

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:CT-105746-06
JAUlicny/MENeedle

date: February 2, 2006

to: John Fowler
Deputy Director, Strategy

from: EDWARD F. CRONIN 
Division Counsel/Associate Chief Counsel (Criminal Tax)

subject: Affect of Claim Disallowance Notices and Frozen Refunds on Criminal Cases

This is in response to your request via email dated January 31, 2006, for legal assistance with respect to frozen refund notices. We understand the question as follows:

Question: Will the freezing of refunds and subsequent issuance of notices of claim disallowance preclude criminal prosecutions.

Answer: Service activity related to the freezing of refunds and issuance of notices of claim disallowances should not technically preclude the prosecution of either the promoters or individual taxpayers participating in schemes involving the submission of false tax returns claiming refunds.

Analysis

Statutory Language

Fraudulent claims for refunds may be prosecuted under Title 18 U.S.C. § 287 (false, fictitious, or fraudulent claims). The purpose of 18 U.S.C. § 287 is to protect the government from false, fictitious, or fraudulent claims. *United States v. Montoya*, 716 F.2d 1340, 1344 (10th Cir. 1983). See also *United States v. Computer Science Corp.*, 689 F.2d 1181, 1187 (4th Cir. 1982). Section 287 states as follows:

Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the

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United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years and shall be subject to a fine in the amount provided in this title.

In order to establish a violation of 18 U.S.C. § 287, the following elements must be proved beyond a reasonable doubt: 1) The defendant made or presented a claim to a department or agency of the United States for money or property; 2) the claim was false, fictitious or fraudulent; and 3) the defendant knew at the time that the claim was false, fictitious or fraudulent.¹ *United States v. Nash*, 175 F.3d 429, 436 (6th Cir. 1999).

The majority of tax false claims cases are brought against individuals who file multiple, fictitious income tax returns claiming refunds of income tax. The cases involve both paper and electronic filing (ELF) of income tax returns, and can involve multiple defendants and taxpayers. Many false claim for refund cases could also be charged as violations of 26 U.S.C. § 7206(1) (false returns). Also, when the false claims appear to be part of a scheme, 18 U.S.C. § 286 (conspiracy to defraud the government)² is often charged in conjunction with § 287.

¹ Section 287 does not specifically require that a claim be false as to a "material" matter. Several circuits have expressly held that materiality is not an essential element of § 287 and need not be alleged in an indictment charging a violation of that statute. In those circuits which have held that materiality is an element of section 287, the issue must be submitted to the jury.

² In order to establish a violation of 18 U.S.C. § 286, the following elements must be proved beyond a reasonable doubt:

1. An agreement, combination, or conspiracy to defraud the United States;
2. By obtaining or aiding to obtain the payment of any false, fictitious or fraudulent claim.

United States v. Okoronkwo, 46 F.3d 426 (5th Cir. 1995). The applicability of § 286 to false claims for income tax refunds has been upheld. See *United States v. Orr*, 864 F.2d 1505 (10th Cir. 1988). The crime proscribed by § 286 is the entering into an agreement to defraud the government in the manner specified. In order to convict, the government must prove that the defendants agreed to engage in a scheme to defraud the government and knew that the objective of the scheme was illegal. There is no requirement that the coconspirators actually obtained the payment or that the government prove that any steps were taken to consummate the filing of a false claim, so long as the existence of the agreement can be proved.

To establish a violation of section 287, the government must prove that the defendant filed or caused to be filed a claim against the United States, or any department or agency of the United States, for money or property. *United States v. Neifert-White Co.*, 390 U.S. 228 (1968); *United States v. Mastros*, 257 F.2d 808, 809 (3d Cir. 1958); *Johnson v. United States*, 410 F.2d 38, 44 (8th Cir. 1969). A tax return seeking a refund is a claim against the United States. *United States v. Drape*, 668 F.2d 22, 26 (1st Cir. 1982). Proof that a return was filed may include the IRS transcript of the account in which the refund claim was made. See *United States v. Bade*, 668 F.2d 1004, 1005 (8th Cir. 1982).

Under § 287, a claim must involve "a demand for money or transfer of public property or an attempt to cause the government to pay out sums of money," *United States v. Jackson*, 845 F.2d 880, 883 (9th Cir. 1988) (internal quotation marks omitted), but there is "no requirement that the claim has actually been honored," *United States v. Coachman*, 727 F.2d 1293, 1302 (D.C. Cir. 1984). The offense is complete on the filing of the claim with the government. The statute does not require that the government pay or honor the claim.³ A conviction under § 287 always involves intended loss to the government. *Li v. Ashcroft*, 389 F.3d 892, 897, FN. 9 (9th Cir. 2004). Thus, violations of section 287 are chargeable even if the government has not lost money due to the false or fictitious claim. *United States v. Coachman*, 727 F.2d 1293, 1302 (D.C. Cir. 1984); *United States v. Miller*, 545 F.2d 1204, 1212 n.10 (9th Cir. 1976). Freezing refunds in cases that are prosecuted under the QRP, therefore, will not adversely affect the criminal prosecution from a technical standpoint. We recognize, however, that the jury appeal of a particular case could be lessened if the government incurs no actual loss. This factor can only be measured on a case-by-case basis.

Sentencing Guidelines

The U.S. Sentencing Guidelines (USSG) generally require that a criminal sentence be based on the total harm caused by the defendant's conduct. However, for convictions of § 287 offenses, USSG §1B1.3(a)(2) provides that the enhancement for monetary loss from a scheme to defraud includes the aggregate of intended losses. Therefore, in false claims cases, the defendant can be held accountable for the total amount of false or fictitious refunds claimed by the defendant and/or co-conspirators whether or not the money is actually received.⁴

³ See by analogy cases involving the use of sight drafts and other fictitious financial instruments that were used to pay tax liabilities and seek erroneous IRS refunds. See e.g. *United States v. Switzer*, 162 F.3d 1171 (9th Cir. 1998)(upholding sentence based on intended loss).

⁴ See e.g. *United States v. Moser*, 123 F.3d 813 (5th Cir. 1997)(case involving use of bogus financial instruments resulted in sentence being upheld based on the face value of the money orders even though no actual loss).

Notice of Claim Disallowance

It is our understanding that CI will be issuing letters to the taxpayers notifying them that their returns are being investigated for possible fraud. These letters will be sent 45 days after the questionable tax returns are posted. Subsequently, if the return is deemed fraudulent, either SBSE, W & I, or CI will send a claim disallowance letter. The issuance of such letters should not negatively impact potential criminal prosecutions. The key element to a § 287 charge is that of knowledge of the defendant, i.e., the defendant must have made a claim knowing it to be false, fictitious or fraudulent. *United States v. Irwin*, 654 F.2d 671, 682 (10th Cir. 1981). By issuing the letters, a taxpayer is put on notice that their claim is considered fraudulent. Any subsequent filings with the same characteristics will demonstrate the taxpayer's knowledge that such conduct was deemed fraudulent by the Service.

Should our assistance be required, please feel free to contact me at (202) 622-4460 or James Ulicny of the Criminal Tax Division at (202) 622-4470.