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Marinello Limits Tax Obstruction—Are *Klein* Conspiracies Next?

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Odds are most readers of THE M&A TAX REPORT have suggested ways to "improve the optics" of a proposed transaction. As the phrase implies, the goal is to shape the IRS's *perception* of the transaction in the event that it is reviewed. Substantive modifications have their role, but optical changes usually have little or no impact on the economics of the deal—and clients like it that way.

Kept within reasonable limits, cosmetic adjustments are just part of the way the tax game is played. Still, there has always been at least the *theoretical* possibility that one of these transactional touch-ups could land a practitioner on the wrong side of Code Sec. 7212(a). Under that provision's so-called "Omnibus Clause," anyone who "corruptly … obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title [*i.e.*, Title 26]" faces a $5,000 fine and a three-year vacation at Club Fed.

A tax advisor who seeks to "lower the audit profile" of a proposed transaction is obviously trying to *influence* the IRS's administration of the Code. But advising a client not to raise the proverbial red flag is probably not what most people would regard as "obstruction." Nevertheless, would it really be so hard to persuade a panel of 12 civilians that the advisor was trying to "impede" the IRS's efforts to identify misreported transactions?

Of course, the Omnibus Clause does not apply unless the defendant acts "corruptly." Tax practitioners, however, are *trained* to believe that "considering the optics" is an essential part of the job. They never imagine that, some fine day, they might find themselves standing, clad in pinstripes, before a federal law and all its stinging stars.

The good news for practitioners is that the IRS sees things pretty much the same way. Prosecutions under Code Sec. 7212(a) typically involve egregious facts. The targets are almost always taxpayers who have acted without the benefit of professional advice. But there are occasional exceptions.

The defendant in *G.M. Popkin* [CA-11, 91-2 USTC ¶50,496, 943 F2d 1535, *cert. denied*, SCt, 503 US 1004 (1992)], for example, was a tax lawyer who set up a California corporation, orchestrated a stock sale, and prepared false tax returns to help a client repatriate offshore (drug) money without drawing the attention of the IRS. The Eleventh Circuit upheld

the attorney's conviction for obstruction. But the upshot of the cases is that practitioner have little to fear from Code Sec. 7212(a) unless they have truly broken bad.

Marinello Cuts Taxpayers Some Slack

Taxpayers, too, can now rest a little easier, thanks to the Supreme Court's ruling in *C.J. Marinello* [138 SCt 1101 (Mar. 21, 2018)]. In a 7-2 decision, the Court held that the Omnibus Clause does not apply unless the defendant has obstructed a *pending* or *reasonably foreseeable* administrative proceeding, such as an audit or other targeted investigation. Obstruction in the air, so to speak, is not enough.

From a parochial tax perspective, *Marinello* may seem questionable. Why give a pass to taxpayers who corruptly impair the IRS's ability to administer the Code in a future audit? The case also raises questions about the prosecution of so-called "*Klein* conspiracies" under 18 USC §371. These have been a mainstay of criminal tax enforcement for 60 years.

Marinello reminds us that the Supreme Court sometimes has bigger fish to fry. The decision may be questioned as a matter of tax administration. But it begins to make more sense when viewed as the latest step in the Court's long-term project of rationalizing—and reining in—the jumble of federal obstruction statutes. If a couple of tax eggs get broken along the way, that could just be the price of the jurisprudential omelet.

Background

For almost two decades, Carlo J. Marinello II owned and managed a freight delivery service in Buffalo, New York. Mr. Marinello made it his practice to shred or discard almost all business records. He paid his employees in cash, did not issue Forms W-2, and freely used corporate funds to pay his personal expenses.

Neither Mr. Marinello nor his corporation had filed tax returns since 1992. In 2004, the IRS decided to investigate, although it did not notify Mr. Marinello that it was doing so. Had he known, Mr. Marinello would have been gratified to learn that the IRS *abandoned* the investigation, precisely because the absence of records made it hard to know whether his case was worth pursuing.

The IRS gave it another try in 2009. This time, an agent interviewed Mr. Marinello, who initially claimed that he did not have to file because he made less than $1,000 per year. He eventually admitted that he earned more than that, but he said that he and the corporation had just "never got around" to filing returns. Mr. Marinello told the agent that he had shredded documents and dealt in cash because that was "the easy way out."

