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Timothy J. Coley

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Disputed Deductions: *Delfino* and the Fourth Circuit's Prudent Adoption of the Restrictive Approach to Tax Evasion Sentencing*

Justice Hugo Black famously remarked that "[t]he United States has a system of taxation by confession. That a people so numerous, scattered and individualistic annually assesses itself with a tax liability, often in highly burdensome amounts, is a reassuring sign of the stability and vitality of our system of self-government."[1] Justice Black was certainly correct in asserting that the United States enjoys a remarkably high compliance rate, as over eighty-six percent of taxpayers properly report and file their federal income taxes.[2] However, the primary motivator driving most Americans to diligently pay their taxes is not sheer moral compulsion, but perhaps a more visceral emotion—the unmitigated fear of audit and conviction for tax-related offenses.[3] In recent years, audit rates have risen, and the courts have imposed progressively steeper sentences for those convicted of tax evasion, pushing taxpayer apprehension even higher.[4]

Recently, in *United States v. Delfino*,[5] the U.S. Court of Appeals for the Fourth Circuit further reinforced this trend by ensuring that those convicted of tax evasion receive even stricter sentences.[6] In

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1. United States v. Kahriger, 345 U.S. 22, 36 (1953).

2. The compliance rate is the ratio of taxpayers who submit their federal income taxes compared to the total number who should. I.R.S., REDUCING THE FEDERAL TAX GAP 1 (2007), http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

3. *See, e.g.*, Posting of Judge Richard Posner, United States Court of Appeals for the Seventh Circuit, to Becker-Posner Blog, http://www.becker-posner-blog.com/archives/2007/11/tafx_evasionposn.html (Nov. 25, 2007, 16:16 EST) (commenting that taxpayers' fear of punishment is a more compelling motivation for taxpaying than moral duty); *see also* John T. Scholz & Neil Pinney, *Duty, Fear, and Tax Compliance: The Heuristic Basis of Citizenship Behavior*, 39(2) AM. J. OF POL. SCI. 490, 490–96 (1995) (examining heuristically the relationship between taxpayer fear and compliance). *But cf.* Posting of Gary Becker, University Professor, Department of Economics and Sociology and the Graduate School of Business, University of Chicago, to Becker-Posner Blog, http://www.becker-posner-blog.com/archives/2007/11/why_so_little_t.html (Nov. 25, 2007, 16:51 EST) (arguing the importance of moral duty).

4. *See infra* notes 28–34 and accompanying text.

5. 510 F.3d 468 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008).

6. *Id.* at 473.

rejecting its prior approach,[7] the Fourth Circuit held that, for sentencing purposes, convicted tax evaders are not allowed the benefit of unclaimed deductions that would otherwise have the effect of reducing their sentences under the United States Sentencing Guidelines ("Guidelines").[8] This holding is significant because the federal courts have been split over the proper role of deductions in sentencing formulations ever since a series of ambiguous amendments to the Guidelines was enacted in 1993 ("'93 Amendments").[9] Accordingly, this Recent Development will argue that, as evidenced by the Fourth Circuit's *Delfino* decision, a pronounced trend has emerged among the federal circuits toward the disallowance of deductions in the calculation of sentences for tax-related convictions. First, this Recent Development will discuss the relevant tax- and sentencing-related concepts behind this issue and will survey the contrasting approaches taken by the federal courts, including the historical contours of the current trend. Next, it will examine the policy implications behind this shift and will conclude that the Fourth Circuit's about-face was a prudent move, as its current approach is more consonant with important policy considerations—namely, administrability, retribution, deterrence, and the Guidelines' overall objectives of consistency and stricter sentencing. Finally, this Recent Development will recommend that the U.S. Sentencing Commission adopt a revised amendment ("Revised Amendment") to the Guidelines, which would codify the Fourth Circuit's current approach, thereby promoting uniformity among the federal courts.

On April 27, 2006, in the Federal District Court for the Eastern District of Virginia, James and Jeaniene Delfino were each convicted on four counts of attempted evasion of income tax, mail fraud, and

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7. *See* United States v. Schmidt, 935 F.2d 1440, 1450–51 (4th Cir. 1991) (allowing defendants to claim deductions when calculating their sentences).

8. *See Delfino*, 510 F.3d at 473. The Federal Sentencing Guidelines were established by the Federal Sentencing Commission with three purposes in mind: 1) ensuring that sentences fulfill the theories underlying the criminal justice system, "*i.e.*, just punishment, deterrence, incapacitation, and rehabilitation"; 2) reducing the "disparity among offenders with similar characteristics convicted of similar criminal conduct, while permitting sufficient judicial flexibility to take into account relevant aggravating and mitigating factors"; and 3) to "reflect, to the extent practicable, advancement in the knowledge of human behavior as it relates to the criminal justice process." U.S. SENTENCING COMM'N, AN OVERVIEW OF THE UNITED STATES SENTENCING COMMISSION 1 (2008), http://www.ussc.gov/general/USSC_Overview_200806.pdf; *see also* Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, 98 Stat. 1976 (1984) (creating the United States Sentencing Commission); U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 (2006) (containing the sentencing provisions regarding tax evasion).

9. *See* U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1) (1993).

conspiracy to defraud the United States.[10] By setting up a series of fraudulent trusts and failing to file any personal tax returns between the years of 1995 and 2001, the defendants deprived the federal government of millions of dollars in tax revenue, enabling them to "enjoy a lavish lifestyle, which included ... a half-million dollar house with a pool and hot tub, numerous luxury autos, two race car[s], and a motorcycle."[11] James Delfino was ultimately sentenced to a seventy-eight month imprisonment, and Jeaniene Delfino received a sentence of sixty-three months.[12]

Contrary to binding precedent at the time,[13] the district court did not allow the Delfinos to claim any deductions to which they would have been entitled had they filed timely returns.[14] This departure was particularly detrimental for the defendants because it resulted in a period of incarceration roughly twenty-two to twenty-six months longer than would have otherwise likely been ordered.[15] Subsequently, the Court of Appeals for the Fourth Circuit granted the case certiorari[16] and on December 18, 2007, affirmed the convictions, explicitly adopting the district court's sentencing calculations.[17]

Currently, the federal circuits fall into two camps regarding the issue of deductions and sentencing: those adopting the restrictive approach, disallowing unclaimed deductions; and those utilizing the permissive approach, allowing deductions to be granted for sentencing purposes. The court's holding in *Delfino* placed the Fourth Circuit squarely in the restrictive camp—a marked departure from the court's prior permissive approach.[18] Formerly, in *United States v. Schmidt*,[19] the Fourth Circuit maintained that "it was error to disallow deductions a defendant could have taken under U.S.S.G.

10. Initial Brief of Petitioners-Appellants at 7, *Delfino*, 510 F.3d 468 (No. 06-4506).

11. News Release, U.S. Dep't of Justice (Jan. 27, 2006), http://www.usdoj.gov/usao/vae/Pressreleases/01-JanuaryPDFArchive/06/20060127delfinonr.pdf.

12. Initial Brief of Petitioners-Appellants, *supra* note 10, at 8–9.

13. United States v. Schmidt, 935 F.2d 1440, 1451 (4th Cir. 1991) (holding that the Guidelines require that defendants convicted of tax-related offenses be allowed to claim deductions for sentencing purposes).

14. Initial Brief of Petitioners-Appellants, *supra* note 10, at 16.

15. The defendants claim that, if deductions had been allowed, they would have received a sentence within the range of forty-one to fifty-one months, rather than the current sixty-three to seventy-eight month range. *Id.* at 8.

16. *See* United States v. Delfino, 510 F.3d 468, 468 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008).

17. *Id.* at 473.

18. *See id.*

19. 935 F.2d 1440 (4th Cir. 1991).

