice (Tax Division) ("DOJ-Tax") issued a policy statement relating to applicable uses of the "omnibus" clause of section 7212(a). Under the policy, the government's position was that the overall purpose of section 7212(a) included a provision to penalize conduct aimed at general IRS administration of the tax laws. The directive provides, in part:

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. However, this charge might also be appropriate when directed at parties who engage in large-scale obstructive conduct involving actual or potential tax returns of third parties.

In relying on its success in court, the government's formal position now is that section 7212(a) contains two clauses. The first clause is more specific and relates to the use of force or threats against employees. The second clause is more general and is referred to as the "omnibus clause," which proscribes any conduct that either corruptly obstructs or impedes, or endeavors to obstruct or impede, the due administration of the Code.

VIII. ELEMENTS OF THE OMNIBUS CLAUSE OF SECTION 7212(a)

There are three elements to the omnibus clause of section 7212(a): (1) in any way corruptly, (2) endeavoring, and (3) to obstruct or impede the due admin-

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52. Id. at 1409.
53. Id. at 1409-10.
55. TAX DIVISION, U.S. DEP'T OF JUSTICE, CRIMINAL TAX MANUAL § 17.02 (citing United States v. Williams, 644 F.2d 696, 699 (8th Cir. 1981)).
istration of the Internal Revenue Code. Each of these elements will be discussed in turn.

1. In Any Way Corruptly

The first element of the statute's omnibus clause is "in any way corruptly." With respect to section 7212(a), the term "corruptly" refers to conduct intended to secure an unlawful benefit or advantage for oneself or another. It includes conduct directed at efforts to impede the collection or audit of one's own or another's tax matters and does not require a showing of bad or evil purpose. In particular, corruptly includes, but is not limited to, an effort to secure a financial gain. The court has concededly afforded broad construction to the "corruptly" element.

2. Endeavoring

The second element of the statute's omnibus clause is "endeavoring." The court has defined "endeavor" under section 7212(a) using language from cases involving other obstruction of justice statutes. Under United States v. Martin, the court adopted the definition of "endeavor" as "any effort...to do or accomplish the evil purpose that section was intended to prevent.

Under a DOJ-Tax operative manual, "[t]he manner by which a defendant can 'endeavor' to impede the due administration of the internal revenue laws is unlimited." The agency relies on the "in any other way" broad language in the opening phrase of the omnibus clause to support its position.

56. I.R.C. § 7212(a) (1994); Williams, 644 F.2d at 699.
58. See e.g., United States v. Reeves, 752 F.2d 995, 1001-02 (5th Cir. 1985). See also United States v. Hanson, 2 F.3d 942, 946 (9th Cir. 1993); United States v. Yagow, 953 F.2d 423, 427 (8th Cir. 1992); United States v. Popkin, 943 F.2d 1535, 1540 (11th Cir. 1991).
59. Reeves, 752 F.2d at 998.
60. Yagow, 953 F.2d at 427.
64. Osborn, 385 U.S. at 333.
65. Tax Division, supra note 55, § 17.05.
66. Id.
3. To Obstruct or Impede the Due Administration of the Internal Revenue Laws

The third element of the statute's omnibus clause is an attempt to obstruct or impede the administration of the Code. The most substantive evolution of application of section 7212(a) is that violation of the statute includes acts not directed at IRS employees. The attempt need not succeed.

IX. THE MODERN TREND IN APPLICATION OF SECTION 7212(a)

Perhaps one of the most demonstrative cases of the shift in prosecutorial use of the statute was before the court in United States v. Popkin. In Popkin, an attorney was convicted of violating section 7212(a) based on his assistance to a client in creating a domestic corporation to disguise the character of income earned from selling illegal narcotics. The "client" was in fact cooperating with the government in a sting operation against the attorney. At the direction of government agents, the client informed the attorney that he had secreted offshore approximately $200,000 from illicit drug deals and that he now wanted to repatriate the funds and therefore needed to show a legal source of the money on tax returns. The attorney assisted the client in forming a California corporation as a purported legitimate source of revenue. The attorney also prepared two years of false tax returns for the client showing a legitimate source of revenue and discussed methods of repatriating the client's offshore funds. The attorney was charged with two counts relating to the filing of the false tax returns (for which he was ultimately acquitted) and one count of violation of section 7212(a) (for which he was ultimately convicted).

The charge against the attorney for violating section 7212(a) was premised on his corruptly obstructing and impeding and endeavoring to obstruct and impede the due administration of the tax laws by creating the domestic cor-

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68. See supra, Part V.
70. United States v. Popkin, 943 F.2d 1535, 1541 (11th Cir. 1991).
71. United States v. Rosnow, 977 F.2d 399, 410 (8th Cir. 1992).
72. Popkin, 943 F.2d at 1535.
73. Id. at 1541.
74. Id. at 1536.
75. Id.
76. Id.
77. Popkin, 943 F. 2d at 1536.
oration for the client for purposes of concealment. On appeal, the attorney's principal argument was that the only act charged in the indictment, creating a corporation, was legal, and not proscribed by the obstructing or impeding language of section 7212(a).

The government's simple response to the defendant's argument was that the plain language of the statute makes it clear that force or threats of force are not required for its violation. The government conceded that the statute was historically used in force or threats of force cases but contended that such historical use does not alter the plain meaning of the statute.

