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2013 Guidelines Amendments

A Mixed Bag for White-Collar Defendants

By David Debold and Matthew Benjamin

On April 10, 2013, the United States Sentencing Commission promulgated its annual amendments to the federal sentencing guidelines. These amendments continue the trend, which we described in these pages one year ago (David Debold and Matthew Benjamin, Increased Fraud Penalties Are on the Horizon, 19 *Business Crimes Bulletin* 11 (July 2012)), of stiffened sentences for economic crimes. Specifically, the Commission voted to increase penalties for: 1) theft and fraud involving pre-retail medical products; 2) trafficking in counterfeit drugs and military equipment; and 3) foreign dissemination of stolen trade secrets.

In a rare and welcome bit of good news for white-collar defendants, however, the Commission also made an important change that will reduce sentences for tax offenses. A current rule in several federal circuits frequently causes "tax loss" to be overstated for sentencing purposes: It directs courts to consider only the amount of undeclared income, thus forbidding consideration of the deductions that would have been available had the defendant reported the undeclared income. The amendment will now require courts to consider the other side of the ledger: related deductions, exemptions, or credits that could have been included on a lawfully filed tax return, thus reducing the tax that was owed.

The Commission also voted to modify the acceptance-of-responsibility guideline, which gives extra credit to defendants who plead guilty early enough to spare the government the expenditure of time and resources needed to prepare for trial. The net effect is to confine both prosecutors and the courts to that particular factor when deciding whether to withhold the credit. That newly adopted amendment, like all the others, will take effect Nov. 1, 2013, unless Congress modifies them through legislation.

Calculating Tax Loss: Defendants Can Seek Credit For Unclaimed Deductions

In a victory for defendants in tax prosecutions, the Commission voted to amend the guideline applicable to most tax offenses. The amendment resulted from a split between the federal courts of appeals that caused tax loss to be overstated in criminal tax prosecutions across the country. In the Second and Tenth Circuits, a defendant has been allowed to present evidence of deductions that could have been lawfully claimed had the defendant filed a correct return — of tax-deductible operating expenses, for example. But six others — the Fourth, Fifth, Seventh, Eighth, Ninth, and Eleventh Circuits — have not allowed such proof, thereby preventing defendants from demonstrating that the true economic impact of their tax evasion was far less than the amount of undisclosed income.

The Commission proposed three different options for resolving this conflict: presumptively allowing consideration of unclaimed deductions, categorically prohibiting their consideration, or presumptively prohibiting calculations based on unclaimed deductions unless the defendant demonstrates through contemporaneous documentation that he or she would have claimed them. During the public comment period, the criminal defense

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bar supported the most permissive option. The Department of Justice's (DOJ's) Tax Division and the Department of the Treasury urged the Commission to categorically prohibit consideration of unclaimed deductions.

The views of the defense community largely prevailed. The Commission decided to add an application note to the Tax Guideline directing sentencing courts to account for any unclaimed deduction that is "needed to ensure a reasonable estimate of the tax loss," so long as such deduction "was related to the tax offense and could have been claimed at the time the tax offense was committed," is "reasonably and practicably ascertainable," and is supported by sufficiently reliable information. The defendant will bear the burden of establishing that an unclaimed deduction was available, though he need not demonstrate through contemporaneous documentation that he would have claimed it.

In a compromise with government stakeholders, the Commission also decided, however, to exclude from consideration "payments to third parties made in a manner that encouraged or facilitated a separate violation of law," such as bribes to public officials or "under-the-table" payments to employees. This amendment will permit a more accurate measurement of the consequences to the federal fisc from a false return, without turning federal sentencing proceedings into *de facto* IRS audits.

For example, a restaurant owner who fails to report cash revenue on his return will now be allowed to show that portions of that revenue were used to pay tax-deductible operating expenses, such as cash wages or food supplies, or deductible state taxes. Consideration of both expenses and income will better reflect the true economic impact of tax offenses — in other words, the actual loss to the government caused by the tax-evading defendant. At the same time, the amendment will continue to prohibit consideration of unclaimed deductions that, because unclaimed, encouraged additional violations of law (like "under the table" payments to employees that allowed the employees to evade their own taxes).

Increased Penalties for Economic Offenses

Theft of Pre-Retail Medical Products

In the SAFE DOSES Act, Pub. L. 112-186 (Oct. 5, 2012), Congress created a new criminal offense for theft of pre-retail medical products; harmonized the penalties for pre-existing statutory offenses when a pre-retail medical product is involved in the offense; and directed the Commission to "review and, if appropriate, amend" the various sentencing guidelines and policy statements applicable to the new and related offenses.

In response, the Commission referenced this new statutory offense to the fraud guidelines and created a new specific offense characteristic, thereby adding to the multitude of redundant, overlapping enhancements that already exist. The new enhancement provides a two-level increase for any offense under the new law, and a four-level increase if the defendant was employed by, or an agent of, an organization in the supply chain for the pre-retail product. The term "supply chain" includes any manufacturer, wholesaler, repacker, own-labeled distributor, private-label distributor, jobber, broker, drug trader, transportation company, hospital, pharmacy, or security company involved in the creation, sale, or distribution of the medical product before it is made available for retail purchase by a consumer.