§ 2T1.3(a) (1989) . . . [since] a fair reading of [the Guidelines] supports . . . punishing a crime whose gravity is represented by the actual loss of tax revenue to the IRS."[20] In *Delfino*, this approach was unambiguously rejected, with the court instead adopting the restrictive approach and holding that an individual's attempted loss was the proper measure.[21]

The difference between actual and attempted loss is an important distinction for purposes of this Recent Development because a court's adoption of either actual or attempted tax loss coincides with its use of either the permissive or restrictive approach, respectively. "Actual loss" is the amount of taxes the IRS could normally collect from a taxpayer—essentially, ordinary taxes payable, excluding any deductions, exemptions, or credits.[22] "Attempted loss" is the amount of "loss that would have resulted had the offense been successfully completed."[23] Hence, a court applying the permissive approach tends toward the use of actual tax loss because the IRS would ordinarily only be able to collect nondeductible income.[24] On the other hand, those circuits utilizing the restrictive approach have tended toward the application of attempted tax loss for the inverse reason—the defendant attempted to conceal his entire gross income from the government, and "unclaimed deductions should not be taken into account because they have no relevance to the amount of loss that the scheme attempted to produce."[25] Thus, in *Delfino*, the Fourth Circuit declared that it will "no longer rely on *Schmidt's* interpretation of [actual] tax loss under the sentencing guidelines," stating instead that the appropriate measure is "the *attempted*, or *intended* loss."[26] Under this new approach, by failing to file tax returns for the years 1995–2001, the Delfinos were deemed to have

20. *See Delfino*, 510 F.3d at 473 (alteration in original) (internal quotation marks omitted) (citing *Schmidt*, 935 F.2d at 1451).

21. *Id.* at 475.

22. United States v. Chavin, 316 F.3d 666, 677–78 (7th Cir. 2002).

23. United States v. Gordon, 291 F.3d 181, 187 (2d Cir. 2002) (quoting U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1) (2001)); *see also Chavin*, 316 F.3d at 677–78 (explaining the difference between "actual" and "attempted" loss).

24. *See, e.g.*, *Gordon*, 291 F.3d at 187–88 (utilizing an actual loss calculation and the permissive approach).

25. *Chavin*, 316 F.3d at 677.

26. *Delfino*, 510 F.3d at 472 (emphasis in original) (internal quotation marks omitted) (quoting *Chavin*, 316 F.3d at 667). Paradoxically, in *Delfino*, the Fourth Circuit held that the change in language between the 1991 and 1993 Guidelines (i.e., the removal of language requiring courts to disregard deductions and use attempted loss) allowed the court to utilize attempted loss instead of actual loss. The court held that *Schmidt* was based on the 1991 Guideline's language, so the court was no longer required to adhere to *Schmidt*'s (permissive) approach after the 1993 Amendments. *Id.* at 472–73.

forfeited their ability to claim deductions, and the court refused to reduce their sentences accordingly.[27]

In general, the federal offense of tax evasion is a felony punishable by up to $100,000 in fines or five years imprisonment.[28] To obtain a conviction for tax evasion, the government must establish three elements beyond a reasonable doubt: (1) the existence of a tax deficiency; (2) an affirmative act constituting an evasion or attempted evasion of the tax; and (3) willfulness.[29] In order to detect financial activity that is indicative of evasion and thereby worthy of an audit, the IRS maintains an extensive network of databases consisting of voluntary and employer-reported information.[30] One's risk of audit is highly dependent upon income. For instance, in the 2007 budget year, a joint or individual filer's risk of IRS audit ("coverage," in IRS terminology) ranged from one percent, for taxpayers in the lowest income bracket, to roughly ten percent, for those in the highest.[31] Not only was this coverage rate the highest since the turn of the century,[32] but the average sentence for those convicted of tax-related offenses rose sharply in the corresponding years as well.[33] Moreover, in recent

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27. *Id.* at 473. To actually compute attempted tax loss, a court "need[s] to look no further than [the] return to find the tax-loss figure." *Chavin*, 316 F.3d at 678. In essence, a defendant's attempted tax loss is the amount he represented as income to the government. However, if a defendant has not filed a return for the years in question, the IRS typically appoints an auditor to examine the defendant's expenditures, paperwork, and other records to try to calculate an accurate tax loss figure. *See, e.g.*, Initial Brief of Petitioners-Appellants, *supra* note 10, at 33–35 (testimony of former IRS auditor John Gordon).

28. 26 U.S.C. § 7201 (2000).

29. *Id.*; *see also* Rebecca Leitman et al., *Tax Evasion*, 33 AM. CRIM. L. REV. 1017, 1019 (1996) (discussing the three elements of tax evasion). For examples of cases using an elemental tax evasion definition, see *United States v. Daraio*, 445 F.3d 253, 258 (3d Cir. 2006) and *United States v. Kaiser*, 893 F.2d 1300, 1305 (11th Cir. 1990).

30. The IRS maintains the "Enforcement Revenue Information System" (ERIS), which "tracks assessments made, revenues collected, direct hours reported, and cost incurred as a result of conducting Internal Revenue Service (IRS) enforcement activities." I.R.S., Enforcement Revenue Information System, http://www.irs.gov/privacy/article/0,,id=154532,00.html (last visited Nov. 19, 2008).

31. *See* Jim Abrams, *The Beauty in Being Poor: IRS Audited 1 Out of Every 11 Millionaires . . . But Only 1 in 100 Earning $100,000 or Less*, Jan. 17, 2008, *available at* 2008 WLNR1159340. In the 2007 budget year, one out of every eleven millionaires was audited and the coverage rate was nearly double that of the 2004 rate. *Id.* Commercial filers also faced an increased coverage rate, with higher-earning businesses facing higher audit rates. *Id.* Approximately one out of every six corporations with assets over $10 million faced an audit. *Id.*

32. In 2000, the average individual audit rate across all tax brackets was a mere 0.49%, while in 2007, it was nearly double at 1.03%. I.R.S., FISCAL YEAR 2007 IRS ENFORCEMENT AND SERVICE STATISTICS 3 (2007), http://www.irs.gov/pub/irs-news/irs_enforcement_and_service_tables_fy_2007.pdf.

33. The mean sentence for tax convictions has risen roughly thirty-one percent since 2000 (average sentence in year 2000: 10.8 months; average sentence in year 2007: 14.2

years, the IRS has stepped up its prosecution and collection efforts, specifically targeting those in the upper tax brackets.[34]

Together, these dynamics have created a perilous situation for the less than scrupulous, or even less than meticulous, taxpayer, particularly for those with higher incomes. The elevated coverage and sentencing rates among high-income earners also demonstrate the IRS's recent "aggressive" focus on prosecuting sophisticated, high-value tax evasion schemes.[35] Whereas the average middle-income taxpayer bases her tax decisions on some combination of unverified assumptions and superstition,[36] high-income tax evaders often exhibit a great degree of sophistication and expertise through tax evasion and avoidance schemes.[37] These schemes, which currently

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months). *Compare* U.S. SENTENCING COMM'N, 2000 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS, at tbl.13, *available at* http://www.ussc.gov/ANNRPT/2000/Table13.pdf, *with* U.S. SENTENCING COMM'N, 2007 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS, at tbl.13, *available at* http://www.ussc.gov/ANNRPT/2007/Table13.pdf.

34. *See Understanding the Causes of and Solutions to Addressing the Federal Tax Gap: Hearing Before the S. Comm. on the Budget*, 110th Cong. 5–6 (2006), http://budget.senate.gov/democratic/testimony/2006/everson_taxgap021506.pdf (written testimony of Commissioner of Internal Revenue Mark Everson on the tax gap and how to solve it); *Appropriated Accounts*, Dep't of the Treasury—BUDGET IN BRIEF FY 2008, Jul. 19, 2007, at 2, *available at* http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf.

