

[REDACTED]
MFKlotz/MENeedle

MAR 27 1997

District Director, South Texas District
Attn: Chief, Criminal Investigation Division

Assistant Chief Counsel (Criminal Tax) [REDACTED]

Henry G. Cisneros
Washington, D.C. [REDACTED]

DECLINATION MEMORANDUM

The purpose of this memorandum is to advise you that for the reasons detailed below, it has been determined that the proposed case involving Henry G. Cisneros does not meet the Service standards for prosecution (guilt beyond reasonable doubt and reasonable probability of conviction), and as a consequence is hereby declined. Be advised that unless we receive formal notice within ten days that the Assistant Commissioner (Criminal Investigation) has decided to protest this determination, the case will be closed and released for civil consideration.

Background

The subject case was forwarded to us by your memorandum dated December 20, 1996, recommending that Cisneros be prosecuted for violations of 26 U.S.C. § 7206(1) for the taxable years 1991, 1992 and 1993. On January 30 and 31, 1997, we met with Special Agents Kesha Lange and Dorman Barrows and Group Manager Sheila Colbertson concerning questions we had about the case. On February 12, 1997, a conference was held with Cisneros' representatives. Pursuant to our memorandum dated March 7, 1997, the case was placed in supplemental status to accommodate your request for a conference concerning our preliminary determination in this matter. This conference was held on March 18, 1997, at which time the case was returned to active status.

This case originated as a result of information given to the Federal Bureau of Investigation during its background investigation to finalize Cisneros' confirmation as Secretary of HUD. The information pertained to the amounts and frequency of payments allegedly made by Cisneros to Linda Medlar.

¹ Since receipt of this case, we have been informed that Cisneros has relocated to Los Angeles, California.

[REDACTED]
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GJ 00-001 Ex. 93

EXHIBIT
#93

Cisneros was born on June 11, 1947, is married and has three children ages [REDACTED]. Cisneros received his undergraduate degree from Texas A&M, a masters degree in urban and renewal planning from Texas A&M, a masters degree in public administration from Harvard and a doctorate degree from George Washington University. As a full time professor at the University of Texas at San Antonio and a part time professor at Trinity University, Cisneros taught public administration and urban affairs. Cisneros was a four term mayor of San Antonio from April of 1981 until June of 1989. After serving as mayor of San Antonio, he established five businesses and from June 1989 until January 1993, served on boards of directors for as many as 35 companies. Of the businesses Cisneros created, Cisneros Communications began operation in June 1989 as a Schedule C sole proprietorship. The primary source of income of this business resulted from Cisneros' speechmaking as arranged by his agent, Royce Carlton, Inc., as well as other income from radio programs, director's fees and events not arranged by his agent. Speaking engagements were also arranged by the office personnel at Cisneros Communications. During the subject years, Cisneros' businesses utilized numerous bank accounts which were, in essence, maintained by two of his employees, Sylvia Arce-Garcia and Alfred Ramirez.²

SAR Recommendation

The Special Agent's Report (SAR) which utilizes the bank deposits and specific items methods of proof, concludes that Cisneros violated § 7206(1) because he failed to report all income from Cisneros Communications on his returns for 1991, 1992 and 1993, deducted contributions to a non-qualified annuity as SEP contributions in 1992 and failed to report distributions from an IRA as income in 1993. The statute of limitations will bar prosecution of the earliest alleged offense after August 24, 1998.

Discussion

The elements which the government must prove beyond a reasonable doubt to establish that Cisneros violated § 7206(1) are that: (1) he subscribed each return that was false as to a material matter; (2) each return contained a written declaration that it was made under the penalties of perjury; (3) he did not believe each return to be true and correct as to every material matter; and, (4) he falsely subscribed each return willfully with the specific intent to violate the law. Sansone v. United States, 380 U.S. 343 (1965), Spies v. United States, 317 U.S. 492 (1943).

² John Rosales assumed the duties of Alfred Ramirez when the latter left Cisneros Communications in September 1992.

