Tax Controversies: Audits, Investigations, Trials

Criminal Charges

1-16 Tax Controversies: Audits, Investigations, Trials § 16.02

§ 16.02 False Returns: IRC Section 7206(1)

Section 7206(1) provides, in pertinent part:

"Any person who-

"(1) Declaration under penalties of perjury.--Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter;

"...

"shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution." n68

Although the statutory maximum punishment for an offense under *IRC Section 7206(1)* n69 is less than that under *IRC Section 7201*, the elements that the government is required to prove are correspondingly less burdensome. The elements of an offense under Section 7206(1) n70 are:

(1) belief of falsity;

(2) willfulness; n71

(3) the false statement was with respect to a material matter; and

(4) the defendant's making and subscribing of the document (usually a return) under penalties of perjury. n72

However, when a taxpayer files a return containing several schedules, Section 7206(1) applies to false statements on the schedules, even if the schedules did not specifically contain a declaration that they were made under penalties of perjury, and even if the applicable regulations did not require the taxpayer to respond to specific questions on the schedule. n73 Unlike Section 7201, Section 7206(1) does not require the government to prove that the false statement resulted in a tax deficiency or that the falsification was motivated by tax evasion. n74 Thus, the government will typically charge a defendant under Section 7206(1) when it can prove that the defendant willfully understated his or her gross receipts or gross income, or claimed false deductions or credits, but there is insufficient evidence to establish a tax deficiency. n75 Since the making and subscribing of a return are elements of a Section 7206(1) offense, generally only the taxpayer himself may be liable under this provision. However, one appellate court held that when a tax preparer prepares and signs a return, as the preparer, he may be charged under Section 7206(1) with "making and subscribing" a false return. n76 The Second Circuit rejected a taxpayer's contention that Section 7206(1), as a perjury statute, could not, as a matter of law, be violated by a corporation. The taxpayer argued under an old line of authority that corporations cannot commit perjury since a corporation cannot take an oath to tell the truth. The court held that while a corporation has no

independent state of mind, the acts of individuals on its behalf may be properly chargeable to it. n77 However, since the "subscribing" of a return is an element to a violation of Section 7206(1), an unsigned return cannot be the basis for a Section 7206(1) conviction.

It is curious that, read literally, Section 7206(1) prohibits the making of a return which the taxpayer believed to be false. Theoretically, one may argue that a prosecution could be brought under this statute for making a return that was completely true and accurate, provided that it could be established that the taxpayer for some reason believed it to be false. This point was recognized in *United States v. Balistrieri*: "[T]he essence of the offense under Section 7206(1) is the lack of belief in the truth and correctness of the matter represented ... An inaccurate statement, in and of itself, is not a violation of Section 7206(1)." n78 However, as a practical matter, under *IRC Section 7206(1)*, the government will proceed only in cases where it believes it can establish an actual false or fraudulent statement in the return coupled with proof of willfulness, in order to establish the taxpayer's belief in the falsity, n79 and some cases have explicitly held that falsity of the return is an element of an offense under Section 7206(1). n80 Indeed, in order for a statement to be deemed "false or fraudulent," some courts have held that the information had to have been supplied with either an intent to deceive or be false in the sense of deception. Under this definition, it was held that an entry of 3 billion dependents on an individual's withholding statement could not, as a matter of law, have been false or fraudulent since a deception could not have been intended to be believed. n81

In general, materiality is defined as all information necessary for the IRS to determine the accuracy of the tax return in question. n82 Proof of a tax deficiency is not necessary to prove materiality. n83 Moreover, an understatement of gross income, even if offset by an understatement of losses, can support a conviction under Section 7206(1). n84 Although the government bears the burden of proving materiality, it need not prove that the defendant had actual knowledge of the materiality of the false declarations in her income tax returns. n85

At one time, most courts held that materiality was a question of law for the court, not an issue of fact to be determined by the jury. n86 In 1995, however, the U.S. Supreme Court decided *United States v. Gaudin*, n87 in which it held that, in a prosecution under *18 USC Section 1001*, n88 materiality is a question of fact, to be decided by the jury. Most courts have since held that the same rule must be followed in prosecutions under *IRC Section 7206*. n89