35. *See A Closer Look at the Size and Sources of the Tax Gap: Hearing Before the Subcomm. on Taxation and IRS Oversight of the S. Comm. on Finance*, 110th Cong. 15 (2006), *available at* http://www.senat~finance//hearings/testimony/2005test/072606rg.pdf [hereinafter *Subcomm. on Taxation Hearing*] (statement of the Honorable J. Russell George, Treasury Inspector General, Tax Administration); *IRS Aggressively Audited High Income Taxpayers, Businesses in 2007, According to Noted Chicago Tax Attorney McKenzie*, BUSINESS WIRE, Mar. 7, 2008, http://findarticles.com/p/articles/mi_m0EIN/is_2008_March_7/ai_n24379440.

36. *See* Frank A. Cowell, *The Economic Analysis of Tax Evasion*, 37 BULL. ECON. RES. 163, 163 (1985) (noting that tax evasion is like pornography—it "seems to arouse a mixture of outrage, guilty curiosity and incredulous admiration. It is an area about which one knows little but suspects much.").

37. *See id.* at 167–72 (analyzing the incentives which lead to a taxpayer's decision to evade or comply). A particularly egregious example of a sophisticated tax evasion scheme was perpetrated by Wade Cook, a well-known financial "guru," famous for lecturing and writing books on investment. In February 2007, Cook was convicted of tax evasion for failing to report or pay any taxes on the $9.5 million in royalties he earned from selling books and hosting seminars. The government proved that, in order to effectuate this tax fraud, Cook funneled revenue into a fictitious partnership, aptly named "Never Ending Wealth, LP," which was, in turn, owned by a tax-exempt, charitable trust. Cook used his untaxed income to purchase "new cars, jewelry, and exotic Arabian horses for [his] ranch . . . and spent $200,000 on a suite at Key Arena in Seattle." *See* Press Release, U.S. Attorney's Office, Western District of Washington (Feb. 20, 2007), http://www.usdoj.gov/tax/usaopress/2007/txdv07cook.html. Cook was also convicted of obstruction of justice for falsifying documents in an attempt to further conceal his assets. *Id.*

deprive the government of roughly $85 billion per annum,[38] essentially boil down to complex cost-benefit analyses—whereby the prospective evaders weigh the potential benefits of evasion versus the concomitant risk of detection and prosecution.[39] By increasing the risk of detection and average sentences, the IRS has further upped the ante in this complicated wager. Ultimately, these developments suggest a contrasting theory to Justice Black's idealistic conception of taxpaying: taxpayers overwhelmingly self-report their income to the IRS each year not out of some higher moralistic obligation, but because the consequences of *not* doing so are steep and are growing increasingly steeper.[40]

Although the circuits have varied in their interpretations of tax loss under the United States Sentencing Guidelines, ironically, the Guidelines were enacted with the purpose of generating consistency in sentencing procedures. The United States Sentencing Commission ("Commission"), which promulgates the Guidelines, was constituted with the purpose, inter alia, of "establish[ing] sentencing policies and practices for the Federal criminal justice system that ... avoid[] unwarranted sentencing disparities."[41] Under the Guidelines, a convicted defendant's sentence is determined by calculating the crime's "base offense level," which, for tax evasion, is based on the tax loss to the government. In addition, prior to 2005, the courts were required to strictly apply the dictates of the Guidelines because 18 U.S.C.S. §§ 3553(b)(1) and 3742(e) stated that the Guidelines were nonderogable and mandatory directives.[42] However, in *United States v. Booker*,[43] the Supreme Court struck down these provisions and

38. *Subcomm. on Taxation Hearing*, *supra* note 35, at 18.

39. *See* Cowell, *supra* note 36, at 167–72.

40. The "tax gap" is the "aggregate amount of true tax liability imposed by law for a given tax year that is not paid voluntarily and timely" and has become a favorite target of the IRS. *See* REDUCING THE FEDERAL TAX GAP, *supra* note 2, at 6. In 2007, the IRS announced that it will conduct "special audits" for 13,000 taxpayers, with the specific goal of narrowing the tax gap. *See 13,000 to Get 'Dear Taxpayer' Letter from IRS*, MSNBC, Sept. 26, 2007, http://www.msnbc.msn.com/id/20996387. The IRS's recent aim of "closing the tax gap" further illustrates its focus on increased audit and prosecution measures. *See* REDUCING THE FEDERAL TAX GAP, *supra* note 2, at 24.

41. 28 U.S.C. § 991(b)(1)(B) (2000). For a discussion of the Guidelines' objective of stricter sentencing, see *infra* notes 123–29 and accompanying text.

42. *See* 18 U.S.C.S. §§ 3553(b)(1), 3742(e) (LexisNexis 2004).

43. 543 U.S. 220 (2005). In *Booker*, the Supreme Court held that mandatory Guidelines violated the Sixth Amendment because they took decisions relating to sentencing away from the jury. *Id.* at 245–46. For an article highlighting the impact of mandatory Guidelines on the courts, see Dana Mulhauser, *The Incredible Shrinking Judiciary*, SLATE, Jul. 9, 2004, http://www.slate.com/id/2103685.

declared that the Guidelines instead are considered only "advisory."[44] Currently, a sentencing court may deviate from the Guidelines, so long as the sentence is not "unreasonable."[45] Nonetheless, courts are not allowed to completely disregard the Guidelines' provisions,[46] and the Guidelines' sentencing recommendations still are generally held in high regard by the courts.[47]

The previous (1991) version of the Guidelines pertaining to sentences for tax evasion (U.S.S.G. § 2T1.1) contained an explicit provision stating that tax loss was equal to the "total amount of tax that the taxpayer evaded or *attempted* to evade."[48] The Official Comment to the Guidelines further stated that unclaimed deductions were "irrelevant" to the calculation of tax loss.[49] Thus, under the 1991 version of U.S.S.G. § 2T1.1, a defendant's ability to claim retroactive deductions appears to have been disallowed. Yet, in the 1991 case of *United States v. Schmidt*,[50] the Fourth Circuit nonetheless interpreted this language to allow for the use of actual loss, stating that "a fair reading of [the Guideline] . . . is represented by the *actual* loss of tax revenue to the IRS."[51] The court then went on misguidedly

44. *Booker*, 543 U.S at 266.

45. *Id.* at 245–46, 261.

46. *Id.* at 264 (citing 18 U.S.C.A. §§ 3553(a)(4)–(5) (West 2004)) (holding that "[t]he district courts, while not bound to apply the Guidelines, must consult those Guidelines and take them into account when sentencing"); *see also* discussion *infra* notes 127–28 and accompanying text (noting that the Guidelines are still influential and the courts must still take them into account during sentencing).

47. *See, e.g.*, Douglas A. Berman, *Assessing Federal Sentencing After Booker*, 17 FED. SENT'G REP. 291, 291–94 (2005) (discussing the effect of the *Booker* decision and noting that "*Booker* did not alter many central features of the federal sentencing system"). *See generally* Prepared Testimony of Judge Ricardo H. Hinojosa, Chair, U.S. Sentencing Comm'n, 17 FED. SENT'G REP. 299 (2005) (highlighting the importance of the Guidelines after *Booker*).

48. U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(a) (1991) (emphasis added).

49. *Id.* at cmt. n.4; *see also* United States v. Chavin, 316 F.3d 666, 678 (7th Cir. 2002) (noting that the pre-1993 statute clearly disallowed deductions in computing tax loss).

50. 935 F.2d 1440 (4th Cir. 1991).