The Act's legislative history indicates that Congress intended to target sophisticated criminal organizations that steal and traffic in large quantities of medical products. But the new two- and four-level enhancements threaten to reach far more ordinary fraud defendants. For example, a CVS truck driver who acquiesces in the theft of ice bags and toothbrushes from his vehicle will now be treated more severely than defendants whose theft or fraud offenses involved the same amount of dollar loss, including a similarly situated CVS in-store employee (or even a store manager) whose theft occurred "post-retail," *e.g.*, after the same products were placed on the store's shelf.

Trafficking in Counterfeit Goods and Services, and Adulterated Drug Offenses

The Commission also created new penalties for trafficking in counterfeit or adulterated drugs and counterfeit military equipment. Explaining the importance of these amendments, Judge Patti B. Saris, Chair of the Commission, noted that counterfeit drugs "can endanger public health and safety," and that counterfeit military equipment, which often originates outside the United States, "can undermine the military and place servicemen and women in harm's way."

The Commission added to the guideline for such offenses two new specific offense characteristics: a two-level enhancement for offenses involving a counterfeit drug, and a two-level enhancement (with a minimum offense level of 14) for offenses involving a counterfeit military good or service "the use, malfunction, or failure of which is likely to cause the disclosure of classified information; impairment of combat operations; or other significant harm to a combat operation, a member of the Armed Forces, or to national security."

In a new application note, the Commission indicated that "other significant harm … " means significant harm other than bodily injury or death, which is already subject to two-level enhancement under the existing guideline.

The Commission also substantially increased punishment for adulterated drug offenses that "have a reasonable probability of causing serious adverse health consequences or death to humans or animals" by referencing such offenses to the guidelines related to tampering with consumer products, thereby increasing the "base" (or starting) offense level from 6 to 25. Defendants sentenced under this provision now face a base offense level equating to a recommended prison range of 57-71 months — higher than the base offense levels applicable to criminal sexual abuse of a minor or involuntary manslaughter.

International Theft of Trade Secrets and Economic Espionage

In response to Congress's directive in the Foreign and Economic Espionage Penalty Enhancement Act of 2012, Pub. L. 112-269 (Jan. 14, 2013), the Commission revised the fraud guidelines' specific offense characteristic governing the misappropriation of trade secrets. Under current practice, a defendant who misappropriates a trade secret with the knowledge or intent that a foreign government, instrumentality, or agent would benefit receives a two-level enhancement. Under the Commission's replacement provision, such a defendant will now receive a four-level enhancement (with a minimum offense level of 14). The provision also creates a new two-level enhancement for misappropriation in which a trade secret is knowingly transported or transmitted out of the United States.

Acceptance of Responsibility: Bad News, Good News

Finally, the Commission responded to two conflicts in the federal courts of appeals involving the guideline for acceptance of responsibility. A defendant who clearly demonstrates acceptance of responsibility for his offense receives a two-level reduction under subsection (a). The circuit conflicts both involve the circumstances under which the defendant is eligible for a third level of reduction under subsection (b), which is available only after a government motion stating that the defendant has offered assistance by "timely notifying authorities of his intention to enter a plea of guilty, thereby permitting the government to avoid preparing for trial and permitting the government and the court to allocate their resources efficiently."

Circuits have disagreed over: 1) whether the sentencing court has discretion to deny the third level of reduction when the government has filed a motion and the defendant is otherwise eligible; and 2) whether the government has discretion to withhold a motion based on whether the defendant agrees to waive his or her right to appeal.

Regarding the first conflict, the Commission amended the guideline's application note to state that the sentencing court does have discretion to deny reduction by the third level. The Commission added, however, that a court may not invoke new requirements as bases to deny the motion. The court's inquiry is the same: whether the defendant assisted authorities in the investigation or prosecution of his own misconduct by timely notifying authorities of his intention to enter a plea of guilty, thereby permitting the government to avoid preparing for trial and permitting the government and the court to allocate their resources efficiently.

In a similar vein, the Commission resolved the second conflict by adding that the government "should not" withhold filing a motion for the third level of acceptance reduction based on interests other than those related to the timeliness of the defendant's plea, such as whether the defendant has agreed to waive his or her right to appeal.

The end result of the amended application note will be to cabin both the sentencing court's and the government's discretion to the benefits realized as a result of the timeliness of the defendant's plea, such as the government's avoidance of the need to prepare for trial. The government will remain free to negotiate for appeal waivers in plea negotiations, but it can no longer threaten to withhold a third-level motion as leverage for extracting waivers of those or other constitutional and statutory rights.

Awaiting Comprehensive Reform

The Commission has stated that its multi-year comprehensive review of the fraud guidelines is underway. The outcome of that review — which may be announced in 2014 — could be dramatic. In the meantime, the Commission's 2013 amendments are more targeted in scope by focusing largely on specific theft and fraud offenses that have been the subject of Congress's recent attention. With the significant exception of the Commission's clarification regarding tax-loss calculation, most of these amendments threaten even greater penalties for white-collar offenses.