



District Court Shoots Down Use of Wire Fraud Statute to Charge Tax Crimes by Robert S. Horwitz

Joseph Garza is a Dallas attorney who allegedly helped clients evade taxes on more than \$1 billion of income through a circular flow of funds between the clients and shell service corporations that purported to provide services to the clients' businesses and shell investment corporations. He was initially charged by the United States with eighteen counts of wire fraud, in violation of 18 U.S.C. §1343, one count of conspiracy to commit wire fraud, in violation of 18 U.S.C. §1349, twenty-four counts of aiding and abetting the filing of false and fraudulent tax returns, in violation of 26 U.S.C. §7602(2), and one count of conspiracy to defraud the United States in violation of 18 U.S.C. §371. A superseding indictment added three CPA as co-defendants. *United States v. Joseph Garza*, Criminal No. 3:22-CR-0390-S (N.D. Tex).

To convict a defendant of violating 18 U.S.C. §1343, the Government must prove beyond a reasonable doubt that the defendant “devised or intend[ed] to devise” a scheme to defraud by use of the wires. To convict a defendant of violating 26 U.S.C. §7602(2), the Government must prove beyond a reasonable doubt that the defendant “willfully” aided or assisted in the preparation of a false or fraudulent tax return. The wire fraud statute has a general *mens rea* (i.e., state of mind) requirement whereas the tax fraud statute requires proof of willfulness, which requires proof that the defendant intentionally and voluntarily violated a known legal duty.

The defendants filed a motion to dismiss counts 1-18, the wire fraud counts, on the grounds that (a) they were an attempt to do an end run around the willfulness requirement of the tax fraud statute in violation of the Due Process Clause of the Fifth Amendment; (b) the wire fraud counts are preempted by the tax fraud counts since both were based on the same alleged scheme; and (c) the wire fraud statute does not extend to tax fraud against the United States and



cannot be used to prosecute a person for tax crimes. A motion, such as the one filed by the *Garza* defendants, to determine any defense or objection to an indictment without trial under Fed. R. Crim. Pro. 12(b)(1) assumes that the allegations in the indictment are true.

On May 6, the district court issued a memorandum opinion and order in which it granted the motion to dismiss in part and denied it in part. The claim that the use of the wire fraud statute was an attempt to do an end run around the willfulness was a case of first impression. According to the court, a willfulness requirement, such as the one contained in the tax fraud statute, is reserved for “statutory violations involving ‘complex’ statutes, including ‘those governing federal tax law.’” The wire fraud statute requires only a lower “intent to defraud” *mens rea*. Of the eighteen wire fraud counts, thirteen involved the defendants’ eFiling of clients’ tax returns, with twelve counts having the same returns that were the basis of twelve tax fraud counts.

The court reasoned that because the filing of tax returns supporting thirteen of the wire fraud counts constitute “tax conduct,” allowing the Government to prosecute these counts under the wire fraud statute would relieve the Government of the burden of proving the critical issue of the defendants’ state of mind. This violated due process.

The court recognized that the Government had discretion to chose which statute to charge a defendant with violating where the underlying conduct can be prosecuted under multiple statutes. Nonetheless, this discretion “must be limited” where there are due process violations. Plus, the wire component of the wire fraud counts involved compulsory conduct, since return preparers who file more than ten returns during the year must file electronically under 26 U.S.C. §6011(e)(3).

The court held that five wire fraud counts were based on wiring payments for valuations and fees and not for filing tax returns and thus did not charge tax conduct that should be prosecuted under the tax fraud statute. The court thus

dismissed thirteen of the eighteen wire fraud counts for violating due process since “the Government’s prosecution of the same tax conduct under both the Tax Fraud Statute and the Wire Fraud Statute violates the Due Process Clause by enabling the Government to avoid proving every fact necessary to constitute tax fraud.”

Next, the court discussed defendants’ preemption argument. Normally, when a specific and a general statute apply, the specific statute must be used. This applies where the two statutes are “interrelated and closely positioned” or where Congress intended to repeal the general statute. The wire fraud and tax fraud statutes were not interrelated or closely positioned and nothing in the legislative history of the tax fraud statute indicating an implicit Congressional intent to repeal the wire fraud statute.

The court finally addressed the argument that the Wire Fraud Statute does not extend to tax fraud against the United States. This argument had two components, an original textualism argument and a Commerce Clause argument. The original textualism component was the argument that the wire fraud statute incorporated the common law meaning of “defraud,” which requires a “person” who is defrauded. For this purpose, “person” does not include the sovereign. The court rejected this argument because 18 U.S.C. §1343 criminalizes “a scheme or artifice to defraud another,” which does include the Government, rather than a scheme to defraud a person.

The defendants’ Commerce Clause argument was that the wire fraud statute does not authorize prosecution for tax conduct since under the Commerce Clause a person cannot be compelled to enter into commerce and thus it cannot be used as a vehicle to prosecute compulsory obligations, i.e., electronic filing of tax returns. The court gave this argument short shrift since the wire fraud statute regulates existing commercial activity, which is appropriate under the law.

It is unusual for the Government to charge wire fraud and tax fraud for the same conduct. Tax Division Directive 128, issued in 2004, states the circumstances in which this can occur:

The Tax Division may approve mail fraud, wire fraud or bank fraud charges in tax-related cases involving schemes to defraud the government or other persons if there was a large fraud loss or a substantial pattern of conduct and there is a significant benefit to bringing the charges instead of or in addition to Title 26 violations

Directive 128 indicates that significant benefit includes supporting forfeiture of the proceeds of a fraud scheme; allowing the government to describe the entire scheme in the indictment; ensuring that the court will admit all relevant evidence of the scheme; permitting flexibility in choosing witnesses; or ensuring that the court can order full restitution.

Unlike a civil case, in a criminal case the Government can appeal the dismissal of less than all counts of an indictment. The Government filed a notice of interlocutory appeal on May 8, two days after the court issued its memorandum opinion and order. If affirmed on appeal, the district court's dismissal could result in the Department of Justice rethinking whether to charge wire fraud for the same type of conduct for which it can charge tax fraud.

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