While it appears that the first two elements can be proven, our major concern with this case turns on willfulness.³ Generally, willfulness is defined as a voluntary intentional violation of a known legal duty. United States v. Pomponio, 429 U.S. 10 (1976), United States v. Bishop, 412 U.S. 346 (1973). For criminal tax purposes, the government is required to prove that the law imposed a duty on a defendant, the defendant knew of the duty and the defendant voluntarily and intentionally violated that duty. Cheek v. United States, 489 U.S. 192 (1991). Courts have recognized that a good faith reliance on others regarding one's tax liability, creates an absence of willfulness necessary to sustain a conviction. In this case, Cisneros seems to have relied significantly on others as he was travelling regularly and was rarely home as a result of his efforts to make money to cover obligations that he was behind on such matters as the payment of bills in general and specifically, Forms 941 payments and payments to Medlar. As Cisneros was out looking for additional work to meet his cash flow demand, he entrusted his office management to a number of employees without realizing they were not fulfilling his obligation to prepare and file complete and accurate returns.

Although the recommended case includes proposed specific items in 1992 and 1993, the main thrust concerns the understatement of gross receipts from Cisneros' speaking engagements as determined by the bank deposits analysis. The SAR's theory is that despite statements to the contrary, Cisneros did not deposit all income into business accounts and " . . . knowingly and willfully bypassed every accounting system which had been specifically set up to insure (sic) all income was deposited, recorded and reported." (SAR p. 50). The evidence does not support the allegation.

According to the SAR of the \$107,052.66 understatement of gross receipts computed for 1991, Cisneros failed to deposit \$50,335.33. And of the \$111,290.78 understatement of gross receipts computed for 1992, Cisneros failed to deposit \$53,190.00. (Parenthetically, 1993 utilizes a specific item method of proof and determines that Cisneros understated gross receipts by \$3,022.⁴) It is the 1991 and 1992 non-deposited

³ Although we disagree with some of the agent's computations and portrayal of understatements, this memorandum focusses primarily on the willfulness issue.

⁴ In computing the \$3,022 understatement, the SAR determines that the correct gross receipts are \$7,532 and the reported receipts are \$4,510. The SAR is wrong for both. As discussed herein, the corrected gross receipts are \$1,745 and the reported receipts are \$4,500.

receipts that purportedly support the element of willfulness - for failure to report income by itself is insufficient to sustain a finding of fraud. The failure to deposit those amounts had they not been captured in the accounting system or reported would support a prima facie case. But, as detailed below, that is not what occurred. To the contrary, as portrayed in Attachment A herein for 1991 all non-deposited gross receipts were captured in the accounting system and most were actually reported on the return. Similarly, as portrayed in Attachment B herein, for 1992 most of the non-deposited gross receipts were again captured in the accounting system and actually reported. Additionally, a receipt from Harvard University for \$1,000 was erroneously included in the SAR recommendation for 1992, although it was paid to Cisneros in 1991, a 1991 Form 1099 was issued to him and all indications are that he reported it in 1991. Similarly, receipts from Time (\$2,500), Royce Carlton (\$1,080), Indiana Electric (\$1,528), and University of Houston (\$679) were erroneously included in the SAR recommendation for 1993 resulting in a determination that Cisneros' underreported his gross receipts by \$3,012, although each of those receipts were paid in 1992, included in 1992 Forms 1099 and all indications are that he reported them in 1992.

The difficulties with willfulness do not end here. The manner in which the returns were prepared also detract from willfulness. Cisneros' returns for the subject years were prepared by Luis Hernandez who replaced Rene Gonzalez who, free of charge, had provided accounting services for Cisneros and prepared his returns for the years 1976 through 1990. Gonzalez was "free help," who could not provide the level of day by day involvement that Cisneros' expected in his burgeoning business. ██████████ When Cisneros hired Hernandez in early 1992 to take over the accounting and prepare all returns starting with the 1991 return, he had no reason to believe that Hernandez would provide anything by competent service. After all, Hernandez is a C.P.A. with advanced degrees in accounting. Cisneros certainly had no way to know that Hernandez had been a numbered informant for the Internal Revenue Service and, in fact, at one time alleged that Cisneros had conspired with another to defraud the city of San Antonio. It is noteworthy that at least one special agent was surprised to hear that Hernandez was working for Cisneros since he believed that Hernandez harbored a great dislike toward Cisneros. And, while this fact does not rise to the level of facts present in United States v. Noles, No. 89-49 CR(4) (E.D. Mo.), under the Attorney General's Giglio policy, the fact that the Service is in the

unique position to know that Hernandez had a grudge against Cisneros will have to be turned over to the defense. See United States v. Giglio, 405 U.S. 105 (1972).

