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TAX EVASION

Two attorneys with Patterson Belknap Webb & Tyler LLP examine a recent ruling by the Second Circuit in which the court affirmed an above-guidelines sentence. The authors discuss why the district court arrived at its sentence and note several points on why the circuit court agreed.

INSIGHT: Second Circuit Affirms \$10 Million Fine in Tax Evasion Case



By HARRY SANDICK AND STEPHANIE TEPLIN

In a per curiam decision issued on July 27, 2018, the Second Circuit affirmed a \$10 million fine imposed on Morris Zukerman as part of a sentence for tax evasion in *United States v. Zukerman*, No. 17-948 (Katzmann, KeARSE, Pooler). The court summarized its reason for affirming the fine, which was well above the \$250,000 Guidelines ceiling, by writing that “Zukerman, a very wealthy man who has repeatedly and brazenly committed sophisticated tax fraud—a rarely caught and more rarely punished offense that undercuts the functioning of state and federal governments—ought to pay a fine hefty enough to take any financial benefit out of his crimes and to give pause to others who might be tempted to commit similar crimes.”

While tax cases often involve downward variances to a non-incarceratory sentence, this case involved a district judge’s strongly held belief that the high fine was important to the purposes of sentencing and that it merited an upward variance. The Second Circuit agreed.

Zukerman, the founder of an eponymously named investment management firm called M.E. Zukerman & Co., or MEZCO, was sentenced after pleading guilty to a scheme designed to avoid paying taxes on a \$110 mil-

lion asset sale and on \$12 million of operating income. Zukerman falsified documents, and, when investigated by the IRS, lied to IRS auditors and fabricated additional documents. In unrelated schemes, Zukerman also avoided more than \$4.5 million in taxes on art purchases, provided false information related to his personal tax returns, and failed to file taxes for a family trust that earned “significant taxable income.”

The Reasonableness of the Sentence

Zukerman’s plea agreement stipulated to a Sentencing Guidelines range of between 70 to 87 months’ imprisonment and a fine range between \$25,000 and \$250,000. The district court imposed a sentence of 70 months’ imprisonment, \$37 million in restitution, and a \$10 million fine. In an earlier summary order, 710 F. App’x 499 (2d Cir. 2018), the court issued a *Jacobson* remand to allow the district court to explain the \$10 million fine. In the more recent decision, the Second Circuit agreed with the district court’s reasoning on every point.

First, the panel quickly disposed of Zukerman’s two arguments that the fine was procedurally unreasonable. Because the procedural arguments were not raised to the district court, the Second Circuit reviewed for plain error. First, Zukerman cited Guidelines section 5E1.2(h), which provides that an earlier version of the Guidelines applies for “offenses committed prior to November 1, 2015.” Zukerman stated during his plea allocution, however, that his offenses took place from 2007 through 2015, which the Second Circuit held cannot be reasonably interpreted to mean prior to November 1, 2015. Next, Zukerman argued that the district court failed to give adequate consideration to his ability to pay a \$10 million fine. Zukerman submitted an affidavit

stating that his net worth was “in the eight-figure range,” and he never provided updated financial information to the district court, even when it was clear that a substantial fine was on the table. Thus, the court concluded, Zukerman had “ample opportunity to attempt to show any limitations on his ability to pay a fine, yet he failed to do so.”

Turning to the arguments in favor of substantive unreasonableness, the court began by stressing the serious nature of tax evasion and the extensiveness of the scheme carried out by Zukerman. It noted that “the district court expressed deserved opprobrium for Zukerman’s ‘calculated scheme to defraud the government of tens of millions of dollars for the sole purpose of increasing his personal wealth,’ executed through efforts that ‘spanned 15 years and involved submitting more than 50 falsified tax forms for at least 10 different individuals.’” Nor was the district court required to conclude that these factors were fully accounted for by Zukerman’s increased offense level. The court also cited approvingly the district court’s conclusion that Zukerman had a history of criminal conduct—albeit uncharged—and his repeated refusal to “come clean” warranted an above-Guidelines fine.

The court found “eminently reasonable” the district court’s emphasis on deterrence in the tax evasion context. In particular, the court observed that the high cost of tax enforcement means that deterrence is all the more important, and that the imposition of significant fines will make tax evasion appear less profitable to potential tax avoiders. The panel also found no fault with the district court’s conclusion that the fine was necessary to specifically deter Zukerman, whose “criminal activities had only grown in size and scope.”