Mr. Marinello was charged with corruptly obstructing or impeding the administration of the Code in violation of Code Sec. 7212(a). A jury convicted him, and he appealed to the Second Circuit. Relying on the Sixth Circuit's decision in *J.J. Kassouf* [CA-6, 98-1 USTC ¶50,437, 144 F3d 952], he argued that the Omnibus Clause does not apply unless the defendant acted with knowledge of a *pending* IRS proceeding. Mr. Marinello had been shredding documents for almost 20 years, but he did not become aware of a pending investigation until 2009.

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The Second Circuit upheld the conviction [CA-2, 2016-2 USTC ¶50,453, 839 F3d 209]. The court rejected *Kassouf*, preferring to line up with the First, Ninth, and Tenth Circuits, which had all declined to find a "pending proceeding" requirement in Code Sec. 7212(a).

We Begin with the Textualist Himself

Noting the split in the circuits, the Supreme Court agreed to hear the case. It is useful to start with Justice Thomas's dissent (joined by Justice Alito), before considering Justice Breyer's opinion for the majority. As a committed textualist, Justice Thomas provided a straightforward account of the statute, and then traced out its literal implications, unburdened by notions of policy.

Putting the dissent's analysis on the table will make it easier to understand the majority opinion, which was driven by an agenda that went beyond the case at bar. The Omnibus Clause makes it a felony to corruptly obstruct or impede, or endeavor to obstruct or impede, "the due administration of this title." As the dissent pointed out, there is nothing in this language to suggest that Congress was referring to the administration of only a select *portion* of Title 26.

On the contrary, many Code provisions clearly use "this title" to refer to the statute as a whole. At the same time, Congress does not hesitate to include cross-citations when it wants a provision to apply selectively. For example, neighboring Code Sec. 7210 punishes persons who neglect to appear or produce documents "required under section 6420(e)(2), 6421(g)(2), 6427(j)(2), 7602, 7603, and 7604(b)." Tax practitioners know all too well the tedium of running down these frequent string-cites.

The dissent then considered which activities are included in the administration of the Code. Drawing on his opinion in *Direct Marketing Assn. v. Brohl* [SCt, 135 SCt 1124 (2015)], Justice Thomas described tax administration as consisting of four main functions: (1) information gathering, (2) assessment, (3) levy, and (4) collection of tax.

Information gathering includes audits and targeted investigations that qualify as administrative "proceedings." But it also embraces the more routine process of collecting returns and other information *before* the IRS launches an investigation. It is no accident that Subtitle F of the Code ("Procedure and Administration") begins with Chapter 61 ("Information and Returns").

Consider the Contextualist

The dissent concluded that Code Sec. 7212(a) literally prohibits obstruction of *any* aspect of tax administration. Corruptly destroying business records is an attempt to obstruct the IRS's information-gathering function. Justice Thomas saw nothing in the *text* of the Omnibus Clause indicating that it did not apply to Mr. Marinello.

The next question was whether there was anything in the statutory *context* that would support a narrower reading. The Omnibus Clause doesn't stand on its own. It is embedded in a sentence that runs for over 120 words:

> Whoever corruptly or by force or threats of force (including any threatening letter or communication) endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title, *or in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title*, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than 3 years, or both, except that if the offense is committed only by threats of force, the person convicted thereof shall be fined not more than $3,000, or imprisoned not more than 1 year, or both. [Emphasis supplied.]

Code Sec. 7212(a) adds that "The term 'threats of force', as used in this subsection, means threats of bodily harm to the officer or employee of the United States or to a member of his family." This is followed by Code Sec. 7212(b), which is directed against anyone "who forcibly rescues or causes to be rescued any property after it shall have been seized under this title."

Most of the text of Code Sec. 7212 focuses on a relatively narrow—but extreme—set of threats to tax administration. Code Sec. 7212(a) addresses force or threats of bodily harm directed at federal officials or their families. Code Sec. 7212(b) deals with the use of force to recover property from federal officials.