When Hernandez undertook to prepare Cisneros' 1991 return, he was provided with a profit and loss statement created from a Quicken computerized accounting system and Forms 1099 issued for that year to Cisneros. [REDACTED]

[REDACTED]. Although Hernandez was told by Ramirez and others that all income was supposed to be deposited, he concluded that transfers from Cisneros' accounts might have been improperly included in income. [REDACTED]

[REDACTED]. Since Arce-Garcia told Hernandez that Cisneros received no income from sources other than cities, universities, and Royce Carlton, Inc. [REDACTED], [REDACTED], Hernandez decided to use the sum of the 1991 Forms 1099 plus various other amounts from the Quicken profit and loss statement for the 1991 tax return. [REDACTED].

As noted above, SAR Appendix B-4 lists the specific income items that were not deposited in each of the subject years. For 1991, this list consists of seventeen checks totaling \$50,335.33 from ten different payors. These non-deposited specific income items were added to the total Cisneros Communication deposits to arrive at Mr. Cisneros' understatement of taxable income. Of the seventeen specific income items that were not deposited, thirteen (totalling \$34,335.33) were reported on 1991 Forms 1099 - thus, each of these was reported on the return. The four that were not reported on Forms 1099 and purportedly not reported on the return were received from three different payors United Way (\$4,500), Harris Methodist Hospital (\$2,000 and \$2,000) and American German Conference (\$7,500). These four non-deposited items, however, were included in Arce-Garcia's green ledger and did not bypass the accounting system as alleged in the SAR. See Attachment A.

In 1992, Hernandez was much more involved with the day-to-day record keeping, and was familiar with the input of data from bank statements, checks and deposit slips into a Quickbooks system, a commercial bookkeeping package compatible with Quicken [REDACTED]. In preparing the 1992 return, Hernandez compared the total bank deposits to the total 1992 Forms 1099 received and Arce-Garcia's records. [REDACTED]. Hernandez decided to again report gross receipts as determined from Forms 1099 for sources of the deposited funds were not identified by Cisneros' office [REDACTED].

The 1992 non-deposited receipts in SAR Appendix B-4 in the amount of \$53,190.00 are made up of twenty-eight checks from twenty-one different payors, as portrayed in Attachment B. Similar to 1991, of the twenty-eight specific income items that were not deposited, fourteen totalling \$35,932 were reported on 1992 Forms 1099, and reported on the return. The fourteen that were not reported on Forms 1099, were received from twelve different payors. Of these fourteen non-deposited items, seven were included in Arce-Garcia's green ledger. The remaining seven that are neither reported on Forms 1099 nor included in the green ledger total \$7,508.08 - the amount that can be said to have bypassed the accounting system, the tax on which is not particularly significant. In addition, as noted above, the \$1,000 paid by Harvard University as set forth in Appendix B-4 for 1992, in fact, appears on a check dated December 31, 1991, and a 1991 Form 1099, and presumably reported on Cisneros' 1991 return along with the other 1099 receipts for that year. [REDACTED]

The SAR also includes as a criminal item for 1992 the disallowance of a deduction for payments Cisneros made to his annuity with Lincoln Benefit Life Company which was not a qualified retirement plan. However, in an affidavit dated February 4, 1997, Hernandez takes full responsibility for this error, thus eliminating any willfulness on Cisneros' part. [REDACTED]

In addition to taking an improper deduction on Cisneros' 1992 return, Hernandez made other mistakes that are amateurish and totally inexcusable - thereby raising significant questions as to whether he was either incompetent or intentionally setting up Cisneros in furtherance of his previous grudge. More specifically, Hernandez erroneously claimed as 1992 Schedule A itemized deduction payments Cisneros made that year for federal income taxes. [REDACTED]

Hernandez also prepared Cisneros' 1993 return from Forms 1099, Forms 1099R, annuity closing statements, discussions with brokers concerning stock sales and other information provided by Cisneros. [REDACTED]. The Forms 1099 were used to determine Schedule C income which Cisneros received from speaking engagements and from director's fees.