At the time when materiality was considered an issue of law, most courts interpreted this element very broadly: any omission of gross income was considered material by some courts, n90 even if small in amount n91 or if the taxpayer had unclaimed offsetting deductions that would eliminate any tax deficiency. n92 Some cases held that any false statement was material, even if it had no tax effect, if it could have affected the IRS's ability to audit the return, n93 such as a misstatement as to the *source* of reported income. n94

Now that materiality is recognized to be an issue of fact for the trial jury, courts have recognized that juries may take a narrower view and fail to find false statements to be material if they do not result in a substantial tax deficiency. n95 These rulings open new possibilities for defense counsel at trial. Notwithstanding the Supreme Court's decision in *Gaudin*, the Second Circuit, in *United States v. Klausner*, ruled that statements of false deductions on a tax return which resulted in an inaccurate computation of taxable income were, as a matter of law, material. n96 The *Klausner* reasoning was expressly rejected by the Ninth n97 and Tenth Circuits n98 and in *Neder v. United States*, n99 the Supreme Court effectively overruled *Klausner* by holding that the District Court erred in failing to charge the jury with materiality. In *Neder*, however, the discrepancy on the tax return was substantial and the Supreme Court, therefore, held that the error was harmless.

While Section 7206(1) requires that the taxpayer "make and subscribe" the false return, there is a statutory presumption that the taxpayer signed the return. n100 Moreover, it is not necessary that the taxpayer personally sign the return, so long as the evidence shows that the taxpayer directed the signing of the return with knowledge of its content. n101 Several courts have assumed that the taxpayer's signature on the return may be considered as evidence that the taxpayer was aware of the return's falsity

when it was signed. n102 However, more recently, the Ninth Circuit held that a jury instruction (taken from the U.S. Department of Justice *Criminal Tax Manual*) that instructed the jury that the defendant's signature on a return created a rebuttable presumption that she both signed it and had knowledge of its contents was erroneous. n103 The jury instruction was based on *IRC Section 6064* and the court concluded that Section 6064 only provides that an individual's signature on the return is*prima facie* evidence that the return was actually signed by that individual. It is not an indication that the signator had knowledge of the contents of the return. n104

The Government can charge, in a single indictment, that a taxpayer violated both Section 7206(1) and Section 7201 for the same years. Under certain factual situations, the Section 7206(1) count may be considered a lesser included offense of the Section 7201 count. A charge is a lesser included offense when "it is composed of fewer than all of the elements of the [greater] offense charged, and if all of its elements are elements of the [greater] offense charged." n105 If the facts in a case permit a jury to rationally find the taxpayer guilty of the lesser charge and not guilty of the greater charge then the jury should be given an instruction as to the lesser included offense, whether or not that lesser included offense is actually charged in the indictment. n106 If, however, the factual issues are identical in both the lesser and greater offenses, then the lesser offense is totally encompassed by the greater offense and no lesser included offense instruction should be given to the jury. n107 When a taxpayer is convicted of both Section 7201 and 7206(1) offenses for the same year, the Section 7206(1) offense will be deemed merged with the Section 7201 offense. As such, the sentencing judge is not permitted to pyramid a Section 7206(1) sentence on top of the maximum penalty provided for Section 7201. n108 If there is no distinction in a given case between the factual elements constituting the Section 7201 and Section 7206(1) charges, then the lesser included offense should not be submitted to the jury, since the jury could not rationally acquit the taxpayer of the Section 7201 charge and convict him of the lesser included Section 7206(1) charge. In *United States v. Citron*, n109 the alleged false statement constituting a Section 7206(1) charge was solely the material underreporting of a substantial sum of the taxpayer's adjusted gross income. Evidence proving the Section 7206(1) false statement would necessarily mean that Section 7201 was violated because of the direct relationship between adjusted gross income and tax due. In *Citron*, the court held that the jury could not reasonably have found that some underreporting occurred which was less than that alleged yet too small to result in substantial tax evasion, i.e., a rational jury could not have both convicted the taxpayer of underreporting, yet acquitted him of tax evasion. Nevertheless, the jury returned a not guilty verdict on several of the Section 7201 counts while convicting the taxpayer under Section 7206(1) for the same tax years. The appellate court ruled that the convictions under Section 7206(1) must be dismissed. n110 Under the reasoning of *Citron*, if there are no differences in the essential elements to be proven on the Section 7201 and Section 7206(1) counts, it is reversible error to allow the jury to return separate verdicts on the two counts. Instead, the prosecution will be required to elect which count is wishes to present to the jury. n111

FOOTNOTES:

(n1)Footnote 68. Although *IRC § 7201* provides for a maximum fine for individuals of $100,000, under *18 USC § 3571*, the Criminal Fine Enforcement Act of 1984, an individual can be fined up to $250,000 for a conviction under *IRC § 7201*.

