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CURRENT ISSUES IN CRIMINAL TAX INVESTIGATIONS

PRESENTED BY

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Hypothetical

Jordan Enterprises, Inc. ("JEI"), a "C" corporation located in Manhattan, is engaged in the business of selling baseball caps and other sportswear items bearing logos and insignia licensed to it by Major League Baseball, the National Football League, the National Basketball Association. Prior to 2006, JEI had two shareholders, Dave Burns and Steve Edwards. In late 2006, Burns and Edwards sold their shares for \$40 million to Mainland Headwear Corporation ("MHC") which is principally owned by Paul Chang, a citizen of China and a lawful permanent resident of the United States. MHC, a Hong Kong corporation, manufactures the caps and sportswear sold by JEI. Burns and Edwards continue to be employed by JEI after its sale to MHC.

During the years 2000-2008, Don Gold was the Chief Financial Officer of JEI. In November 2008, Gold was fired because of allegations that he had sexually harassed some female employees. Shortly after receiving notice of his termination, Gold wrote a detailed letter to the IRS in which he alleged the following:

- (1) During the years 2000-2006, Burns and Edwards, in addition to their regular salaries (processed through payroll), received payments of \$50,000 each annually from JEI which they instructed Gold to charge as shareholder-officer loans. Gold did so. They are, however, no loan documents, promissory notes, or other documentation to support these loans and no interest payments were ever made by Burns and Edwards to JEI.
- (2) During 2002-2006, improvements on the personal residences of each of the homes owned by Burns and Edwards. The cost of these improvements for each of these homes was approximately \$250,000. Jack Green, the contractor who built these

improvements, sent the invoices for this work to JEI which paid them. At the instruction of Burns and Edwards, Gold charged the invoices to a corporate account for repairs and maintenance. The invoices falsely described the work as contracting services for JEI.

- (3) Lisa Burns, wife of Dave Burns, received \$75,000 annually during 2001-2006 for commissions allegedly earned on sales of JEI merchandise. Lisa Burns is a kindergarten teacher who never appeared at JEI's offices and never submitted any documentation verifying that she earned these commissions.
- (4) In mid 2006, Dave Burns and Steve Edwards presented Gold with a single page written agreement which created a monetary penalty for JEI to pay to MHC if JEI did not exceed an annual level of purchases from MHC which level had never previously been achieved. Burns and Edwards instructed Gold to accrue a \$1 million liability to MHC, even though the annual purchases from MHC (per the benchmark agreement) would not have required that large amount of payment. In March 2007, \$1 million was paid by wire transfer from JEI to MHC's bank account in Hong Kong. The JEI purchases account was charged for this \$1 million payment. In May 2007, MHC transferred \$950,000 to an account in the name of Thermidor LLC, located at a bank in the Island of Nevis. Paul Chang is the only authorized signatory on this account.

You may assume the following facts:

- (1) JEI, Dave and Lisa Burns, Steve Edwards and Paul Chang timely filed their federal income tax returns for the years 2003-2008.
- (2) MHC is not subject to U.S. taxation.

- (3) Paul Chang's U.S. individual tax returns for 2006-2008 did not answer the foreign bank account question contained in Schedule B and did not report any foreign source income he received.
- (4) The tax returns filed by Dave and Lisa Burns and Steve Edwards did not report the payments and other items described at page 2, items (1)-(2).