As noted above, the SAR determined that in 1993 Cisneros received \$7,532.00 in speaking fees from six different payors, and that since he only reported \$4,500.00, concluded he understated his gross receipts by \$3,032.00 (See, fn. 4, supra). The SAR is in error. Of the six specific income items four were paid to Cisneros by checks dated in 1992, reported on 1992 Forms 1099, and presumably reported on the 1992 return along with the other 1099 receipts for that year.

So while the two that were not reported on Forms 1099 (University of Wisconsin - \$1,465, and Texas A&M - \$280), all the SAR definitively proves is that Cisneros may have overstated his gross receipts for that year. See Attachment C.

The SAR also concludes that although Cisneros' 1993 return reports annuity distributions, it failed to report distributions he received from his Massachusetts Mutual IRA account. [REDACTED]. The difficulty with including these as criminal items is that one Form 1099 for these distributions was mailed to Cisneros' San Antonio address where he no longer resided and one was mailed to the unoccupied Cisneros Communication address. In addition, due to a Massachusetts Mutual error, the amount of the distributions on one of the Forms 1099 contained an understatement of \$2,836.23. This error was acknowledged by Massachusetts Mutual in a letter dated October 30, 1996. [REDACTED]. Also of note is the fact that Hernandez prepared Cisneros' Public Financial disclosure Reports for 1992 and 1993 and, therefore, he should have known that since the Massachusetts Mutual account was no longer included on the 1993 Report, there must have been a distribution.

In short, although the SAR, on its face, establishes that not all of Cisneros' income was deposited in the years involved, the non-depositing of income does not support the conclusion that the items either bypassed the accounting systems or were not reported. In sum, the non-depositing of income was not relevant to how the returns were prepared, and as such are of minimal value in proving willfulness. The fact of the matter is that the evidence shows there were ample records which reflected Cisneros' income for the subject years including bank deposits, Forms 1099 and Arce-Garcia's ledgers. Hernandez chose the Forms 1099 as opposed to deposits, as Gonzalez had done in prior years, and prepared the returns on this basis. There is no evidence that Cisneros hid the non-depositing from his staff. In fact, as shown on Attachments A and B, Arce-Garcia captured \$2,350.00 of these items in the green ledger and frequently noted that they represented payments made by particular institutions directly to Cisneros. There is no evidence that Cisneros directed anyone not to report income. In fact, a substantial amount of it (\$67,267.33) was reported. See Attachments A and B. Furthermore, an argument can be made that if all of the institutions which paid Cisneros income during the years in question had issued Forms 1099 as required by law, all of his income would have been reported regardless of the fact that all income was not deposited. The evidence further shows that Cisneros was aware that the income portions of his returns were prepared based on Forms 1099 and, thus, it cannot be proven that he knew that his returns were false in that regard.

In sum, all of Cisneros' income for 1991 was either deposited, accounted for on Forms 1099 or in Arce-Garcia's green ledger. Consequently, there was no concealment because all of the income appeared in one or more record keeping systems. In 1992, all income, with the exception of \$7,508.08, was either deposited, accounted for on Forms 1099 or in Arce-Garcia's green ledger. Again, but for \$7,508.08 there was no concealment. In addition, Hernandez made glaring errors on the 1992 return, including the deducting of the SEP contributions included in the SAR as a criminal adjustment, and the deducting of federal income tax payments as itemized deductions. In 1993, although all income is not deposited, several of the non-deposited items are incorrectly attributed to 1993, and when compared to the \$4,500 reported on Cisneros' Schedule C, there, may in fact, have been a Schedule C overstatement. In regard to the Massachusetts Mutual item, the evidence surrounding Hernandez' knowledge of this item as well as the incorrect mailing of the Forms 1099 and the error on one Form 1099, renders this item questionable for criminal purposes.

In addition to the matters previously mentioned, what is most noteworthy about this case is that rather than be awash with substantial funds inconsistent with his reported income as the SAR would suggest he should have been, Cisneros' financial well being greatly suffered in the years at issue. His bank accounts dwindled and he had to resort to cashing in annuities previously set up to supplement his public service pensions.