Sentence Disparity, Unfair Punishments

The court also addressed the concern that a fine so far outside of the Guidelines range could result in unwarranted sentencing disparity, but credited the district court’s conclusion that there were few similarly situated defendants given the scope of Zukerman’s tax evasion. Zukerman cited only one purportedly comparable defendant to the district court, but that case had differing factual circumstances, and resulted in a longer prison sentence to go along with a somewhat lower fine. Moreover, 18 U.S.C. § 3571(d) permits a fine equal to twice the gross loss caused by the offense. Given the \$45 million tax loss resulting from Zukerman’s conduct, a much higher fine would have been warranted under the statute. And—while no rule specifically authorizes it—the Second Circuit wrote approvingly of the district court’s consideration of the time gap between the tax loss to the government and the imposition of the restitution award, because to do otherwise would allow Zukerman to profit from his tax evasion.

The court concluded that Zukerman was not being “unfairly punished for his wealth” just because the district court took into account his net worth in determining what level of fine was necessary to deter future misconduct. “A fine can only be an effective deterrent if it is painful to pay, and whether a given dollar amount hurts to cough up depends upon the wealth of the person paying it.” The Guidelines’ instruction to consider the defendant’s ability to pay is not “a one-way ratchet” that can result in lower fines but never an increase.

Finally, the court approved of the district court’s reasoning that the restitution portion of the sentence would be borne by MEZCO, and only the fine would be paid by Zukerman personally. (The court concluded that Zukerman was being “disingenuous” when he claimed to feel the pain from MEZCO’s restitution payment, since Zukerman also argued that he was totally separate from MEZCO in seeking to not have MEZCO’s value count toward his financial position.) Restitution, moreover, serves a different purpose than a fine by “forc[ing] the defendant to confront, in concrete terms, the harm his actions have caused.” A fine is meant to be punitive in light of the other sanctions.

Commentary on Decision

A few thoughts on this decision: First, defendants who complain that the district court did not provide a sufficient basis for its sentencing decision sometimes need to be careful what they wish for. Here, the district court provided a supplemental memorandum laying out its explanation, in detail, for the very hefty fine that was imposed. Sometimes an insistence on a written rationale is to the defendant’s benefit: when written out, the rationale does not support the sentence, creating opportunities to challenge the sentence on appeal. But this did not happen here. The longer rationale also gave the district court an opportunity to explain the many reasons why it believed that Zukerman’s conduct was troubling. This made it easier for the Court of Appeals to affirm the sentence as substantively reasonable.

Second, the court’s decision focused extensively on the need for tax fraud sentencing to provide general deterrence. Tax fraud is only prosecuted in a fraction of the cases in which there has been a tax law violation. The Guidelines themselves state in the introductory comment to Part T that “detering others from violating the tax laws is a primary consideration underlying these guidelines,” adding that “[r]ecognition that the sentence for a criminal tax case will be commensurate with the gravity of the offense should act as a deterrent to would-be violators.” The court seemed reluctant to minimize the importance of deterrence. The court agreed with the district court’s statement that “tax criminals are more likely to account for the size of a fine and the likelihood that it will be imposed.”

Third, despite the rhetoric concerning this specific defendant, the court also provided some analysis that will be useful to justify below-the-range sentences in future cases. The court stated that the guidelines relating to tax offenses “drastically vary as to the recommended sentence based simply on the amount of money involved,” and that “a district court may find that even after giving weight to the large or small financial impact, there is a wide variety of culpability amongst defendants and, as a result, impose different sentences.” To the court, this means that tax sentences “should be reviewed especially deferentially.” One presumes that this will run in both directions—with variances up and down receiving the same level of deference. There are tax cases (and fraud cases too) in which the high dollar amount tends to overstate the relative culpability of the defendant and this decision should be cited to defend downward variances.

Finally, the court seemed willing to accept a fine that was imposed based on the defendant’s wealth. The court’s discussion of this issue seemed to recognize that

wealth is typically not a permitted basis to pick a particular sentence. However, it drew a fine distinction between socioeconomic status and financial resources. The latter is a pertinent consideration in setting the fine. None of this, however, should ever be a permitted consideration in setting a term of imprisonment.

Author Information

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