In view of the statutory context, we might not expect Code Sec. 7212(a) to apply to a business owner who peacefully shreds documents, even if it is to frustrate some future audit. However, the statute does not limit itself to attempts to obstruct the administration of the Code by "force or threats of force." Taken literally, it also applies to anyone who "corruptly" obstructs, or tries to obstruct, the administration of the Title 26.

Dog Sleds, Too?

Anglo-American courts have recognized for centuries that literal interpretations do not always capture what a statute means. A statute makes it a felony to willfully interfere with the operation "of a car, truck, bus, or any other form of conveyance." Is it a felony to interfere with the operation of a dog sled? After all, a dog sled is literally a "form of conveyance."

Under the venerable principle of *ejusdem generis*, a court must ask whether a dog sled is really a conveyance "of the same kind" as cars, trucks and buses. The court will have to exercise judgment, not just reach for the dictionary. On a good day, this judgment will be informed by some coherent view of the *purposes* for which the statute was applied to cars, trucks and buses in the first place.

That is exactly what textualists think courts should *not* be doing. Justice Thomas tried to take *ejusdem generis* off the table, invoking the quasi-scholastic distinction he had developed in his opinion for the majority in *Ali v. Fed. Bureau of Prisons* [SCt, 552 US 214, 225 (2008)]. According to Justice Thomas, the ancient canon should not be applied when a statute uses a disjunctive phrase that combines "one specific and one general category."

Suppose that our statute had, more succinctly, made it a felony to interfere with the operation of "a car or other form of conveyance." Instead of beginning with a series of particulars ("car, truck, bus"), the abbreviated statute disjunctively links a *single* specific category ("car") with a *single* general category ("or any other form of conveyance"). Under *Ali*, *ejusdem generis* cannot be used to limit the apparent generality of "conveyance." So, interfering with the operation of a dog sled is a felony.

Code Sec. 7212(a) begins with specific language about intimidating or impeding an officer acting under Title 26 that can be viewed as a unit. This "one specific category" is disjunctively linked to the general language of the Omnibus Clause ("or in any other way … obstructs or impedes"). Relying on *Ali*, Justice Thomas concluded that the Omnibus Clause applies to conduct (*e.g.*, shredding documents) that is not part of an effort to intimidate a federal officer.

Majority Rules

The opinion for the majority took a different approach. Justice Breyer began by briefly laying out Code Sec. 7212(a) and the history of the proceedings below. But his analysis focused primarily on how the Court has dealt with other criminal-obstruction statutes *outside* Title 26.

Justice Breyer began with *R.P. Aguilar* [SCt, 515 US 593 (1995)], which addressed the scope of the federal statute famously prohibiting the obstruction of justice. Under 18 USC §1503(a):

> Whoever corruptly, or by threats or force, or by any threatening letter or communication, endeavors to influence, intimidate, or impede any [juror, officer, or magistrate in any court of the United States] … in the discharge of his duty, … or injures any such [juror, officer or magistrate] … in his person or property on account of the performance of his official duties, *or corruptly or by threats or force, or by any threatening letter or communication, influences, obstructs, or impedes, or endeavors to influence, obstruct, or impede, the due administration of justice,* shall be punished as provided in subsection (b). [Emphasis supplied.]

18 USC §1503(a) starts concretely with threats of force, but it closes with abstract language reminiscent of the Omnibus Clause. *Any* action corruptly intended to "influence, obstruct, or impede" the due administration of justice literally violates Code Sec. 1503(a). Code Sec. 1503(b) backs this up with imprisonment for up to 10 years, so the stakes are high.

The defendant in *Aguilar* was a federal judge who had lied to an FBI agent who was investigating the illegal disclosure of a wiretap. The judge was convicted of corruptly endeavoring to influence, obstruct or impede the due administration of justice. At the time of the interview, however, it had been unclear whether the FBI agent would testify to a grand jury.

The Supreme Court overturned the judge's conviction. Writing for the majority, Chief Justice Rehnquist declared that 18 USC §1503 does not apply unless there is a "nexus"—a relationship in time, causation, or logic—between the defendant's conduct and a *specific judicial proceeding*. Lying to influence an investigation undertaken independently of a court's or grand jury's authority is not obstruction of justice under Code Sec. 1503(a).

