No. 12-328

In the Supreme Court of the United States

JOHN PSIHOS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether a defendant can use undocumented deductions that he never claimed on any tax return to reduce the amount of tax loss under Section 2T1.1 of the Sentencing Guidelines.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-14) is reported at 683 F.3d 777. The order of the district court (Pet. App. 15-19) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 15, 2012. The petition for a writ of certiorari was filed on September 13, 2012. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner pleaded guilty to four counts of willfully making and subscribing false tax returns in violation of 26 U.S.C. 7206(1). Pet. App. 20. At sentencing, the district court found that petitioner underreported his income for 2001 through 2004 by more than $3.2 million, causing a tax loss to the government of $837,724. *Id.* at

18-19. The district court sentenced petitioner to 24 months of imprisonment, to be followed by one year of supervised release, and ordered him to pay restitution in the full amount of the tax loss. *Id.* at 21, 23, 27-28. The court of appeals affirmed. *Id.* at 13.

1. Petitioner owned and operated three restaurants in the Chicago area: Flanagan's, Full Moon, and Café Oceana. Pet. App. 2. In early 2005, petitioner listed Flanagan's for sale and stated in a broker's "fact sheet" that the restaurant took in over $2 million per year in gross receipts. *Ibid.* That number was inconsistent with petitioner's tax filings. Accordingly, in April 2005 the IRS sent undercover agents to pose as potential buyers and examine petitioner's books. *Id.* at 2-3.

Petitioner showed the agents detailed records of what he was "actually getting" from operating Flanagan's and explained how the records were kept. Pet. App. 3. Every night at closing, the restaurant's managers brought petitioner "envelopes with all of the money, receipts, register tapes, and payout information" for the day. *Ibid.* One of the managers then used these envelopes to prepare a weekly "summary report." *Ibid.*

In May 2005, IRS agents executed search warrants at petitioner's properties and seized the weekly reports and "the envelopes detailing Flanagan's nightly sales and cash payouts." Pet. App. 3. The IRS used these records to calculate Flanagan's annual gross receipts and net income for 2001 through 2004. That calculation revealed that petitioner had underreported the gross receipts by millions of dollars, thereby evading hundreds of thousands of dollars in federal taxes. *Id.* at 4, 19; see *id.* at 2 (explaining how the restaurants were organized as S-corporations).

The government's calculation gave petitioner credit for expenses and deductions supported by his own contemporaneous records. The summary sheets and the envelopes reflected certain cash payments made by petitioner, as well as amounts that were collected for tips when customers paid their bills by credit card. Pet. App. 18; Gov't C.A. Br. 10. The IRS subtracted these payments and tips in computing the loss petitioner caused to the government. Pet. App. 18.

2. Petitioner pleaded guilty to four counts of making false statements in a tax return. Pet. App. 4. Sections 2T1.1 and 2T4.1 of the Sentencing Guidelines, which govern the amount of "tax loss" that the defendant caused, applied in determining petitioner's advisory sentencing range. The Guidelines define "tax loss" as "the total amount of loss that was the object of the offense (i.e., the loss that would have resulted had the offense been successfully completed)." Sentencing Guidelines § 2T1.1(c)(1). The Guidelines also provide a means of calculating that loss for an "offense [that] involved filing a tax return in which gross income was underreported." Sentencing Guidelines § 2T1.1(c) note A. With respect to such an offense, "the tax loss shall be treated as equal to 28% of the unreported gross income * * * unless a more accurate determination of the tax loss can be made." *Ibid.*; see *id.* § 2T1.1, comment. (n.1) (stating that in "some instances" the "amount of tax loss may be uncertain" and the district court should "make a reasonable estimate based on the available facts").

At sentencing, the government argued that the tax loss in this case was $837,724. Pet. App. 18-19. Under Section 2T4.1, that amount dictated an offense level of 20. Pet. App. 33. Petitioner argued that the government's tax-loss number was far too high. He asserted that he was entitled to more than $2 million in expenses and deductions that he had never claimed on any tax return, including money transferred from Flanagan's to Café Oceana, complimentary drinks and food for customers, and cash payments to promoters, bouncers, and wait staff. *Id.* at 4-5, 14. Petitioner had no contemporaneous records of these amounts; he asserted "approximate" numbers and submitted various documents showing generally how his businesses operated. *Id.* at 14; Pet. C.A. Br. 26-27. According to petitioner, these submissions established that Flanagan's unreported gross receipts were actually $79,615.26, the tax loss was a mere $22,292.27, and the appropriate offense level was only 12. Pet. App. 5; Sentencing Guidelines § 2T4.1.