In its opinion, the court primarily addressed the term "corruptly," as used twice in the statute, and whether performing a legal act (i.e. forming a corporation) could be deemed as "corrupt" within the meaning of the statute. The court noted that the second (omnibus) clause of the statute does not require force or threats of force and that the clause "expands the reach of the statute by providing that it is violated if a person 'in any other way,' either corruptly or by force or threats of force does the prohibited act."

In turning to the issue of whether the attorney's act of creating a corporation was a corrupt act within the meaning of the statute, the court concluded that "corruptly" is used to forbid acts "done with the intent to secure an unlawful benefit either for oneself or for another." The court went on to conclude that the attorney's act of creating a corporation for a client was a corrupt act for the purpose of enabling the client to disguise the character of illegally earned income in order to secure an unlawful benefit for the client.

The Fourth Circuit adopted the rationale of Popkin in United States v. Mitchell where a defendant concededly acted criminally but claimed his conduct was not violative of section 7212(a). In Mitchell, a United States Department of Interior zoologist incorporated, and obtained tax-exempt status for, an organization for purposes of soliciting contributions from big-game hunters to have endangered animals delisted. Mitchell then caused the hunters to falsely claim

78. Id. at 1537.
79. Id.
80. Id. at 1538.
81. Id.
82. Popkin, 943 F.2d at 1539-41.
83. Id. at 1539 (emphasis added).
84. Id. (quoting United States v. Reeves, 752 F.2d 995, 1001 (5th Cir. 1985)).
85. Id. at 1540.
87. Id. at 1276-77.
On appeal, Mitchell argued that section 7212(a) requires conduct directed at another person and that "corruptly" refers to the means of obstructing or impeding rather than simply a state of mind. In unanimously dismissing Mitchell's argument, the court cited Popkin's interpretation of section 7212(a)'s omnibus clause that the "word corruptly was used to 'prohibit all activities that seek to thwart the efforts of government officers and employees in executing the laws enacted by Congress.'" The court cited several other cases where courts presumed a broad construction of the statute.

The modern trend in enforcement of section 7212(a) is to look to the statute in virtually every potential tax fraud case. The six year old DOJ-Tax policy statement does not accurately reflect the more aggressive posture being taken by the government in the past few years. The statute will be used more against doctors, lawyers and accountants. In particular, the offense is deemed appropriate for practitioners who perform a legal act for an unlawful purpose. As in Popkin and Mitchell, prosecution was based on conduct partially related to the defendants' roles as tax advisors.

Recent cases where the IRS planned to recommend prosecution for violation of section 7212(a) include a case against an attorney based on his co-mingling of income and trust funds into one bank account; a physician who paid employees in cash to defeat the payment of income and employment taxes; and a restaurant owner who attempted to conceal his true income and expenses by dealing mostly in cash, rather than through a business bank account.

The prosecutorial appeal of section 7212(a) in no small way emanates

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88. Id. at 1277.
89. Id.
90. Id. at 1278.
91. Mitchell, 985 F. 2d at 1278-79 (citing United States v. Popkin, 943 F.2d 1535 (11th Cir. 1991); United States v. Williams, 644 F.2d 696 (8th Cir. 1981); United States v. Shriver, 967 F.2d 572 (11th Cir. 1992); United States v. Yagow, 953 F.2d 423 (8th Cir. 1992); United States v. Hatchett, 918 F.2d 631, 634 (6th Cir. 1990); United States v. Hammerman, 528 F.2d 326, 328 (4th Cir. 1975); United States v. Krause, 786 F. Supp. 1151 (E.D.N.Y. 1992); United States v. Martin, 747 F.2d 1404, 1409 (11th Cir. 1984)).
92. Krysa, supra note 41.
93. TAX DIVISION, supra note 54.
94. Krysa, supra note 41.
95. Id.
96. Id.
97. Interview with John Voorhees, Special Agent, IRS, Criminal Investigation Division (Jan. 4, 1996).
from its lesser standard of proof. The statute does not require "wilfulness" as an independent element of the offense. Rather, culpability is premised on the concept of corruptness.

X. AVOIDING THE PITFALLS

The practitioner’s best defense against section 7212(a) is to keep detailed records of tasks they have been engaged to perform for a client. Practitioners Robert Webb and Silvija Strikis advise practitioners on the following practices:

1. Clearly define, in correspondence with the IRS, an understanding of the obligation to provide certain information or documents, and clearly state what information is being provided.

2. Carefully document the advice given to clients concerning sensitive tax issues, and have an associate present when conducting initial interviews of vulnerable clients.

3. Follow applicable state or professional society rules of conduct so as to avoid the appearance of impropriety.

4. When advising a client, consider how the advice would be viewed if it appeared on the front page of a newspaper.

5. Be extremely wary when performing work for clients under criminal investigation.

6. As appropriate, seek the counsel of one experienced in criminal tax matters if conduct or advice in representing a taxpayer may violate Section 7212(a).

The law or tax practitioner should not be concerned that the IRS stands ready to wield its freshly honed weapon against the unsuspecting. As expressed by the courts, the operative word in the statute is "corruptly." Beyond the sound advice of careful documentation of transactions with clients, there is the old-fashioned "duck" test. If it looks like a duck, acts like a duck, and smells like a duck, it might be a duck. And some ducks just do not float.

98. United States v. Reeves, 752 F.2d 995 (5th Cir. 1985).
100. Id. at 366.
101. Id.