Aguilar was not controlling precedent, but Justice Breyer thought its rationale applied with equal force in *Marinello*. Chief Justice Rehnquist had emphasized that the Supreme Court prefers to "exercise restraint" when considering the scope of federal criminal statutes. This is attributable, in part, to deference to Congress. But it also reflects concern that citizens should be given "fair warning," in terms they will understand, that specific forms of conduct are illegal.

Justice Breyer argued that the broad language of the Omnibus Clause, if taken literally, would criminalize just about *any* conduct that would make life harder for the IRS. He "sincerely doubted" that an individual who fails to keep donation receipts from every charity to which he or she contributes would believe that he is facing a potential felony prosecution for obstructing the IRS.

The majority in *Marinello* also pointed to *Arthur Andersen LLP* [SCt, 544 US 696 (2005)], which interpreted 18 USC §1512(b)(2)(A). This statute prohibits:

> knowingly ... [and] corruptly persuad[ing] another person ... with intent to ... cause or induce [that] person to ... withhold testimony, or withhold a record, document, or other object, from an official proceeding.

Arthur Andersen had been convicted of persuading its employees to shred Enron-related documents to prevent their use in an official proceeding. The Supreme Court reversed, holding (in another Rehnquist opinion) that the government was required to prove that the defendant acted with knowledge that a *specific* proceeding was pending or in the offing.

Parsing the Text, Sort of

Justice Breyer would probably have been happy to decide *Marinello* simply by analogy to *Aguilar* and *Arthur Andersen*. But this is 2018, so he had to perform some textual gymnastics *en route* to the result that he believed made policy sense. He began by proposing that a specificity requirement might be inherent in Code Sec. 7212(a)'s use of "obstruct" and "impede":

> [T]he verbs "obstruct" and "impede" suggest an object—the taxpayer must hinder a particular person or thing. Here, the object is the "due administration of this title." The word "administration" can be read literally to refer to every "[a]ct or process of administering" including every act of "managing" or "conduct[ing]" any "office," or "performing the executive duties of" any "institution, business, or the like." Webster's 34. But the whole phrase—the due administration of the Tax Code—is best viewed, like the due administration of justice, as referring to only some of those acts or to some separable parts of an institution or business [138 SCt at 1106].

It is true that "obstruct" and "impede," like other transitive verbs, are used to describe activities with at least two participants, one of which is characterized as the "object." Sometimes the object is specific. If Captain Ahab announces, "I'm hunting the pale monster that took my leg," he is targeting Justice Breyer's "particular person or thing."

But what if Ahab gestures to the horizon and says, "I'm hunting whales"? This *could* be a specific reference, *e.g.*, if Ahab is trying to track down Moby Dick and his sister, Moby Jane. But Ahab may be telling us that he is "hunting whales" in the *generic* sense. That is, he is hoping to detect and dispatch *some* whale or whales, even if he has no idea *which* whales they may be, or where or when they will be found.

All speakers commit such acts of *non-specific* reference dozens of times each day. Hence, Justice Breyer's suggestion that the text's use of "obstruct" or "impede" implies that the defendant's conduct must hinder a *particular* person or thing fell wide of the mark. Nothing in the grammar or semantics of these verbs licenses the conclusion that the Omnibus Clause requires an attempt to interfere with a *specific* IRS audit or investigation.

Justice Breyer apparently had his own doubts, because he concluded that the text of the Omnibus Clause was "neutral" as regards the scope of Code Sec. 7212(a). He therefore turned to the broader statutory *context*. Code Sec. 7212(a) begins by referring to "force or threats of force," and Code Sec. 7212(b) deals with the "forcible rescue" of property seized by the IRS. Unlike Justice Thomas, Justice Breyer thought that this context "confirmed" that the seemingly generic language of the Omnibus Clause covers only attempts to obstruct or impede "specific, targeted acts of administration."

Notably, Justice Breyer did not try to justify his conclusion by invoking *ejusdem generis*. Perhaps he was daunted by the technical objection raised in Justice Thomas's dissent. One senses, however, that Justice Breyer simply does not buy the premise that statutory interpretation must be governed by "canons of interpretation." In that case, there would have been no point in debating the scope of *ejusdem generis*.

