

WEDNESDAY THURSDAY FRIDAY MONDAY **TODAY**

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Wednesday, August 15, 2012

Tax law: is substance abuse an excuse for willful tax violations?

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Lawyers in California are required to complete a total of 25 hours of approved legal education credit every three years. One of those hours must be for the "Detection/Prevention of Substance Abuse or Mental Illness." Partly in response to this problem, "The Other Bar" exists to help our colleagues in all areas of recovery.

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What is the relationship of substance abuse to the tax laws? Tax crimes, of course, have a willfulness requirement. Also, some civil tax penalties have a willfulness requirement. Finally, taxpayers sometimes try to discharge their tax obligations in bankruptcy. However, a willful

attempt to evade or defeat a tax is not dischargeable. So will a substance abuse problem help a tax problem by vitiating a taxpayer's willfulness? The answer is that, generally speaking, a claim of substance abuse is not greeted with much sympathy by our tax laws.

The U.S. Sentencing Guidelines provide that a "standard" condition for probation is that "the defendant shall refrain from excessive use of alcohol." Section 5B1.3(c)(7). If "the court has reason to believe that the defendant is an abuser of narcotics, other controlled substances or alcohol," it should require the defendant to participate in a substance abuse program approved by the U.S. Probation office, "which ... may include testing to determine whether the defendant has reverted to the use of drugs or alcohol." Section 5B1.3(d)(4). However, as a general matter, "Drug or alcohol dependence or abuse ordinarily is not a reason for a downward departure" from the sentencing guidelines because "Substance abuse is highly correlated to an increased propensity to commit crime." Section 5H1.4.

The guidelines are only guidelines. In *U.S. v. Tomko*, 498 F.3d 157 (3d Cir. 2007), *reversed* 562 F.3d 558 (3d Cir. 2009) (en banc), William Tomko used his construction company to build his mansion using falsified invoices. Since the costs were deducted as business expenses, he had a \$230,000 tax deficiency. The sentencing guideline was 12 to 18 months' imprisonment. However, the district court imposed three years' probation, the first of which was to include home detention in the mansion built using tax fraud and participation in an alcohol treatment program. The court's lenience was due, in part, to the fact that Tomko's only prior crime was alcohol-related. The entire 3rd U.S. Circuit Court of Appeals upheld the probation despite the fact that most of the judges would have imprisoned Tomko.

Moving from the criminal to the civil tax realm, one of an employer's most important responsibilities is to pay to the government the money withheld from an employee's wages for income tax, social security and Medicare taxes. These are the "Trust Fund Taxes," held in trust by the employer until paid to the U.S. A 100 percent penalty is imposed on any "person required to collect, truthfully account for, and pay over" those taxes who *willfully* fails to do so. Internal Revenue Code Section 6672. In *Landau v. U.S.*, 155 F.3d 93 (2nd Cir. 1998), Robert Landau failed to remit those taxes to the IRS and was penalized \$1 million. During the relevant period, he was an alcoholic and addicted to cocaine. He voluntarily entered a drug rehabilitation hospital but left, uncured, after a few days. He continued to take six to eight grams of cocaine and a quart of alcohol per day and, as a result, the corporation declared bankruptcy. Landau

Questions and Comments

NEWS RULINGS VERDICTS

Tuesday, August 28, 2012

Bar Associations

Supreme Court returns 18 more discipline cases to State Bar -- but not 24

The Supreme Court sent 18 more discipline plea bargains back to the State Bar but rejected the bar's motion to remand 24.

Government

Judicial Council committee urges slower approach to AOC reforms

Recommendations to the state Judicial Council on how to adopt proposed reforms of the Administrative Office of the Courts were made public Monday.

U.S. Court of Appeals for the 9th Circuit Appeals court allows state, utilities to seek refunds from power providers

A federal appellate court on Monday opened the door for the state of California, Pacific Gas & Electric Co. and others to get refunds for money they spent buying power during the energy crisis a decade ago.

California Supreme Court

Santa Clara judge withheld evidence as a prosecutor

A Santa Clara County deputy district attorney who is now a judge had a key role in willful prosecutorial misconduct, the state Supreme Court held Monday in granting a San Quentin death row inmate a new shot at life.

Law Practice

Sidley taps new tech transactions leader

Sidley Austin LLP has hired Glenn G. Nash, a former Latham & Watkins LLP partner, to serve as the new global co-leader of the firm's technology transactions practice.

Judges and Judiciary

9th Circuit reverses Wright for the third time this year

U.S. District Judge Otis D. Wright II of Los Angeles was wrong to admit evidence at a chief executive's securities fraud trial that the SEC filed a prior civil complaint against him, a 9th U.S. Circuit Court of Appeals panel held Monday.