51. United States v. Delfino, 510 F.3d 468, 472 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008) (quoting *Schmidt*, 935 F.2d at 1451 (emphasis added in *Delfino*)). As a note, *Schmidt* dealt explicitly with U.S.S.G. § 2T1.3 (which was subsequently deleted), instead of § 2T1.1, but the language of the two Guidelines is substantively the same. In so holding, the *Schmidt* court reasoned that

> [t]he choice before us is thus between punishing a crime whose gravity is represented by the actual loss of tax revenue to the IRS and one whose gravity is represented by the full extent of participation in a tax evasion scheme regardless of the tax consequences to the government. A fair reading of § 2T1.3(a) supports only the former. . . . Certainly [the use of an attempted loss calculation] would die of its own weight the minute the Service attempted to collect its "loss" by asserting a claim to all of the income reported on the . . . tax returns.

to adopt the permissive approach, even though the then-mandatory Guidelines plainly declared that deductions should not be considered for sentencing purposes.[52]

Ultimately, § 2T1.1 of the Guidelines was amended in 1993,[53] with the goal of "eliminat[ing] the anomaly of using actual tax loss in some cases and an amount that differs from actual tax loss in others."[54] Despite this beneficial purpose, the imprecise definition of "tax loss" provided by the '93 Amendments actually created, not eliminated, sentencing discrepancies among the federal courts. Problematically, the '93 Amendments did not state explicitly whether actual loss or attempted loss was the cause of the "anomaly" the Commission aimed to eliminate.[55] Instead, the '93 Amendments stated only that "tax loss" was the "total amount of the loss that was the object of the offense (*i.e.*, the loss that would have resulted had the offense been successfully completed)."[56] To this definition, the '93 Amendments added additional perplexing language, which stated that "if the offense involved failure to file a tax return, the tax loss shall be treated as equal to 20% of the gross income . . . less any tax withheld or otherwise paid, unless a more accurate determination of the tax loss can be made."[57] Yet, notwithstanding the Commission's goal of enhanced consistency in enacting the '93 Amendments,[58] these changes had the exact opposite effect—resulting in the current circuit split over the role of deductions in calculating tax loss.

Schmidt, 935 F.2d at 1451.

52. *Compare Schmidt*, 935 F.2d at 1451–52 (adopting the actual loss approach and allowing otherwise legitimate unclaimed deductions, stating that "the understated gross income here is represented *only* by non-legitimate deductions" (emphasis added)), *with* U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 cmt. n.4 (1991) (declaring unclaimed deductions "irrelevant" to the calculation of tax loss, whether or not they would normally be legitimate). Despite the Fourth Circuit's confounding former interpretation of tax loss under the Guidelines, the parties in *Schmidt* did not appeal the holding to the Supreme Court of the United States. Nonetheless, such an appeal likely would have been fruitless since the Supreme Court subsequently denied *certiorari* to the Second Circuit's analogous holding in *United States v. Gordon*. United States v. Gordon, 291 F.3d 181, 187 (2d Cir. 2002), *cert. denied*, 537 U.S. 1114 (2002). Moreover, as demonstrated by the Supreme Court's denial of certiorari in *Delfino*, United States v. Delfino, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008), the Supreme Court has appeared unwilling to resolve this circuit split.

53. U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1) (1993).

54. *See id.* at app. C, amend. 491.

55. *Id.*

56. *Id.* § 2T1.1(c)(1); *Delfino*, 510 F.3d at 472.

57. U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1)(A) (1993).

58. *See* 28 U.S.C. § 991(b)(1)(B) (2000).

After the enactment of the '93 Amendments, the severity of a convicted tax evader's sentence is dependent largely upon the circuit in which that defendant is tried.[59] Presently, roughly half of the circuits have not yet weighed in on this issue,[60] and, notably, some circuits have changed their approach subsequent to these amendments being enacted. Importantly, these circuits have gone in one direction only; in the fifteen years since the '93 Amendments to U.S.S.G. § 2T1.1, two federal circuits have converted toward the restrictive camp, and none have switched to the permissive approach.[61]

The Second Circuit was the first to confront the issue of deductions and tax loss calculations following the '93 Amendments. In dicta to the 1998 case of *United States v. Martinez-Rios*,[62] the court stated that the "determination of the tax loss involves giving the defendant the benefit of legitimate but unclaimed deductions" because doing so would constitute a "more accurate determination."[63] In so deciding, the Second Circuit reasoned that a compromise was necessary: under the '93 Amendments, "[a]t each level of tax loss," the Guidelines "prescribe a greater offense level (and thus a heavier sentence) than the 1991" version of the Guidelines; in exchange, the court will "permit[] consideration of legitimate but unclaimed deductions," which "tend[] to produce smaller tax loss figures."[64] Effectively, in light of the overall stricter sentencing framework imposed by the 1993 version of the Guidelines, the court stated that it would mitigate this harshness by utilizing actual loss and granting unclaimed deductions.[65] This approach was subsequently adopted by the full court four years later in *United States v. Gordon*.[66]

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59. For a discussion of the sentencing differences between the restrictive and permissive approaches for the *Delfino* defendants, see *supra* note 15 and accompanying text, as well as *infra* note 118 and accompanying text.

60. Currently, five of the eleven federal circuit courts of appeals have not yet decided a case on point: the First, Third, Sixth, Eighth, and Eleventh Circuits.

61. *See* discussion *infra* notes 75–79 and accompanying text.

62. 143 F.3d 662 (2d Cir. 1998).

63. *Id.* at 671.

64. *Id.* at 670–71. As a note, *Martinez-Rios* addressed the 1995 Amendment to U.S.S.G. § 2T1.1, but that version uses essentially the same language as the previous 1993 Amendment.

65. *Id.* at 671.

66. 291 F.3d 181, 187–88 (2d Cir. 2002). Interestingly, however, in *Gordon*, the Second Circuit did not allow deductions to be granted, deeming their non-recognition by the trial court to be "harmless error" because the defendant still lacked adequate evidence to prove their existence. *Id.* at 188; *see also* discussion *infra* notes 82–101 and accompanying text (discussing the administrative problems of proving deductions under the permissive approach).

In the years following *Martinez-Rios*, the Tenth Circuit also confronted the issue of deductions and the calculation of tax loss after the '93 Amendments. However, the Tenth Circuit came out on the opposite side. The Tenth Circuit's initial response came in the form of dicta to the 1999 case of *United States v. Spencer*,[67] stating that the "more accurate determination" language does not require the court to consider unclaimed deductions.[68] In adopting the restrictive approach, the Tenth Circuit "question[ed]" the Second Circuit's conclusion that deductions were permitted under § 2T1.1, stating, "[w]e do not interpret this provision as giving taxpayers a second opportunity to claim deductions after having been convicted."[69] In rejecting the permissive approach, the court stated that the recognition of a defendant's unclaimed deductions would be improper, since the defendant chose not to claim these deductions at the proper time of filing.[70] Moreover, the Tenth Circuit said that it is not required to grant deductions because the calculations involved in determining tax loss are intrinsically different from those used to establish a diligent taxpayer's tax debt.[71] The full court subsequently adopted the restrictive method two years later, in *United States v. Sullivan*.[72] Recognizing the inherent superiority of the restrictive practice, this approach was subsequently adopted by both the Fifth[73] and Ninth[74] Circuits.

Significantly, after *Delfino*, there are now two federal circuits that initially utilized the permissive approach after the '93 Amendments, but have subsequently readopted the restrictive system.[75] For almost a decade after the enactment of these

67. 178 F.3d 1365 (10th Cir. 1999).

68. *Id.* at 1367–69.

69. *Id.* at 1368.

70. *Id.* at 1367–69.

71. *Id.*

72. 255 F.3d 1256, 1263–64 (10th Cir. 2001).