The district court rejected petitioner's argument. The court found that petitioner's claim of "hundreds of thousands of dollars of * * * cash payouts and transfers" was "completely undocumented," despite the fact that petitioner generally maintained "detailed records." Pet. App. 18. The court also noted that "the government, in its calculation of the tax loss amount, gave credit to the [petitioner] for any cash payouts that were reflected on * * * the daily envelopes collected by his managers." *Ibid.* More generally, the court explained that previously "unclaimed" payments—no matter how well documented—"have no relevance to the amount of loss that the scheme attempted to produce" and, therefore, should play no role in the calculation of tax loss under the Sentencing Guidelines. *Id.* at 16-18 (quoting *United States* v. *Chavin*, 316 F.3d 666, 677 (7th Cir. 2002)).

The district court reduced petitioner's offense level in light of his acceptance of responsibility and calculated an advisory guidelines range of 24 to 30 months of imprisonment. Pet. App. 33-34. The court sentenced petitioner at the lowest end of that range and required him "[u]pon release" to pay the government $837,724 as restitution by "mak[ing] payments * * * in the amount of 10% of his net[ ] monthly income." *Id.* at 27-28.

3. The Seventh Circuit affirmed. The court adhered to its decision in *United States* v. *Chavin*, 316 F.3d 666 (2002), which held that unclaimed deductions say "nothing about the amount of loss to the government" that a defendant's "scheme intended to create." *Id.* at 677. Under *Chavin*, the court explained, petitioner's "alleged cash payments" were "irrelevant in determining the tax loss caused by his fraudulent statements." Pet. App. 7. Although *Chavin* dealt with deductions and not "'above-the-line' reductions from gross income," the court refused to distinguish the decision on that basis, stating that "the point of *Chavin*" is that "tax loss is based on the object of the offense and should not take into account 'unrelated mistakes'" of any sort. *Id.* at 8; see also generally *Knight* v. *Commissioner*, 552 U.S. 181, 184 (2008).

The court of appeals also explained that it would have ruled the same way even if it had "follow[ed] the reasoning" of decisions from the Second and Tenth Circuits suggesting that unclaimed deductions are relevant to the tax-loss calculation if they are "legitimate" and substantiated by more than "speculation" or "weak support." Pet. App. 8-9 (quoting *United States* v. *Hoskins*, 654 F.3d 1086 (10th Cir. 2011), *United States* v. *Gordon*, 291 F.3d 181 (2d Cir. 2002), cert. denied, 537 U.S. 1114 (2003), and *United States* v. *Martinez-Rios*, 143 F.3d 662 (2d Cir. 1998)). Petitioner "would not benefit" from that approach "because, as the district court concluded, there was an utter lack of support" for the alleged expenditures, for which petitioner had "absolutely no documentation" even though he "had kept meticulous records" and "detailed notes" of other kinds of payments. Pet. App. 8-9; see *id.* at 9 (stating that "even if the sentencing guidelines did not 'categorically prevent a court from considering unclaimed deductions,' * * * the absence of any contemporaneous supporting documentation of the purported cash outflows makes this case well suited to the general rule established in *Chavin*") (quoting *Hoskins*, 654 F.3d at 1094); *id.* at 10 (noting lack of "contemporaneous documentation of the purported payouts"); *id.* at 12 (stating that petitioner "lacks the corresponding records" of money transfers between restaurants and "kept no record of the cash payments" he claimed); *id.* at 13 (stating that the district court found that petitioner "had not provided adequate documentation" and "has not established that he actually made the claimed payments").

ARGUMENT

Petitioner argues that the circuits are divided on whether unclaimed deductions may be considered in determining the amount of "tax loss" under the Sentencing Guidelines. But this case does not implicate any disagreement among the circuits. As the Seventh Circuit carefully explained in the decision below, no court of appeals has accepted the argument that a sentencing court must give a defendant credit for "completely undocumented" payments like those on which petitioner relies. Petitioner's case therefore would have been decided exactly the same way in the circuits that have left the door open to consideration of unclaimed deductions. Moreover, the United States Sentencing Commission (Commission) is the appropriate body to resolve any questions about the interpretation of the relevant guidelines. This Court's review is therefore unwarranted.