Personal Injury & Torts

Grave matters: morgue discovery leads to legal battle

A plaintiffs' claim of medical negligence in a case of a woman who may have been sent to the morgue alive cannot proceed after a Los Angeles Superior Court judge ruled earlier this month attorneys did not meet the statute of limitations.

Bar Associations

Pasternak named to State Bar Board of Trustees

The California Supreme Court named David J. Pasternak, a former Judicial Council member from Los Angeles, to the State Bar Board of Trustees, the first appointment by the court under the bar's new governance rules.

Criminal

plead guilty to wire and mail fraud charges. The district court rejected his argument that his voluntary intoxication was a defense to the willfulness requirement. However, it allowed his jury trial request. Landau's physician testified that, due to the cocaine habit, Landau was paranoid, anxious, "totally out of control of his mood behavior and thinking" and was "not thinking rationally." The doctor conceded that Landau could have negotiated contracts and attended business meetings. The court instructed the jury that the taxpayer only had a defense if his addiction meant that "he didn't know and couldn't know what he was doing and had no capacity to remember." The jury voted in favor of Landau, but the judge set aside the verdict, and the Court of Appeals affirmed.

Generally speaking, a claim of substance abuse is not greeted with much sympathy by our tax laws.

Discharge is the manifestation of the "fresh-start" policy that lies at the heart of bankruptcy. However, a discharge is unavailable if the debtor has violated some norm of behavior specified in the bankruptcy laws. In *U.S. v. Fretz*, 244 F.3d 1323 (11th Cir. 2001), Dr. William Fretz was an alcoholic and failed to file returns or to pay taxes from 1982 through 1992. However, he managed to work as a physician for 12 to 24 hour shifts in emergency rooms. He never drank within 8 hours before a shift, but afterwards would drink until he passed out. In 1990 the IRS notified him of having received no returns for 1982 through 1988. He joined Alcoholics Anonymous and quit drinking in 1993. In 1994 he signed IRS-prepared returns for 1982 through 1992, which included civil fraud penalties. In 1997 he filed for bankruptcy, and the question before this court was whether his tax liability - over \$1 million - was dischargeable. A tax debt is not dischargeable if "the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat" the tax. 11 U.S.C. Section 523(a)(1)(C). The bankruptcy court held that the taxes were dischargeable because, due to Fretz's alcoholism, he had no "scheme or design" to evade his taxes. The district court affirmed. However, the Court of Appeals held that "someone who can control his drinking enough to perform medical procedures during 12 to 24 hour shifts ... over a period of years can control his drinking enough to file tax returns and pay taxes during that same period." Accordingly, his income taxes were not dischargeable in bankruptcy.

Substance abuse is not simply a personal tragedy. It is usually of no help for the failure to meet your tax obligations.

OC lawyer gets 6-month sentence for tax offenses

An Orange County attorney who failed to file multiple income tax returns and helped create an offshore corporation later investigated by federal authorities now owes the government more than \$225,000 - plus prison time.

Judges and Judiciary

Two judges vie to be second-in-command of San Francisco County Superior Court

Two judges are about to face off in a race for San Francisco County Superior Court's assistant presiding judge seat.

Litigation

Saudi prince wins round in mansion battle against LA

State court judge rules in favor of Prince Abdul-Aziz ibn Abdul-Aziz al Saud, the third son of Saudi King Abdullah and Saudi Arabia's deputy foreign minister, in real estate spat.

Mergers & Acquisitions

Dealmakers

A roundup of recent mergers and acquisitions and financing transactions and the lawyers involved.

Criminal

In the spotlight: what is the legal definition of rape?

Examining the legal definition of rape - and how it differs from the public's concept of rape. By

Wendy Patrick

Law Practice

Listening practice

Better listening is the key to being heard. By **Timothy Tosta** of McKenna Long Aldridge LLP

Public Interest

Lawyers' critical role in the war on poverty

Access to the judicial branch ensures that the government, in the person of a judge, will hear grievances and respond. By **David A. Lash** of O'Melveny & Myers LLP

Law Practice

Who can enforce mortgages sold in the secondary market?

Courts and litigants are often confused about just who can enforce a mortgage that has been transferred in the secondary market. Here's the law. By **Mark Didak**

Judicial Profile

Tim P. Kam

Superior Court Judge Solano County (Vallejo)

Intellectual Property

Apple's patent win puts company on the offensive

Apple Inc.'s \$1 billion verdict from a San Jose federal jury for patent and trade dress infringement Friday is only likely to whet the company's appetite for more aggressive action in the worldwide smartphone wars, legal observers say.