73. The Fifth Circuit has not explicitly stated that it would disallow deductions, but, in *United States v. Moore*, 997 F.2d 55 (5th Cir. 1993), it held attempted loss is the proper measure, and, as discussed in the text accompanying note 25, the court would in all likelihood follow the restrictive approach to deductions. *See id.* at 59–61. Further, the *Moore* court considered the Fourth Circuit's erstwhile holding in *U.S. v. Schmidt* and expressly rejected it. *Id.* at 61.

74. In 2002, the Ninth Circuit followed the Tenth Circuit's restrictive approach, stating that "deductions are a matter of legislative grace." United States v. Bishop, 291 F.3d 1100, 1116 (9th Cir. 2002) (citing Everson v. United States, 108 F.3d 234, 236 (9th Cir. 1997)).

75. *See* United States v. Delfino, 510 F.3d 468, 468 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008); United States v. Chavin, 316 F.3d 666, 666 (7th Cir. 2002).

amendments, no clear trend existed regarding the role of deductions in sentencing, and the circuits were equally split. By 2002, however, one circuit explicitly acknowledged the inutility of the permissive approach and adopted the restrictive approach instead. This conversion was the tipping point in a distinct trend that ultimately led to the other circuits' rejection of the Second Circuit's permissive approach and the manifest adoption of the restrictive method.[76] The first circuit to convert to the restrictive camp was the Seventh Circuit. In *United States v. Chavin*,[77] the Seventh Circuit adopted the restrictive approach to tax loss without even mentioning its prior permissive interpretation of the Guidelines.[78] In *Chavin*, the court justified its sudden change of doctrine by stating simply that it "refuse[d] to ignore" the fact that "the current definition of tax loss appears to exclude consideration of unclaimed deductions."[79] By converting to the restrictive approach and acknowledging the inherent inadequacy of the permissive approach, the Fourth Circuit in *Delfino* essentially followed the path blazed by the Seventh Circuit in *Chavin*.

Accordingly, what was at one time a true circuit split, with an equal number of circuits on either side of the issue,[80] has now evolved into a discernible movement toward the restrictive approach, leaving the first circuit to address the issue (the Second Circuit) an isolated aberration.[81] In other words, when viewed against the other circuits' movements over the past fifteen years, the Fourth Circuit's holding in *Delfino* is merely the most recent act of conversion within a larger, consistent trend toward the disallowance of deductions under U.S.S.G. § 2T1.1. Furthermore, the courts' widespread disallowance of deductions is a positive development, not merely because it fosters greater consistency among the circuits, but also because the restrictive approach is better supported by policy considerations than its permissive counterpart.

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76. *See Delfino*, 510 F.3d at 468; *Chavin*, 316 F.3d at 666.

77. 316 F.3d 666 (7th Cir. 2002).

78. Interestingly, *Chavin* was decided with very similar facts to the Seventh Circuit's previous case on point, *United States v. Minneman*, 143 F.3d 274 (7th Cir. 1998). However, the *Chavin* court did not even refer to *Minneman* in its opinion or attempt to reconcile the divergent holdings.

79. *Chavin*, 316 F.3d at 678.

80. As discussed *supra* notes 62–74 and accompanying text, prior to 2000, three circuits (Second, Fourth, and Seventh) adopted the permissive approach and three (Fifth, Ninth, and Tenth) adopted the restrictive method.

81. *See supra* notes 62–74 and accompanying text. Currently, the Fourth, Fifth, Seventh, Ninth, and Tenth Circuits all follow the restrictive approach, while the Second Circuit is the only remaining proponent of the permissive approach.

The jurisprudential shift toward the restrictive method is a positive development because this approach possesses superior administrability, both for the courts and the IRS. The Fourth Circuit's current approach is administratively superior because it allows the court to make an accurate, provable determination of tax loss, whereas the prior, permissive approach necessarily entails an arbitrary and unverifiable approximation of this figure.[82] As an illustration, the statute of limitations for the criminal prosecution of tax evasion and similar offenses is six years.[83] However, as demonstrated by *Delfino*, final sentencing decisions may not take place until many years after the acts or omissions in question initially occurred.[84] In *Delfino*, sentencing proceedings were not conducted at the trial level until ten years after the defendants committed their initial acts of evasion,[85] and at the appellate level, sentencing considerations were still being deliberated twelve years afterward.[86] If the Fourth Circuit had abided by its former permissive approach, it would have been required to sort through the validity of seven years of deductions, ranging from six to twelve years prior.[87] Further, in 2007, for taxpayers with incomes of $200,000 or more, like the Delfinos,[88] a very conservative estimate of the amount of average itemized deductions was over $108,000 (this figure accounts only for medical expenses, charitable contributions, and tax and interest payments).[89] If the Fourth Circuit had not reversed its holding in

82. *See* discussion *infra* notes 83–101 and accompanying text.

83. 26 U.S.C. §§ 6531(2), 6351(2)–(5) (2000). These "similar offenses" are those that share Guideline § 2T1.1 with tax evasion: Willful Failure to File Return, Supply Information, or Pay Tax; Fraudulent or False Returns, Statements, or Other Documents. Nonetheless, there is an unlimited statute of limitations for civil fraud or nonfiling. 26 U.S.C. § 6501(c) (2000).

84. *See also Chavin*, 316 F.3d at 678 (highlighting the inadministrability of the permissive approach, which requires the court to speculate about which deductions were proper).

85. The defendants were sentenced on April 27, 2006. Brief of Respondent-Appellee at 1, United States v. Delfino, 510 F.3d 468 (4th Cir. 2007) (No. 06-4506).

86. The Delfinos did not file taxes between the years of 1995 and 2001. News Release, U.S. Dep't of Justice, at 1 (Jan. 27, 2006), http://www.usdoj.gov/usao/vae/Pressreleases/01-JanuaryPDFArchive/06/20060127delfinonr.pdf.

87. The Delfinos' evasion spanned from 1995–2001, and they did not face sentencing until 2007. *See* Brief of Respondent-Appellee, *supra* note 85, at 1; Press Release, U.S. Dept. of Justice, *supra* note 86, at 1.

88. For the pertinent years, the defendants' annual income ranged from roughly $200,000 to $300,000. Brief of Respondent-Appellee, *supra* note 85, at 3.

89. This figure is the average amount of itemized deductions for all taxpayers, filing both individually and jointly. 2007 CCH WHOLE BALL OF TAX, AVERAGE ITEMIZED DEDUCTIONS, http://www.cch.com/WBOT2007/026AvgItemizedDeductions.asp (last visited Nov. 14, 2008).

Schmidt, the court would have potentially been required to determine the validity of over $1.5 million worth of deductions, some of which stemmed from events that occurred over a decade prior.[90]

This concern over administrability was a fundamental reason cited by the Seventh Circuit in rejecting its prior adoption of the permissive approach. In *Chavin*, the court held that accurately calculating a defendant's unclaimed deductions is unworkable because "it would require [the court] to create a 'perfect' tax return, taking into account all the legitimate unclaimed deductions, which would undoubtedly engender a great deal of dispute between the parties over which deductions were legitimate and which were not."[91] Accordingly, like the Seventh Circuit in *Chavin*, the Fourth Circuit in *Delfino* realized that it is inherently inadministrable to require important sentencing considerations to be made years, or even decades, after the events in question occurred, without basing said decisions on anything but arbitrary approximations of decades-old "actual loss."[92]

Moreover, many of the most commonly-claimed deductions are subject to either ceiling or floor requirements, such as deductions for mortgage interest, medical and dental expenses, casualty expenses, and miscellaneous deductions.[93] Deductions with floor requirements, including medical (7.5%), casualty (10%), and miscellaneous (2%) deductions, are especially impracticable to calculate years later because they first require an accurate computation of the taxpayer's adjusted gross income (AGI) before these deductions can even be

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90. This estimate assumes that the Delfinos' deduction rate would have been reasonably close to the average of those in their same income level. Relying on the average deduction amount of both individual and joint filers likely will not produce an exact figure of the Delfinos' deductions. Still, this figure provides a useful framework to illustrate the potential deductions. The calculation used: 7 (number of years tax returns not filed) x $108,210 (conservative average of yearly deductions) x 2 (for the 2 defendants) = $1,514,940.