1. Most courts of appeals that have addressed the issue have held that a defendant should not be permitted to reduce his tax loss based on previously unclaimed expenses and deductions. Like the court below, these courts have reasoned that the reference in Section 2T1.1 to the "object of the offense" places the focus of the tax-loss inquiry on the defendant's intent, and thereby forecloses speculation about how the defendant might have lowered his tax liability had he filed an imaginary, perfect return. See Pet. App. 7; see also, *e.g.*, *United States* v. *Yip*, 592 F.3d 1035, 1041 (9th Cir. 2010) ("We hold that § 2T1.1 does not entitle a defendant to reduce the tax loss charged to him by the amount of potentially legitimate, but unclaimed, deductions."); *United States* v. *Clarke*, 562 F.3d 1158, 1164 (11th Cir.) (holding that "'tax loss' under [Section] 2T1.1(c)(1) is the amount of loss the defendant intends to create when he falsifies his tax return and must therefore be calculated based upon the fraudulent return," and "not on the tax return [the defendant] could have filed but did not"), cert. denied, 130 S. Ct. 809 (2009); *United States* v. *Delfino*, 510 F.3d 468, 473 (4th Cir. 2007) ("The Delfinos chose not to file their income tax returns. * * * By doing so, they forfeited the opportunity to claim these deductions."), cert. denied, 555 U.S. 812 (2008); *United States* v. *Phelps*, 478 F.3d 680, 682 (5th Cir.) (per curiam) (holding that the defendant could not reduce tax loss by taking a deduction that he did not claim on his false return), cert. denied, 552 U.S. 973 (2007); *United States* v. *Wu*, 81 F.3d 72, 75 (7th Cir. 1996) (explaining that it is not "the responsibility of the United States Courts to comb the books of convicted tax evaders seeking ways in which

they could have lowered their tax liability and their sentences").

The Tenth Circuit and Second Circuit have left open the possibility that a sentencing court may consider previously unclaimed deductions—and petitioner points (Pet. 12-15) to these decisions in asserting that the circuits have disagreed on an issue relevant to his case. See *United States* v. *Hoskins*, 654 F.3d 1086, 1094 (10th Cir. 2011); *United States* v. *Gordon*, 291 F.3d 181, 187 (2d Cir. 2002), cert. denied, 537 U.S. 1114 (2003).[1] Each of the decisions in question, however, makes clear that such deductions are not relevant to the calculation of tax loss if they are not adequately documented. See Pet. App. 8-9 (discussing the relevant decisions).

In *Hoskins*, the Tenth Circuit explicitly "agree[d] with * * * other circuits that where a defendant offers weak support for a tax-loss estimate, nothing in the Guidelines *requires* a sentencing court to engage in the 'nebulous and potentially complex exercise of speculating about unclaimed deductions.'" 654 F.3d at 1094

[1] The petition for a writ of certiorari (at 15) also discusses decisions from the Third Circuit and Eighth Circuit, but those decisions do not reach any conclusion about whether unclaimed deductions are relevant to the tax-loss calculation. In *United States* v. *Bennett*, 341 Fed. Appx. 776 (3d Cir. 2009), the court simply mentioned in passing that the government "gave [the defendant] the standard deductions he could have claimed had he actually filed his tax returns, but the majority of the courts of appeals do not require this." *Id.* at 780 n.4. And in *United States* v. *Blevins*, 542 F.3d 1200 (8th Cir. 2008), cert. denied, 555 U.S. 1147 (2009), the court stated that it did not need to "decide whether an unclaimed tax benefit may *ever* offset tax loss," since the unclaimed benefit was not relevant to the offense and could still be claimed by third parties. *Id.* at 1203-1204; see *United States* v. *Sherman*, 372 Fed. Appx. 668, 676-677 (8th Cir. 2010) (rejecting defendant's attempt to use "previously unclaimed tax deductions" to reduce the amount of tax loss).

(quoting *Yip*, 592 F.3d at 1041). The court of appeals determined only that a sentencing court may take into account "convincing proof" of unclaimed deductions. *Ibid.*; see *id.* at 1095 (offering a hypothetical involving a restaurant owner who has "immaculate" and "meticulously kept" documentation of "every business expense"). And the Tenth Circuit ultimately held that the district court did not err in rejecting the defendant's tax-loss calculation, since there were "many reasons to be skeptical of [the] proposed deductions." *Id.* at 1096; see *id.* at 1096-1097 (noting that the "projected deductions" were based on "marginally relevant" and "self serving" information that could not be "independently verif[ied]").