(n2)Footnote 69. When an *IRC § 7206(1)* charge is a lesser included offense of a tax evasion charge (*IRC § 7201*), the imposition of cumulative sentences is improper. *US v White, 417 F2d 89, 93 (2d Cir 1969).* See also *United States v Dale, 991 F2d 819, 858-59 (DC Cir1993)* (§ 7206 and § 7201 convictions merge where both premised on same improper tax deductions); *United States v Sturman, 951 F2d 1466, 1487-88 (6th Cir 1991)* (simultaneous convictions for § 7201 and § 7206 may stand only where proof of tax evasion does not necessarily prove the preparation and filing of a fraudulent return); *United States v Helmsley, 941 F2d 71, 99 (2d Cir 1991)* (§ 7201 and § 7206 counts merge where both were premised on omission of the same item of income from the same tax returns).

(n3)Footnote 70. See, eg, *US v LaSpina, 299 F3d 165, 179 (2d Cir 2002)* (setting forth elements).

(n4)Footnote 71. The standard of willfulness under *IRC § 7206(1)* is the same as the standard under *IRC § 7201*. *US v Bishop, 412 US 346 (1973)* . See *§ 16.01[1][c]*, *supra*, for a discussion of the willfulness element in criminal tax charges.

(n5)Footnote 72. In *US v Levy, 533 F2d 969 (5th Cir 1976)* , the court reversed an *IRC § 7206(1)* conviction for filing a false IRS Form 433-AB (Statement of Financial Condition and Other Information) on the ground that the form was not authorized by Code or regulation and that due process required that the taxpayer be given notice of the uses to which forms may be put before he may be criminally prosecuted in connection therewith. A year later, in *US v Taylor, 574 F2d 232 (5th Cir 1978)* , the Fifth Circuit held that *IRC § 7206(1)* would apply to forms that are incorporated by reference into other forms whose use has express statutory or regulatory basis. The Second Circuit, contrary to the Fifth Circuit, has held that a form need have no express statutory or regulatory basis to serve as the basis of an *IRC § 7206(1)* prosecution. *US v Holroyd, 732 F2d 1122 (2d Cir 1984)* . See also *US v Pansier, 576 F3d 726 (7th Cir 2009)* (7206(1) conviction sustained based on defendant's filing false Form 8300); *US v Hunerlach, 197 F3d 1059 (11th Cir 1999)* , *appeal after remand*, *258 F3d 1282 (11th Cir 2001)* (conviction sustained based on a signing of false Form 433A); *US v Darrah, 119 F3d 1322 (8th Cir 1997)* (false Form 433); *US v Marston, 517 F3d 996, 1002 (8th Cir 2008)* (false document filed with IRS need not constitute a tax return in order to support a conviction under 7206(1)).

(n6)Footnote 73. *US v Hills, 618 F3d 619 (7th Cir 2010)* (false Schedule C attached to tax return); *US v Presbitero, 569 F3d 691 (7th Cir 2009)* (false schedule A on tax return); *US v Greulich, 22 Fed Appx 807 (9th Cir 2001)* (Forms W-2G and 5754 containing misrepresentations were attached to [taxpayers] forms 1040 and therefore became "integral parts" of that filing); *US v Franks, 723 F2d 1482 (10th Cir 1983)* (Form 4683 pertaining to foreign bank accounts appended to Form 1040); See also *US v Saani, 557 F Supp 2d 97 (DDC 2008)* (7206(1) prosecution based on Schedule B to tax return that failed to identify interest in foreign bank account); *US v Sun Myung Moon, 532 F Supp 1360, 1365-66 (SDNY 1982)* , *affd*, *718 F2d 1210 (2d Cir 1983)* . *US v Taylor, 574 F2d 232 (5th Cir 1978)* ; *US v Gonzales, 620 F Supp 1143 (ND Ill 1985)* ; *US v Henderson, 399 F Supp 508 (SDNY 1975)* . But see *US v Adams, 314 Fed Appx 633 (5th Cir 2009)* (prosecution under 7206(1) based on allegedly false schedule C attached to Form 1040X was unsustainable, because jurat to 1040X expressly stated that taxpayer was attesting to accuracy of the amended return, but was silent as to accuracy of any accompanying schedules).