91. United States v. Chavin, 316 F.3d 666, 678 (7th Cir. 2002).

92. United States v. Delfino, 510 F.3d 468, 472 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008).

93. Mortgage interest deductions can only be taken for property valued up to $1,000,000 for acquisition debt and $100,000 for home equity debt; medical and dental expenses are deductible only to the extent they exceed 7.5% of AGI; casualty and loss expenses can be deducted only to extent they exceed 10% of AGI; and miscellaneous deductions can be taken only to the extent they exceed 2% of AGI. *See* 26 U.S.C. § 163(h)(3) (2000) (mortgage interest deductions); 26 U.S.C. § 213 (2000) (deductions for medical and dental expenses); 26 U.S.C. § 165(h) (2000) (deductions for casualty and loss expenses); 26 U.S.C. § 67 (2000) (miscellaneous deductions); Sandra Block, *Don't Cheat Yourself*, USA TODAY, MONEY, Jan. 30, 2003 (updated Feb. 5, 2003), *available at* http://www.usatoday.com/money/perfi/taxes/2003-01-30-mym_x.htm.

calculated.[94] In addition, other common deductions, such as charitable deductions, require receipts or other written verification.[95] Due to the very nature of tax evasion cases, however, defendants take great steps to actively conceal their income, and any proof thereof, from the federal government—making an accurate determination of their AGI, and any corresponding deductions, improbable.[96]

IRS auditor John Gordon's testimony reflected this predicament. Gordon stated that he "was pretty confident there probably would have been deductions" the Delfinos could have claimed, but he "disallowed all the deductions because there was no support for [them]."[97] Gordon's testimony was cited in the *Delfino* defendants' appellate brief as proof that they were improperly denied credit for deductions in sentencing.[98] Still, the Fourth Circuit realized that proving the *existence* of unclaimed deductions is a far different task from computing an accurate total amount of those deductions. In *Delfino*, the court held that the recognition of unclaimed deductions would force the court "to speculate as to what deductions [the Delfinos] would have claimed and what deductions would have been allowed," which "would place the court in a position of considering the many 'hypothetical ways' that the [defendants] could have completed their tax returns."[99] Thus, unlike the restrictive approach, which makes use of defendants' prededuction income,[100] the permissive approach requires the federal courts to sift through several years of tax records, receipts, and papers and decide the merits of potentially millions of dollars worth of deductions—deductions the

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94. *See* 26 U.S.C. §§ 213, 165(h), 67 (2000).

95. Any individual charitable contribution of $250 or more requires written verification from the donee and a receipt thereof. 26 U.S.C. § 170(f)(8) (2000).

96. *See, e.g.*, United States v. Sullivan, 255 F.3d 1256, 1264 (10th Cir. 2001) (expressing the difficulty in achieving a precise AGI determination, the Tenth Circuit noted "the defendant destroyed his records. The defendant would not provide information as far as his deductions. And although the Government has records of what expenses were and those records were turned over to the defense, there's been no attempt in the last four months to sit down and—everything was intermingled—personal expenses, business expenses—as to what was paid for how, what was paid for in cash. There's simply no way of determining that with any degree of accuracy.").

97. Initial Brief of Petitioners-Appellants, *supra* note 10, at 33–34 (quoting Transcript of Record at A372–73, United States v. Delfino, 510 F.3d 468 (4th Cir. 2007) (No. 06-4506)).

98. *Id.*

99. United States v. Delfino, 510 F.3d 468, 473 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008) (citing United States v. Chavin, 316 F.3d 666, 678 (7th Cir. 2002)).

100. The restrictive approach uses a defendant's Gross Income ("GI"), which still allows for personal exemptions and business expenses to be deducted, so that a taxpayer is taxed only on income and not gross receipts. *See* discussion *infra* note 132.

defendants actively strove to conceal from the federal government in the first place. Such an approach is fundamentally impracticable.[101]

The superior administrability of the restrictive approach also dovetails with the retributive policies underlying the punishment of tax evasion in general. From a retributive standpoint, tax evasion is a punishable offense because it is primarily an antisocial enterprise.[102] Tax evasion is undertaken with the aim of depriving the federal government and fellow citizens of crucial revenue while still receiving the benefits of federal expenditures such as national defense, government agencies, and the federal court system itself.[103] Moreover, on a macro level, tax evasion is detrimental to the national economy as a whole.[104]

Put simply, tax evaders should not be allowed the benefit of unclaimed deductions, because "[t]he principle that a wrongdoer shall not be permitted to profit through his own wrongdoing is fundamental in our jurisprudence."[105] The restrictive approach recognizes that equity falls squarely on the side of disallowing deductions, because a defendant convicted beyond a reasonable doubt of evading federal tax law should not in turn be allowed a reduced sentence by retroactively claiming deductions. In *Delfino*, the court noted that the defendants "chose not to file their income tax returns .... By doing so, they forfeited the opportunity to claim these deductions.... The law simply does not ... entitle the Delfinos to the benefit of deductions they might have claimed now that they

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101. *See* United States v. Gordon, 291 F.3d 181, 188 (2d Cir. 2002); *supra* note 66 (commenting that, even in the landmark case for the permissive approach, *United States v. Gordon*, the Second Circuit still disallowed the defendant from using unclaimed deductions since there was insufficient proof).

102. *See, e.g.*, Konstantinos Angelopoulos & Apostolis Philippopoulos, *The Role of Government in Anti-Social Redistributive Activities* (CESifo Working Paper Series No. 1427, Mar. 2005), *available at* http://ssrn.com/abstract=680525 (arguing that tax evasion is an example of an anti-social redistributive activity that has a significant and harmful effect on the macroeconomy).

103. This is the free-rider dilemma—billions of dollars make up the tax gap, and those who do not fund the system essentially free-ride off of legitimate taxpayers. *See 13,000 to Get 'Dear Taxpayer' Letter from IRS*, *supra* note 40. Over half of federal discretionary spending goes toward defense spending, and the remainder goes toward funding various federal programs, such as the Department of Health and Human Services, the Department of Transportation, and the National Institutes of Health. For a high-resolution illustration of the various federal taxpayer-funded programs, see *Death and Taxes: A Visual Guide to Where Your Federal Tax Dollars Go 2008*, http://www.wallstats.com/deathandtaxes (last visited Nov. 10, 2008).

104. Angelopoulos & Philippopoulos, *supra* note 102, at i.

105. Perma Mufflers v. Int'l Parts Corp., 392 U.S. 134, 151 (1968).

stand convicted of tax evasion."[106] Accordingly, the Fourth Circuit acknowledged that the permissive approach unfairly permits an individual charged with tax evasion to mitigate her potential sentence by retaining the ability to claim deductions. The restrictive approach, on the other hand, appropriately disallows tax evaders the benefit of deductions that would not have been claimed had their evasion actually been successful.