The Second Circuit has taken the same approach. In *Gordon*, the Second Circuit stated that the district court should have considered "potential unclaimed deductions in its sentencing analysis." 291 F.3d at 187. But the court of appeals went on to hold that the defendant—who "bears the full burden of proof"—had failed to "provide sufficient proof to establish an unclaimed deduction," since the contention that certain funds were "likely" to be treated as salary was not good enough. *Id.* at 187-188; see *United States* v. *Martinez-Rios*, 143 F.3d 662, 670-671 (2d Cir. 1998) (stating in dicta that the current version of Section 2T1.1 "giv[es] the defendant the benefit of legitimate but unclaimed deductions," but ultimately applying an earlier version of that Guideline and refusing to take any deductions into account).

As these decisions illustrate, no court of appeals has held that a district court is required to give a defendant credit for undocumented expenses or deductions that he says he would have claimed had he not violated the tax laws. That is hardly surprising. Evaluating a hypothetical tax return that the defendant never filed is a difficult proposition even where the unclaimed deductions are reflected in contemporaneous records. See, *e.g.*, *Delfino*, 510 F.3d at 472-473. Without such records, the exercise becomes a fanciful one. See *Hoskins*, 654 F.3d at 1094; see also *INDOPCO, Inc.* v. *Commissioner*, 503 U.S. 79, 84 (1992) (explaining that the "burden of clearly showing the right to the claimed deduction is on the taxpayer").

The district court found as fact that petitioner's claimed payments were "completely undocumented"—in contrast to the "detailed" expenses reflected in petitioner's records, for which petitioner was given credit at sentencing—and the court of appeals accepted that factual finding. Pet. App. 8-9, 18. On that basis, the court of appeals expressly stated that its decision would have been the same if it had followed the approach taken by the Second and Tenth Circuits. *Id.* at 8-9 ("In this case, even if we were to follow the reasoning of *Hoskins*, [petitioner] would not benefit because, as the district court concluded, there was an utter lack of support for [petitioner's] claimed cash payments. * * * For the same reason, [petitioner's] reliance on dicta from the Second Circuit * * * serves him no better.").

In an attempt to escape that conclusion, petitioner attacks (Pet. 19-20) the factual finding that his expenses were completely undocumented, contending that he submitted a variety of written materials establishing the existence of those expenses. This Court is not the appropriate arena for a challenge to that finding. See S. Ct. R. 10. In any event, at best, petitioner's documents gave rise to a general inference that the restaurant incurred expenses not reflected in its books and records—but the specific amounts petitioner claimed were simply not supported by the evidence. Pet. App. 18; Gov't C.A. Br. 31-34. Moreover, the evidence itself was open to question given petitioner's admission that he had previously given his accountant a false set of documents about the restaurant's revenues. See *Hoskins*, 654 F.3d at 1097; 08-cr-1026 Docket entry No. 57 (N.D. Ill. April 8, 2010) at 2-8.

2. Review is unwarranted for an additional reason. This Court does not review decisions interpreting the advisory Sentencing Guidelines, because the Commission can amend them to eliminate any conflict or to correct an error. See *Braxton* v. *United States*, 500 U.S. 344, 347-349 (1991). The Commission is charged by Congress with "periodically review[ing] the work of the courts" and making "whatever clarifying revisions to the Guidelines conflicting judicial decisions might suggest." *Id.* at 348 (citing 28 U.S.C. 994(*o*)); see *United States* v. *Booker*, 543 U.S. 220, 243, 263 (2005) ("The Sentencing Commission will continue to collect and study appellate court decisionmaking. It will continue to modify its Guidelines in light of what it learns, thereby encouraging what it finds to be better sentencing practices."); 28 U.S.C. 994(u) (giving the Commission power to make its Guidelines revisions retroactive).

With respect to Section 2T1.1, the Commission is undoubtedly aware of the various court of appeals decisions addressing whether unclaimed deductions should be part of the "tax loss" calculation. The Commission has previously revised the definition of "tax loss" when it deemed a "uniform definition" necessary. Sentencing Guidelines App. C, Amend. 491 (1993); see Pet. 10 (discussing the 1993 revision). To the extent that any need exists to clarify the meaning of the current version of the provision, the Commission could resolve such a conflict by amending the Guideline.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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