(n7)Footnote 74. *US v Scholl, 166 F3d 964 (9th Cir 1999)* ; *US v Peters, 153 F3d 445 (7th Cir 1998)* ; *US v Minneman, 143 F3d 274 (7th Cir 1998)* ; but see *Boulware v US, 552 US 421, n.9 (2008)* (noting that defendant's "§§ 7201 [tax evasion] and 7206(1) [false return] convictions stand or fall together," reasoning that "[a]lthough the Courts of Appeals are unanimous in holding that § 7206(1) 'does not require the prosecution to prove the existence of a tax deficiency,' ... it is arguable that 'the nature and character of the funds received can be critical in determining whether ... § 7206(1) has been violated, [even if] proof of a tax deficiency is unnecessary' ").

(n8)Footnote 75. See, eg, *US v Langford, 647 F3d 1309, 1323-24 (11th Cir 2011)* (where defendant, a public official, accepted bribes consisting of cash, clothing, and jewelry, defendant's failure to report such cash, clothing, and jewelry on his income tax return was sufficient to establish that he filed a false return in violation of *IRC § 7206(1)*); cf. *US v Powell, 576 F3d 482 (7th Cir 2009)* (§ 7206(1) prosecution for filing false tax return that omitted income, notwithstanding fact that taxpayer had filed amended return reporting the previously omitted income and paid the additional tax due).

(n9)Footnote 76. *US v Shortt Accountancy Corp, 785 F2d 1448 (9th Cir 1986)* .

(n10)Footnote 77. *US v Ingredient Technology Corp, 698 F2d 88 (2d Cir 1983)* .

(n11)Footnote 78. *346 F Supp 341, 348 (ED Wis 1972)* . *IRC § 7206(1)* has been upheld against claims it is unconstitutionally vague. *US v Marrinson, 620 F Supp 198 (ND Ill 1985)* .

(n12)Footnote 79. *US v Borman, 992 F2d 124 (7th Cir 1993)* (in filing a truthful Form 1040A, taxpayer omitted certain information which, although not required on Form 1040A, should have been reported on Form 1040; held, for the taxpayer); *US v Reynolds, 919 F2d 435 (7th Cir 1990)* (same). See also *Gaunt v US, 184 F2d 284, 288 (1st Cir 1950).*

(n13)Footnote 80. Eg, *US v Hanson, 2 F3d 942, 945 (9th Cir 1993)* .

(n14)Footnote 81. *US v Snider, 502 F2d 645 (4th Cir 1974)* . *Cf US v Bennallack, 106 F3d 409 (Table)* (9th Cir 1996) ("government must prove defendants acted with specific intent to defraud ..."); *US v Salerno, 902 F2d 1429 (9th Cir 1990)* ("government must prove not only that the defendant's conduct affected tax revenue, but that tax fraud was an objective") (§ 7206(2) cases). But see *US v Winchell, 129 F3d 1093 (10th Cir 1997)* (taxpayer's argument that his filings were not material since they were "objectively incapable of influencing the IRS because of [his] well-known tax protestor status and the preposterous monetary figures provided" was rejected).

(n15)Footnote 82. *US v Hills, 618 F3d 619 (7th Cir 2010)* (7206(1) requires showing that false entry on tax return was "material," either because it " 'has the potential [to] hinder[ ] the IRS's efforts to monitor and verify the tax liability' " of the taxpayer, or because "it results in the underpayment of tax"). See also *US v Josephberg, 562 F3d 478 (2d Cir 2009)* (deduction of net operating loss from disallowed tax shelter held to be material misstatement, where taxpayer was previously told that loss was impermissible); *US v Anderson, 353 F3d 490 (6th Cir 2003)* (defendant's claim that the falsity of the information on the Form 8300 was not "material" because in the absence of any reportable transaction there was no duty to file the Form 8300 and no tax to be computed by the IRS was rejected; as a matter of law it is material to falsely report a transaction on Form 8300 even when no transaction in fact occurred).