Additionally, the restrictive approach is more consistent with the general deterrent policies behind tax evasion prosecution because it has the effect of better discouraging potential evaders from attempting to commit the offense. Letting convicted tax evaders recover unclaimed deductions effectively reduces the adverse consequences of conviction, allowing those individuals to hedge their bets when making the decision to evade. Despite the sanguine taxpaying motivations referenced by Justice Black,[107] in reality, taxpayers are inordinately wary of facing an IRS audit (colloquially referred to as a "financial root canal"), much less conviction of tax-related offenses.[108] To the ordinary taxpayer, the most familiar reason for diligently paying one's taxes is the risk of audit and the concomitant risk of prosecution for tax evasion, not necessarily moral "confession."[109] This disproportionate fear is not a malfunction of bloated government[110] or miserly tax collectors;[111] instead, taxpayer apprehension is a necessary and indeed desirable effect of the taxation and collection system, because it has the operative effect of deterring those contemplating evasion.

As noted above, prospective tax evaders often make educated decisions in determining whether the risks of detection and attendant prosecution are outweighed by the gain realized through concealing those assets from collection.[112] Under the Fourth Circuit's prior permissive practice, the commission of "efficient evasion"[113] was

106. United States v. Delfino, 510 F.3d 468, 473 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008).

107. *See* discussion *supra* notes 1–4 and accompanying text.

108. Leonard Wiener, *The Odds of an IRS Audit Are Still in the Taxpayer's Favor, But Don't Bet the House*, U.S. NEWS & WORLD REP., Apr. 2, 2001, at 55.

109. United States v. Kahriger, 345 U.S. 22, 36 (1953) (Jackson, J., concurring).

110. *See* Daniel J. Mitchell, *Bloated Government Threatens Long-Term Prosperity*, THE HERITAGE FOUND., Mar. 12, 2004, http://www.heritage.org/Press/Commentary/ed031204b.cfm.

111. *See* IRWIN SCHIFF, THE GREAT INCOME TAX HOAX: WHY YOU CAN IMMEDIATELY STOP PAYING THIS ILLEGALLY ENFORCED TAX 9–10 (1985).

112. *See* discussion *supra* notes 37, 39 and accompanying text.

113. In other words, similar to the "efficient breach" of a contract, if the incentives are misaligned, a taxpayer may realize he has more to gain by evading taxes than by paying

certainly more plausible, because the detrimental effect of any potential sentence would have been lessened by allowing deductions from the years in which taxes were evaded. Moreover, the compromise read into the '93 Amendments by the permissive Second Circuit unnecessarily frustrates the Guidelines' policy of deterrence.[114] Such a compromise is unnecessary because the Guidelines are no longer mandatory, and a sentencing court is free to set reasonable sentences in individual cases as it sees fit.[115] In addition, by allowing deductions to counterbalance the '93 Amendments' stricter framework, the Guidelines are purged of their objective of tougher sentencing, along with any corresponding deterrent effect.[116] In essence, prospective tax evaders are further encouraged to illegally withhold taxes under the permissive approach, as any potential sentence would be decreased by the deductions they could have claimed, had a timely and accurate return been properly filed.

Contrastingly, the Fourth Circuit's current restrictive approach produces a greater general deterrent effect, because it inevitably produces harsher sentences for tax-related offenses.[117] For example, in *Delfino*, had the Fourth Circuit maintained its former practice, the defendants could have received sentences that were twenty-seven and twenty-two months shorter, respectively.[118] By ensuring that convicted tax evaders' sentences are on the higher end of the sentencing spectrum, a stronger message of general deterrence is exuded by the court. Indeed, in addition to consistency,[119] the "primary consideration" behind the enactment of the '93

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them. Thus, if there is a low level of general deterrence, one's incentives to pay taxes will also be low, which may lead some to the (economically) rational decision to evade, especially when the amount saved through evasion is high.

114. *See* discussion *supra* notes 62–66 and accompanying text.

115. United States v. Booker, 543 U.S. 220, 261 (2005).

116. For a discussion of the Guidelines' objective of stricter sentencing, see *infra* notes 123–29.

117. Institutionally, the federal courts' fiscal self-interest may be another motive for adopting the restrictive approach, because the restrictive method generates greater amounts of revenue in sentencing fines and penalties. If, *arguendo*, the restrictive approach produced a result dissonant with the policies of criminal punishment and equity, then perhaps suggesting that the approach's budgetary advantage would be improper. Nevertheless, the fiscal benefits of the restrictive approach are legitimized by the fact that, as discussed *supra* notes 102–11 and accompanying text, this approach aligns with the interests of equity and fairness.

118. Initial Brief of Petitioners-Appellants, *supra* note 10, at 17.

119. 28 U.S.C. § 991(b)(1)(B) (2000); *see also* discussion *supra* notes 41, 54 and accompanying text (elaborating on the reasons for establishing the Commission and enacting the Guidelines).

Amendments to U.S.S.G. § 2T1.1 was "deterring others from violating the tax laws" by means of stricter sentencing.[120] This purpose is realized through the restrictive use of attempted loss and hindered by the permissive use of actual loss. For instance, the Fourth Circuit held that, "if the Delfinos' scheme had succeeded, the Government would have been deprived of the tax on the amount by which they underreported (or failed to report) their taxable income. It was this amount which the district court properly used to calculate the tax loss for purposes of sentencing."[121] The court's utilization of attempted tax loss thereby creates a powerful disincentive to prospective tax evaders, because defendants in the Fourth Circuit will be aware that, upon conviction, neither the amount of tax loss nor the resultant sentences will be reduced by the amount of any unclaimed deductions.[122]

Further, the United States Sentencing Guidelines were implemented with the aim of toughening, not relaxing, federal sentencing standards.[123] The "disparities in sentencing," which the U.S.S.G. and its subsequent revisions were intended to target, were typified by those sentences that fell below the corresponding average sentence.[124] This point is illustrated by the erstwhile mandatory minimum sentencing requirements, which eliminated judicial sentencing discretion, but only on the bottom end of the sentencing spectrum.[125] After *Booker*, however, these mandatory minimums

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120. *See* U.S. SENTENCING GUIDELINES MANUAL § 2T1 introductory cmt. (2004); U.S.S.G. § 2T1.

121. United States v. Delfino, 510 F.3d 468, 472–73 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008).

122. Some critics may counter that defendants will not actually realize this distinction, so no real deterrent or disincentive effect exists. However, tax-evading defendants generally possess a high level of sophistication and working knowledge of the tax system. If this level of contemplation goes into the decision to evade, it seems likely that the potential risks (i.e., sentences) will be examined in length as well. *See supra* note 37.

123. This aim was made explicit in the federal sentencing manual:

> Under pre-guidelines practice, roughly half of all tax evaders were sentenced to probation without imprisonment, while the other half received sentences that required them to serve an average prison term of twelve months. This guideline is intended to reduce disparity in sentencing for tax offenses and to somewhat *increase* average sentence length.

U.S. SENTENCING GUIDELINES MANUAL § 2T cmt. background (2004) (emphasis added).

124. As stated in the manual, the Guidelines' aim was not merely to provide uniformity in sentences, but to reduce the "number of purely probationary sentences." *Id.* Accordingly, the objective of the Guidelines was consistently stricter sentences, not merely consistent sentences in and of themselves.

125. While a disproportionately harsh sentence can also be overturned, such an occurrence would not be based on the Guidelines, but on the Cruel and Unusual

have instead become merely recommended minimum sentences.[126] Nonetheless, the spirit behind these Guidelines persists. Their objective of stricter sentencing remains significant because the courts are still required "to take account of the Guidelines together with other sentencing goals" during sentencing, even though they are no longer mandatory.[127] As a result, the United States Sentencing Guidelines remain extremely influential and are still heavily relied upon by the federal courts when making sentencing decisions.[128] As laid out above, such an amendment would create uniformity among the courts, thereby realizing the Guidelines' objective of eliminating discrepancies in the calculation of tax loss.[129]

Finally, it would be inaccurate to maintain, as have the permissive circuits, that an individual who attempts to illegally withhold revenue from the federal government should undergo the same accounting of taxes-due as would a normal, diligent taxpayer.[130] The means by which an individual would ordinarily compute his taxes owed to the IRS are quite different from the framework under which a convicted tax evader's tax loss is determined—primarily because the policy behind granting income tax deductions does not support such an application. Those circuits that apply the restrictive approach to tax loss calculation have properly noted that income tax deductions exist at the grace of the legislature and courts, holding that deductions

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Punishment Clause of the Eighth Amendment. U.S. CONST. amend. VIII. Also, as discussed *infra* note 129, excessive punishment is not found often, since a sentence must be "grossly disproportionate" to be overturned. Thus, even though disproportionate sentences are policed on both ends of the spectrum, the U.S.S.G. were enacted solely to police the bottom, not the top end.