History in Case It's Helpful

Justice Breyer then observed, for the benefit of "those who find legislative history helpful," that Congress gave no indication in 1954 that it intended for Code Sec. 7212(a) to apply to *every* type of conduct that corruptly seeks to obstruct or impede the IRS. According to the House Report:

> [Code Sec. 7212] provides for the punishment of threats or threatening acts against agents of the Internal Revenue Service, or any other officer or employee of the United States, or members of the families of such persons, on account of the performance by such agents or officers or employees of their official duties [H.R. Rep. No. 1337, at A426].

The House Report added that Code Sec. 7212 "will also punish the corrupt solicitation of an internal revenue employee." There was no indication that the provision was directed at defendants who do *not* threaten or attempt to bribe federal officers.

The Senate Report also took a narrow view:

> [Code Sec. 7212] covers all cases where the officer is intimidated or injured; that is, where corruptly, by force or threat of force, directly or by communication, an attempt is made to impede the administration of the internal-revenue laws [S. Rep. No. 1622, at 147].

Nothing in this legislative history indicated that Congress intended for Code Sec. 7212(a) to apply to a taxpayer who corruptly destroyed business records, but who did so without intimidating or injuring anyone.

Avoiding Statutory Inflation

The majority also pointed out that an untethered reading of the Omnibus Clause would be hard to square with the broader structure of the Code's enforcement provisions:

> That is because the Code creates numerous misdemeanors, ranging from willful failure to furnish a required statement to employees, §7204, to failure to keep required records, §7203, to misrepresenting the number of exemptions to which an employee is entitled on IRS Form W-4, §7205, to failure to pay any tax owed, however small the amount, §7203. To interpret the Omnibus Clause as applying to all Code administration would potentially transform many, if not all, of these misdemeanor provisions into felonies, making the specific provisions redundant, or perhaps the subject matter of plea bargaining [138 SCt at 1107].

In his dissenting opinion, Justice Thomas responded that most of the alleged overlap would have been illusory, because of differing *mens rea* requirements. The Code's misdemeanor provisions are triggered only if the defendant acts "willfully"—*i.e.*, with the intention to violate a known legal duty. The Omnibus Clause, in contrast, requires the defendant to act "corruptly."

In general usage, "corruptly" probably sounds more damning than "willfully." However, the case law suggests that "corruptly" is not a particularly demanding standard, even if the word may sound bad. For a defendant to act *corruptly*, it is enough that he intended "to procure an unlawful benefit either for [himself] or for some other person." [*C. Adams*, CA-1, 2014-1 USTC ¶50,124, 740 F3d 22, 31.]

It would be a rare criminal tax case in which the defendant had not been caught trying to

"procure an unlawful benefit" for himself or a third party. Justice Breyer therefore concluded that "willfully" and "corruptly" did not correspond to any meaningful difference in culpability. Hence, he remained unconvinced by Justice Thomas's contention that an expansive reading of the Omnibus Clause would not transform a wide range of compliance misdemeanors into the felony of obstructing or impeding the IRS.

Justice Thomas had also suggested that, as a practical matter, the government is unlikely to waste resources bringing felony charges against taxpayers who have committed traditional misdemeanors. However, as Justice Breyer noted, the United States had admitted at oral argument that, where more punitive and less punitive criminal provisions *both* apply to a defendant's conduct, it will charge a violation of the *more punitive* provision if it can readily prove that violation at trial.

This rigorous approach was attributed to Attorney General Sessions, who circulated a memorandum to that effect to all federal prosecutors shortly after he came into office. [*See* Office of the Attorney General, *Department Charging and Sentencing Policy* (May 10, 2017).] The A.G.'s memorandum reminded prosecutors that they have a duty to "fully utilize the tools Congress has given us."

The majority was understandably wary about relying on prosecutors to exercise restraint. Justice Breyer's solution was to follow *Aguilar* and *Arthur Andersen*, which imposed a requirement that the defendant's efforts at obstruction be directed against some specific proceeding. The proceeding need not be literally pending, but it must be at least reasonably foreseeable.

