

Internal Revenue Service
memorandum

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date: April 25, 1997

to: Assistant Commissioner (Criminal Investigation) [REDACTED]
National Office

from: Chief, Criminal Investigation Division [REDACTED]
South Texas District

subject: PROTEST OF DECLINATION MEMORANDUM

HENRY G. CISNEROS
[REDACTED]

We are protesting the declination memorandum issued by Assistant Chief Counsel (Criminal Tax) on March 27, 1997, for the above-named case. This document provides the basis for our protest and addresses the many erroneous conclusions and misrepresentations made in their analysis. These errors begin with the very first sentence of their background discussion and continue throughout their memorandum.¹ Assistant Chief Counsel (Criminal Tax) even misstates the origin of the case.²

DISCUSSION

When one removes the smokescreen created by defense counsel for a high profile individual, this turns out to be a very simple case. That is, a smart, well educated and successful man subverts the established recordkeeping system and diverts receipts for his personal benefit. In their discussion of the case, Assistant Chief Counsel (Criminal Tax) (hereinafter ACC) raises two basic issues: Willfulness and the Computation of the Criminal Omission of Income. Their major concern is whether it can be proven that CISNEROS' actions were willful and they assert that willfulness cannot be proven.

¹ Assistant Chief Counsel asserts that the case was forwarded for their review on 12/20/96. CID actually forwarded the case to District Counsel in Austin on this date. Assistant Chief Counsel later took the case from them during the week of 1/13/97.

² Counsel states that the IRS-CID investigation originated from information provided to the FBI during CISNEROS' background check in 1993. The IRS-CID administrative investigation was actually initiated after media reports about a civil lawsuit reporting CISNEROS made payments to his mistress, Medlar.

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An excellent definition of willfulness came out of the Spies case.³ It indicated that an affirmative willful attempt may be inferred from conduct such as keeping two sets of books, concealment of assets, covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal. The facts and evidence that bear directly on the proof of CISNEROS' knowledge and willfulness are presented below:

CISNEROS' Knowledge and Willfulness:

ACC's memorandum essentially states that Cisneros was ignorant of what went on in his office and he entrusted his office management to employees without realizing they were not fulfilling his obligation to prepare and file complete and accurate returns. The facts in this case show just the opposite.

The reader should first refer to the Special Agent's Report (SAR), PP. 7 - 12 for CISNEROS' complete business history and work experience. This clearly demonstrates his knowledge and understanding of financial matters, detailed planning, and ability to manage many projects at one time (Attachment 1).

The following are highlights of the evidence, which exhibit CISNEROS' knowledge of his financial matters and direction given to his employees (additional points are noted in Attachment 1, SAR, P. 12).

1. When CISNEROS opened his private office in June 1989, he and Rene Gonzalez, CPA, worked together to establish sound office procedures. The most important procedure was to deposit all income [REDACTED]. Gonzalez stated there was no question everyone in the CISNEROS Communications office knew income checks needed to be deposited [REDACTED]. Under those procedures, Gonzalez was able to compare the details of the sources of income listed on the deposit slips to the Forms 1099 as a double check to ensure income on the Forms 1099 was all deposited.

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³ Spies v. United States, 317 U.S. 492 (1943).

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2. When CISNEROS later retained Luis Hernandez as his CPA, CISNEROS told Hernandez, in June 1992, all employees knew all income was required to be deposited in the bank accounts in order for the income to be recorded for tax purposes [REDACTED]
3. CISNEROS had periodic conversations and written communications with Hernandez to keep abreast of the financial status [REDACTED]. The declination memorandum asserted CISNEROS relied on others while he was traveling and away from home. However, the evidence shows, CISNEROS was active in the daily financial matters of his business:
 - a. CISNEROS directed his employees, specifically Ramirez, Arce-Garcia, [REDACTED], or Rosales, to make cash withdrawals [REDACTED]
 - b. CISNEROS was in control to the point of directing Arce-Garcia on which business bank account she should deposit the income checks to [REDACTED]
 - c. CISNEROS directed Arce-Garcia and Ramirez to withdraw cash from the bank or cash income checks to make deposits to Medlar's account [REDACTED]
 - d. CISNEROS directed Ramirez on whether Ramirez should withdraw cash, take "less cash" on a deposit, or use an income check to make deposits to Medlar's accounts [REDACTED]
 - e. Any decisions required to run the office were made by CISNEROS [REDACTED]
 - f. CISNEROS was so involved in the Communication's business financial matters he had weekly income projections and controlled which bills were paid:

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- (1) CISNEROS used Arce-Garcia's green ledgers to project future income from speeches. Arce-Garcia provided them to CISNEROS whenever he asked for them. [REDACTED]
 - (2) CISNEROS was aware of how the internal office system worked from its inception in June 1989 [REDACTED]
 - (3) When [REDACTED] was responsible for entering the check register into the Quicken Program in 1990, [REDACTED] provided CISNEROS a copy of each week's check register transactions on each Monday for his review [REDACTED]
 - (4) When [REDACTED] was responsible for the check register in 1991, she provided a report to CISNEROS each week of the expected income and bills due. CISNEROS told [REDACTED] which bills to pay [REDACTED]. CISNEROS complained if moneys due in were not received timely [REDACTED]
 - (5) When Rosales was responsible for the check register in the last quarter of 1992, he provided CISNEROS reports of bills due [REDACTED]. CISNEROS directed Rosales regarding which bills to pay [REDACTED]
4. CISNEROS told the investigating agents he was "always very careful to review his tax records" [REDACTED]
 5. CISNEROS stated he was "meticulous, scrupulous and uncompromising in making sure everything was reported for taxes" [REDACTED]
 6. CISNEROS exhibited a working knowledge of the difference between gross and net income for tax purposes when he stated, in 1990, he would have to make at least \$65(000) to \$80(000) before taxes to net the

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\$48,000 he paid to Medlar [REDACTED]

7. CISNEROS paid a total of \$111,588 to his wife (MARY ALICE), Lincoln Benefit, and school tuition in 1991 when he only reported \$105,509 in taxable income. He paid an additional \$73,024 to Medlar in 1991. CISNEROS' reported taxable income would not have covered his personal expenditures, even before considering the payments to Medlar (Appendix B-1; Attachment 2; [REDACTED])
8. CISNEROS paid a total of \$88,520 to his wife (MARY ALICE) and for school tuition in 1992 when he only reported a taxable income of \$68,599. In addition, he paid \$67,580 to Medlar. The reported taxable income did not cover CISNEROS' personal expenditures before considering the payments to Medlar (Attachment 3; Appendix B-1; [REDACTED])
9. Anna Maria Ornelas, CISNEROS' insurance agent from May 1991 through 1993, explained the tax effect of CISNEROS' contributions to his annuities, retirement accounts, and distributions from the accounts, to CISNEROS [REDACTED]. CISNEROS had a very thorough understanding of his policies and did not require a Form 1099 to determine the taxable nature of distributions [REDACTED]. Ornelas sent CISNEROS a memo with the distribution checks from his annuities indicating the taxable nature of the distributions in 1993 [REDACTED]
10. CISNEROS wired money to Medlar in increments under \$10,000 and stated a larger amount would set off alarms because of the drug laws, and he was sure it (cashing in annuities) would be a big tax problem for him [REDACTED]
11. CISNEROS stated his payments to Medlar "...get to you (Medlar) before they get to the system," and the accountant, Hernandez, would not know [REDACTED]

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The "System":

The ACC's office has asserted all records were available to the accountants, and therefore, no willfulness can be attributed to CISNEROS because he was relying on the accountants and his office staff. This is clearly erroneous. The following discussion presents the facts regarding the office system of keeping records.