126. *See generally* United States v. Booker, 543 U.S. 220 (2005) (holding that the Sixth Amendment applies to the United States Sentencing Guidelines).

127. *Id.* at 259 (citing 18 U.S.C.S. § 3553(a)(4) (2000 & Supp. IV 2004).

128. *See, e.g.*, Douglas A. Berman, *Assessing Federal Sentencing After Booker*, 17 FED. SENT'G REP. 291, 291–94 (2005) (noting that the *Booker* decision has had a marginal effect on the overall federal sentencing system). *See generally* Prepared Testimony of Judge Ricardo H. Hinojosa, Chair, U.S. Sentencing Comm'n, 17 FED. SENT'G REP. 299 (2005) (highlighting the importance of the Guidelines to sentencing courts after *Booker*).

129. One concern when advocating stricter sentences is that such sentences may potentially constitute excessive punishment. However, in noncapital cases, "the Eighth Amendment does not require strict proportionality between crime and sentence. Rather, it forbids only extreme sentences that are '*grossly disproportionate*' to the crime." Harmelin v. Michigan, 501 U.S. 957, 1001 (1991) (quoting Solem v. Helm, 463 U.S. 277, 288 (1983) (emphasis added)). Accordingly, sentences reached under the restrictive approach will not violate the "grossly disproportionate" standard, because, definitionally, they represent a proportional amount of the taxes evaded (i.e., the offense's base level is controlled by the amount of tax loss).

130. United States v. Spencer, 178 F.3d 1365, 1368 (10th Cir. 1999).

are not guaranteed as a matter of absolute right.[131] In addition, deductions are generally granted where the legislature wishes to encourage specific behavior (a tax preference), or where equity otherwise requires.[132] In the case of tax evasion, certainly neither of these rationales applies.

Consequently, the permissive approach to tax loss calculation is inconsistent with the policy justifications underlying the allowance of deductions, while the restrictive approach recognizes that the policies and rationale behind granting such deductions do not support their extension to cases of willful income tax evasion.[133] This view was reflected by the Fourth Circuit in its adoption of the restrictive approach in *Delfino*:

> It must be remembered that, in tax loss calculations under the sentencing guidelines, we are not computing an individual's tax liability as is done in a traditional audit. Rather, we are merely assessing the tax loss resulting from the manner in which the defendant chose to complete his income tax returns.[134]

In other words, merely because a traditional taxpayer would only pay nondeductible income, it does not follow that a convicted tax-offender's sentence should necessarily utilize the actual loss figure. Instead, attempted loss is the proper measure, because the court

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131. United States v. Bishop, 291 F.3d 1100, 1116 (9th Cir. 2002) (holding that "it is not the government's or the court's responsibility to establish the defendants' itemized deductions, if no itemized deduction information was offered by the defendants" upon the initial filing of their income taxes); United States v. Delfino, 510 F.3d 468, 473 (4th Cir. 2007), *cert. denied*, No. 07-1273, 2008 WL 972703 (U.S. Oct. 6, 2008) (stating that the defendants "chose not to cooperate with the initial IRS audit, at which time they could have claimed deductions to which they were entitled. By doing so, they forfeited the opportunity to claim these deductions.").

132. Sally Wallace, *Itemized Deductions*, *in* THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 215–16 (Joseph J. Cordes et al. eds., 1999). Business expenses are deductible for another reason—so that one is taxed only on net income, and not all gross receipts. *See* 26 U.S.C. § 62 (2000). Constitutionally, these business expenses must be deducted because the government may only tax *income*, not aggregate gross receipts. *See* U.S. CONST. amend. XVI. Still, labeling business expenses "deductions" is misleading because such expenses are operationally subtracted to calculate gross income itself (receipts minus costs incurred); they are not subtracted from a taxpayer's adjusted gross income, as are itemized deductions.

133. This point is further bolstered by the fact that, unlike law-abiding taxpayers, convicted tax evaders are required to pay penalties ranging from 28–100% of tax debt, and the court may assess additional fines of up to $100,000. Thus, because tax offenders undergo a variety of fees, penalties, and tax debt calculation, it is facile to maintain, as have the permissive circuits, that convicted tax evaders should receive deductions merely because ordinary taxpayers enjoy them. *See* U.S. SENTENCING GUIDELINES MANUAL § 2T1.3 (2007).

134. *Delfino*, 510 F.3d at 473 (quoting *Spencer*, 178 F.3d at 1368).

should not recognize deductions that the defendant never claimed at the outset.

Regardless of which justification for punishment one believes is most efficacious—administrability, retribution, deterrence, or the Guidelines' objectives of consistency and strictness in sentencing—all support the Fourth Circuit's adoption of the restrictive approach. While a definite trend toward the restrictive approach has emerged among the circuits in recent years, an official clarification to U.S.S.G. § 2T1.1 is nevertheless needed. Accordingly, this Recent Development proposes that the United States Sentencing Commission issue a Revised Amendment to U.S.S.G. § 2T1.1, which explicitly states that, for sentencing purposes, a defendant's unclaimed deductions may not be considered in calculating her sentence. As laid out above, this Revised Amendment would send a uniform message to the courts, encourage genuine consistency among the federal circuits, and work toward eliminating discrepancies in the calculation of tax loss. Alternatively, if the Commission is unwilling or unable to enact a full revision, at the very least, it should provide an explanatory note or comment to § 2T1.1, definitively stating that the changes between the 1991 and 1993 versions were not intended to affect the "irrelevant" status of deductions or the use of attempted loss in sentencing calculations under the Guidelines.[135]

Ultimately, the holding in *United States v. Delfino* illustrates that the Fourth Circuit, like numerous circuits before it, has realized that disallowing convicted tax evaders the subsequent benefit of unclaimed deductions is the most prudent practice. This restrictive approach to tax loss calculation is fundamentally consistent with the policies underlying the prosecution of tax offenses and the Guidelines, whereas the permissive approach, which allows for the retroactive recognition of deductions, is erroneous, inequitable, and untenable. Furthermore, the federal courts have by and large acknowledged the superiority of the restrictive approach, as there has been a consistent trend toward its adoption and a corresponding rejection of the permissive approach in recent years. This trend will likely continue as undecided federal circuits hear future cases and recognize the appropriateness of the restrictive approach. Nonetheless, even though the courts appear to be converging toward the adoption of the restrictive approach, the Commission's objective behind the '93 Amendments of eliminating sentencing anomalies has

135. *See* U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 cmt. n.4 (1991).

never been fully realized.[136] Yet, this goal can finally be achieved through the enactment of a Revised Amendment to § 2T1.1 that explicitly rejects the use of unclaimed deductions for sentencing purposes. Such a Revised Amendment would not only produce doctrinal uniformity among the federal courts, but would also provide an approach that is fundamentally consistent with the policies of administrability, retribution, deterrence, and stricter sentencing that underlie the United States Sentencing Guidelines.

TIMOTHY J. COLEY

136. *See* U.S. SENTENCING GUIDELINES MANUAL app. C, amend. 491 (1993).