Bad News for *Klein* Conspiracies?

Under 18 USC §371, it is a felony, punishable by up to five years' imprisonment, for "two or more persons [to] conspire … to defraud the United States, or any agency thereof in any manner or for any purpose," provided that there is an overt act to further the object of the conspiracy. Although the use of "defraud" might suggest that the crime requires some form of deceit, the Supreme Court held more than a century ago that the statute reaches "any conspiracy for the purpose of impairing, obstructing or defeating the lawful function of any department of government." [*Haas v. Henkel*, SCt, 216 US 462, 479 (1910).]

What if Mr. Marinello had had a business partner with a similar aversion to filing tax returns and paying taxes? If they had agreed to take turns shredding the company's business records and paying expenses in cash, what then? Would they have been engaged in a criminal conspiracy to impair, obstruct or defeat the IRS's lawful assessment and collection of tax?

In *H.H. Klein* [CA-2, 57-2 USTC ¶9912, 247 F2d 908, *cert. denied*, SCt, 355 US 924, 78 SCt 365], the Second Circuit affirmed the conviction of a group of individuals under 18 USC §371 in connection with evasion of the federal tax on whiskey sales. The evidence showed that the defendants had not only agreed to conceal income (*e.g.*, by falsifying business records) but also to make false statements to the IRS on tax returns and in responses to interrogatories.

The original *Klein* conspiracy ultimately involved concerted attempts to impair or obstruct a targeted IRS investigation. But it started with conduct designed to make it more difficult for the IRS to discover the tax evasion in the event of some *future* investigation. Under *Klein*, an agreement between Mr. Marinello and a business partner to shred records and deal in cash would be a conspiracy punishable under 18 USC §371.

Typical jury instructions in *Klein*-based prosecutions refer to conspiracies that seek to "impede, impair, obstruct or defeat" the IRS in its efforts to assess and collect taxes. The instructions further specify that the defendants must use fraud, deceit, or some "dishonest means," a requirement that can be traced back to Chief Justice Taft's opinion in *Hammerschmidt* [SCt, 265 US 182, 188 (1924)].

This formulation sounds like it should protect defendants. But "dishonest means" are not limited to the kinds of conduct that would constitute common-law fraud. [*See, e.g., R. Dennis*, 384 US 855, 861 (1966)]. A taxpayer can be convicted under 18 USC §371 not only for *falsifying* records but also for *destroying* them.

Yet there are indications that the courts—even the Second Circuit—are having second thoughts. In *R. Coplan* [CA-2, 2012-2 USTC ¶50,695, 703 F3d 46], Judge Cabranes suggested

(in *dictum*) that *Haas* and *Hammerschmidt* may have taken undue liberties with the text of 18 USC §371. But he made it clear that it was up to the Supreme Court to decide whether those precedents should be overruled.

Marinello has opened another line of attack. Code Sec. 7212(a) did not apply to Mr. Marinello because his attempts to obstruct or impede the IRS were not directed at specific, targeted acts of administration. Why, defense counsel will inevitably ask, should a taxpayer be subject to prosecution under 18 USC §371 if he conspires with a business partner to do exactly the same thing?

Concluding Observation

In practical terms, the government's ability to prosecute *Klein* conspiracies is a good deal more important to tax administration than the ability to punish individuals for obstruction under Code Sec. 7212(a). Yet neither Justice Breyer's opinion for the majority in *Marinello* nor Justice Thomas's dissent even mentions 18 USC §371.

Dissenting opinions are usually quick to point out that the majority could be opening a can of worms. Textualists, however, assume a high-minded indifference to consequences, which are supposedly none of a judge's business. So, it is not surprising that Justice Thomas did not warn about the implications of *Marinello* for *Klein* conspiracies.

The majority opinion is another matter. Justice Breyer, the Court's leading pragmatist, probably understood the close relationship between the Omnibus Clause and 18 USC §371. That makes his silence harder to understand—maybe he was worried about the optics. Be that as it may, it is just a matter of time until the Court will have to decide whether a *Klein* conspiracy can exist in the absence of a currently pending IRS proceeding.

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