Tape Recordings

In analyzing the evidence the SAR greatly emphasizes the contents of tape recordings Cisneros' girlfriend, Linda Medlar, surreptitiously made of Cisneros. Use of these tapes are problematical at best, and their evidentiary value is not what the SAR suggests. To admit them in evidence, since they were not recorded under law enforcement supervision, only Medlar will be able to authenticate them. It is noted that her cooperation with the government has been sporadic, periodically requiring that she be immunized. There is confusion as to the whereabouts of the original tapes. And, pursuant to 18 U.S.C. § 2511(d) the admissibility must be determined by state law. In that regard, we cannot overlook the many travels of Cisneros into jurisdictions some of which (e.g Massachusetts) require as a condition precedent to admissibility that both parties consent to the recording - something that did not occur herein. See Mass. Annotated Laws, Chap. 272, § 99 D. (1&2).

Moreover, the results from our review of the tapes is different from the investigating agent. Rather than conclude they contain evidence of Cisneros' intent to understate his

taxes, we are impressed by his statements that he believed he was paying his taxes.⁵ [REDACTED] Proof that he believed otherwise is lacking.

Character Evidence

Furthermore, when considering the merits of this case, the fact that Cisneros is a popular figure with many years of high level public service, cannot be overlooked. He will be able to parade numerous dignitaries before the court to establish his high moral character potentially raising questions about his willfulness even without any of the foregoing difficulties.

Disclosure Violations

Finally, we are concerned with the apparent disclosure violations that occurred during the course of this investigation. Numerous items were regularly provided to the Independent Council beyond the express terms of disclosure orders. Even after admonitions from this office dialogue continued. Even though the most recent (i) Order would now allow turnover, it did not accurately reveal to the court that the disclosure of the sought after documents had already taken place, albeit improperly. These occurrences are both disappointing and will most likely burden any prosecution with damaging distractions. Although disclosure violations should not lead to dismissal of charges or suppression of evidence, under the aforementioned Giglio policy, violations by testifying witnesses must be revealed. In this regard we note that despite prior statements that only the Disclosure Officer turned items over to the Independent Council many of the transmissions are signed by the case agent.

Conclusion

As a result, considering all the evidence as well as all of the facts and circumstances surrounding this case, we cannot say that the evidence indicates guilt beyond a reasonable doubt and that there is a reasonable probability of conviction.

⁵ We are cognizant of the tape wherein Cisneros is heard to respond to whether Hernandez knew of the payments to Medlar that " . . . he doesn't get involved with that, he accounts with the accounts for the money that we put into the system and the money I help you with comes before that, comes out before it gets to him." [REDACTED] When considering this statement in the context of the question and all the other evidence, we believe its significance simply goes to the fact that there were payments to Medlar and not that the money would not be reported for tax purposes.

Notwithstanding the foregoing, we considered the possibility of forwarding this matter to the Tax Division with a prosecution recommendation predicated upon taking Hernandez, Arce-Garcia and Alfred Ramirez before the grand jury to ascertain whether their testimony would be different in that atmosphere as compared to the setting of their prior testimony before the special agents and one of Cisneros' attorney. We concluded there is no reason to believe that the witnesses will change their testimony to the extent that it will establish that Cisneros directed them to not record income or to conceal income from Hernandez. In fact, all evidence of income was available to Hernandez to the same extent it was available to Gonzalez in prior years. By way of restatement, virtually all of the unreported income was either in Arce-Garcia's green ledger or on Forms 1099 or in the Quicken program. Why all income was not reported remains an unanswered question which rests heavily on Hernandez - a person with history as an informant who had a grudge against Cisneros. Regardless, the fact is that some income not on the returns is unexplainable but, unfortunately, lack of explanation does not equate to guilt beyond a reasonable doubt.

To summarize, we have concluded that the recommended offenses cannot be proven beyond a reasonable doubt and that there is no reasonable probability of conviction. Accordingly, we decline to refer this case to the Tax Division, Department of Justice, for criminal prosecution and instead, recommend that the criminal aspects of this case be closed.

Unless we receive notification within ten working days from the date of this memorandum that the Assistant Commissioner (Criminal Investigation) intends to protest this matter, we will proceed to close our files and release this case for civil disposition.