(n16)Footnote 83. *US v Scholl, 166 F3d 964, 980 (9th Cir 1999)* ; *US v Peters, 153 F3d 445 (7th Cir 1998)* .

(n17)Footnote 84. *US v Taylor, 574 F2d 232 (5th Cir 1978)* . Similarly, there is no requirement that any amount of unreported income be substantial. *US v Holland, 880 F2d 1091 (9th Cir 1991)* . Thus, a trial court's refusal to allow expert testimony that the defendant overpaid its taxes was proper. *US v Loe, 248 F3d 449, 469 (5th Cir 2001)* .

(n18)Footnote 85. *US v Boulerice, 325 F3d 75 (1st Cir 2003)* .

(n19)Footnote 86. *US v Fawaz, 881 F2d 259 261-62 (6th Cir 1989)* ; *US v Greenberg, 735 F2d 29, 31 (2d Cir 1984)* .

(n20)Footnote 87. *515 US 506 (1995)* .

(n21)Footnote 88. See *§ 16.08[2]*, *infra*, for a discussion of *18 USC § 1001*, concerning prosecutions for false statements.

(n22)Footnote 89. *US v Clifton, 127 F3d 969 (10th Cir 1997)* ; *US v Uchimura, 125 F3d 1282 (9th Cir 1997)* ; *US v DeRico, 78 F3d 732 (1st Cir 1996)* ; *US v McGuire, 99 F3d 671 (5th Cir 1996)* (*en banc*) (holding that the issue of materiality had been properly submitted to the jury); *US v DiDomenica, 78 F3d 294, 302-303 (7th Cir 1996)* ; *contra*, *US v Klausner, 80 F3d 55, 58-61 (2d Cir 1996)* , but see *id at 63-64* (dissenting op).

(n23)Footnote 90. *US v Scholl, 166 F3d 964 (9th Cir 1999)* ; *US v Aramony, 88 F3d 1369, 1384 (4th Cir 1996)* .

(n24)Footnote 91. *US v Clemmer, 748 F Supp 1249, 1255 (SD Ohio 1989)* , *revd on other grounds 918 F2d 570 (6th Cir 1990)* .

(n25)Footnote 92. *US v Marashi, 913 F2d 724, 736 (9th Cir 1990)* ; *US v Lasiter, 819 F2d 84, 87-88 (5th Cir 1987)* . The existence of a tax deficiency is not an element of the crime. *US v Marabelles, 724 F2d 1374, 1380 (9th Cir 1984)* .

(n26)Footnote 93. *US v Scholl, 166 F3d 964 (9th Cir 1999)* ; *US v Peters, 153 F3d 445 (7th Cir 1998)* ; *US v Minneman, 143 F3d 274 (7th Cir 1998)* ; *US v Shetty, 130 F3d 1324 (9th Cir 1997)* ; *US v Fawaz, 881 F2d 259, 263-64 (6th Cir 1989)* ; *US v Greenberg, 735 F2d 29, 32 (2d Cir 1984)* .

(n27)Footnote 94. *US v Lamberti, 847 F2d 1531 (11th Cir 1988); US v Bliss* , *735 F2d 294 (8th Cir 1984)* ; *US v DiVarco, 343 F Supp 101 (ND Ill 1972)* , *affd*, *484 F2d 670 (7th Cir 1973)* .

(n28)Footnote 95. *US v Uchimura, 125 F3d 1282, 1285-86 (9th Cir 1997)* (defense of offsetting unclaimed deductions raises a jury issue as to materiality of omitted income); *US v Clifton, 127 F3d 969, 971 (10th Cir 1997)* (same).

(n29)Footnote 96. *80 F3d 55 (2d Cir 1996)* . See also *US v Zvi, 168 F3d 49, 59 (2d Cir 1999)* .

(n30)Footnote 97. *US v Uchmira, 125 F3d 1282, 1285 (9th Cir 1997)* .