BARRY J. FINKELSTEIN

BARRY J. FINKELSTEIN

Attachments
As stated

MFKlotz/BJFinkelstein/pt 3/27/97
CISNEROS.BJF

Specific Income Items Not Deposited

1993

SOURCE	AMOUNT	FORM 1099 RECEIVED
Time Inc. *	\$2,500.00	\$2,500.00
Royce Carlton *	1,080.00	1,080.00
Indiana Electric *	1,528.00	1,528.00
University of WI	1,465.00	
University of Houston*	679.00	679.00
TX A & M	280.00	
TOTALS	7,532.00	5,787.00

* (\$5,787.00) Total amount of specific income items that were dated in 1992 and reported on a 1992 Form 1099.

Attachment C

PC:EL:LT	CC:SI					
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Specific Income Items Not Deposited

1991

SOURCE	AMOUNT	FORM 1099 RECEIVED	ENTERED IN GREEN LEDGER
Royce Carlton	\$5,600.00	\$5,600.00	
Royce Carlton	4,000.00	4,000.00	
National Assn Ind Ins	3,000.00	3,000.00	\$3,000.00
Southwestern University	1,500.00	1,500.00	\$1,500.00
Southwestern University	425.00	425.00	425.00
Royce Carlton	9,425.00	9,425.00	
Royce Carlton	3,250.00	3,250.00	
University of California	1,395.00	1,395.00	
Royce Carlton	122.21	122.21	
Amer Lead Forum/Gulf Chp	500.00	500.00	500.00
United Way Houma La	4,500.00		4,500.00
Harris Methodist Hospital	2,000.00		2,000.00
Harris Methodist Hospital	2,000.00		2,000.00
American German Conf.	7,500.00		7,500.00
Federal Reserve	1,414.88	1,414.88	
Rockefeller	3,503.24	3,503.24	
Federal Reserve	200.00	200.00	
TOTAL	50,335.33	34,335.33	21,425.00

Attachment A

CC:EL:U	CC:U					
MW						

Specific Income Items Not Deposited

1992

SOURCE	AMOUNT	FORM 1099 RECEIVED	ENTERED IN GREEN LEDGER
Harvard University **	\$1,000.00	\$1,000.00	
Federal Reserve *	408.00		
CRSS	1,500.00	1,500.00	-
Round Rock Chamber Comm	2,500.00	2,500.00	\$2,500.00
Nat'l Assoc Dev Ed	3,000.00		3,000.00
Round Rock Chamber Comm	58.00	58.00	
Citizens Chamber Comm	2,000.00		2,000.00
Ethnic Coalition	1,500.00		1,500.00
Tarrant County JR College	2,000.00	2,000.00	2,000.00
Federal Reserve *	500.00		
S.B.Hispanic Achievement*	2,000.00		
Tax Conference on Aging *	500.00		
Int'l Reading Assn *	1,000.00		
Federal Reserve [REDACTED] *	100.00		
Am Assn Respiratory Care	2,500.00	2,500.00	2,500.00
Rio Grande Council *	3,000.00		
Royce Carlton [REDACTED]	675.00	675.00	675.00
So Tax Econ Conf/CPL	2,500.00		2,500.00
Royce Carlton	750.00	750.00	750.00
Northern Ind Elec Assn	3,750.00	3,750.00	3,750.00

- 000.00

Specific Income Items Not Deposited

1992

SOURCE	AMOUNT	FORM 1099 RECEIVED	ENTERED IN GREEN LEDGER
Harvard University **	\$1,000.00	\$1,000.00	
General Reserve *	408.00		
	1,500.00	1,500.00	
Rock Chamber Comm	2,500.00	2,500.00	\$2,500.00
Assoc Dev Ed	3,000.00		3,000.00
Rock Chamber Comm	58.00	58.00	
ns Chamber Comm	2,000.00		2,000.00
Coalition	1,500.00		1,500.00
County JR College	2,000.00	2,000.00	2,000.00
Reserve *	500.00		
Basic Achievement*	2,000.00		
Conference on Aging *	500.00		
Reading Assn *	1,000.00		
Reserve [REDACTED] *	100.00		
Respiratory Care	2,500.00	2,500.00	2,500.00
Council *	3,000.00		
on [REDACTED]	675.00	675.00	675.00
Conf/CPL	2,500.00		2,500.00
n	750.00	750.00	750.00
Elec Assn	3,750.00	3,750.00	3,750.00