(n31)Footnote 98. *US v Clifton, 127 F3d 969 (10th Cir 1997)* .

(n32)Footnote 99. *Neder v US, 527 US 1 (1999)* . See also *US v Foster, 229 F3d 1196 (5th Cir 2000)* ; *US v Zvi, 168 F3d 49 (2d Cir 1999)* ; *US v Radazzo, 80 F3d 623 (1st Cir 1996)* .

(n33)Footnote 100. *IRC § 6064*. See *US v Kim, 884 F2d 189 (5th Cir 1989)* ; *US v Cashio, 420 F2d 1132 (7th Cir 1969)* (presumption applies in criminal cases); *US v Fawaz, 881 F2d 259, 265 (6th Cir 1989)* ; *US v Wilson, 887 F2d 69, 72 (5th Cir 1989)* .

(n34)Footnote 101. *US v Ponder, 444 F2d 816, 822 (5th Cir 1971)* .

(n35)Footnote 102. *US v Tucker, 133 F3d 1208, 1218 (9th Cir 1998)* ("Tucker's signature on his return is sufficient to establish knowledge once it has been shown that the return was false."); *US v Olbres, 61 F3d 967 (1st Cir 1995)* ; *US v Drape, 668 F2d 22, 26 (1st Cir 1982)* (holding that the defendant's signature on his return sufficed to establish knowledge of incorrect contents); *US v Romanow, 505 F2d 813, 814 (1st Cir 1974)* (dismissing taxpayer's denial that he had read tax form, and stating that "it is clear that a jury could disbelieve him and conclude from nothing more than the presence of his uncontested signature that he had in fact read" the document).

(n36)Footnote 103. *US v Trevino, 394 F3d 771, 776 (9th Cir 2005)* .

(n37)Footnote 104. Although the *Trevino* court found that it was error to give such instruction, the error was found to be harmless.

(n38)Footnote 105. *US v LoRusso, 695 F2d 45, 52 n 3 (2d Cir 1982)* .

(n39)Footnote 106. See *Sansone v US, 380 US 343 (1965)* .

(n40)Footnote 107. See generally, *Fed R Crim P Rule 31(c)*; "What constitutes lesser offenses 'necessarily included' in offense charged, under*Rule 31(c) of Federal Rules of Criminal Procedure*," *11 ALR Fed 173* ; *Berra v US, 351 US 131 (1956)* ; *Sansone v US, 380 US 343 (1965)* ; *US v Bishop, 412 US 346 (1973)* .

(n41)Footnote 108. *US v Pulawa, 532 F2d 1301 (9th Cir 1976)* ; *US v White, 417 F2d 89 (2d Cir 1969)* . If cumulative sentences are erroneously imposed, the issue arises as to which sentence should be vacated. *Compare US v Michel, 588 F2d 986, 1001 (5th Cir 1979)* (the proper remedy is to vacate the conviction of the lesser-included offense) *with US v Stone, 702 F2d 1333 (11th Cir 1983)* (remanding case for resentencing on either offense). *IRC §§ 7201* and *7206(1)* are treated identically under the sentencing guidelines. See Chapter 21. See also *US v Gricco, 277 F3d 339 (3d Cir 2002)* ; *US v Helmsley, 941 F2d 71 (2d Cir 1991)* .

(n42)Footnote 109. *783 F2d 307 (2d Cir 1986)* .

(n43)Footnote 110. *Id.* See *US v Chrane, 529 F2d 1236 (5th Cir 1976)* (taxpayer was convicted of violating four counts of *IRC § 7203* for a two-year period, i.e., two counts of failure to file income tax returns and two counts of failure to supply information to the IRS on a Form 1040; the appellate court held that the two offenses were coterminous and the defendant could not be convicted of both; the case was

remanded with instructions that the government elect which convictions it wished to leave in effect and that the taxpayer be resentenced on those convictions alone); *US v Kaiser, 893 F2d 1300 (11th Cir 1990)* .

(n44)Footnote 111. But *cf US v Gricco, 277 F3d 339, 351 (3d Cir 2002)* (because the sentences imposed on the defendants for making false returns are concurrent to their sentences for tax evasion, the former sentences do not increase the length of their incarceration, entry of judgments by the district court on both offenses was harmless error).