The primary source of income for CISNEROS Communications was from speeches for numerous organizations [REDACTED]

[REDACTED]. CISNEROS also received income from director's fees and travel reimbursements [REDACTED]. The organizations were required to pay half the fee up front and the remaining half after the speech [REDACTED]

As discussed above, it was well known since the June 1989 opening of his private office, by CISNEROS and all the employees that all income was to be deposited.

Arce-Garcia kept track of future speeches by noting them in her green ledger on the page of the month the speech was to be performed [REDACTED]

[REDACTED]. The payments received were noted by the name of the organization on the page of the month the speech was to be performed in, not in the month the payment was received [REDACTED]

A comparison of the green ledgers and the bank deposit source items reveals that in a particular month of the green ledger, the list of speeches and income does not tie to the bank deposits. The names of the organizations in the ledger often differ from the names of the organizations in the source items. The notations in the green ledger do not tie to the dates the source items were deposited [REDACTED].

Arce-Garcia said she provided copies of her ledgers to the CPAs for the tax returns [REDACTED]. But, [REDACTED], the accountant who performed the work on the CISNEROS books with Gonzalez, said there was no information, other than

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the bank accounts, given to identify individual income items
[REDACTED]

Hernandez stated he did not receive Arce-Garcia's ledgers for use in preparing the tax returns [REDACTED]. Arce-Garcia, when asked again, stated she gave the ledgers to Ramirez at the end of the year. She would also give the ledgers to CISNEROS to use for income projections [REDACTED]
[REDACTED]

CISNEROS asked Hernandez to help figure out his cash flow [REDACTED]. Arce-Garcia stated there was no pattern to providing Hernandez the copies of the income projections [REDACTED]. The cash projections Hernandez did see indicated more than enough monthly income to cover the monthly expenditures listed by CISNEROS and Ramirez [REDACTED]
[REDACTED]

Hernandez suspected something was wrong because there was a difference in the income in the bank accounts and the income projections [REDACTED]. When Hernandez asked Arce-Garcia to explain her system of tracking the receivables, she showed him her green ledgers. Hernandez could not reconcile the green ledgers to the bank accounts [REDACTED]

It must be noted, Gonzalez and Hernandez never had the deposit source items to assist them in ever beginning a comparison to the green ledgers. Hernandez told Arce-Garcia her green ledgers were not adequate, and he could not determine the income from her ledgers, nor could he tie bank deposits back to the green ledgers [REDACTED]

Hernandez asked Arce-Garcia six times, from May 1992 through September 1992, to identify sources of income on the deposits [REDACTED]. Hernandez provided Arce-Garcia two different formats to use so deposits would be identified and the green ledgers would tie to deposits [REDACTED]. Hernandez told Arce-Garcia, if income was received in the amounts shown on her ledgers, there should not be a problem paying the bills [REDACTED]

Hernandez had no success in getting Arce-Garcia to identify the source of income on the deposit slips. He discussed the problem with CISNEROS, but CISNEROS brushed him off and told

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him just to work it out with Arce-Garcia. Hernandez was frustrated by the lack of cooperation in getting the deposits identified.

Hernandez did not know CISNEROS was making payments to Medlar [REDACTED]. Arce-Garcia stated CISNEROS never instructed the employees to follow any of the suggestions made by Gonzalez or Hernandez, though CISNEROS had stated he wanted to make the system of records better for tax purposes [REDACTED].

Tax Return Preparation 1991:

Rene Gonzalez maintained the books and records through 1991 and prepared CISNEROS' personal tax returns for the years 1976 through 1990 [REDACTED]. Gonzalez did not charge CISNEROS for the accounting services or tax return preparations. However, Gonzalez did charge for the services he provided to CISNEROS Asset Management Co., owned primarily by CISNEROS and two others [REDACTED].

[REDACTED] The ACC's office has implied Gonzalez is not a good witness or return preparer because he was "free help". The undisputed fact is that Gonzales established a workable system to record and report CISNEROS' income based on the bank deposits.

Luis Hernandez maintained CISNEROS' books and records for 1992 to the present and also prepared CISNEROS' personal tax returns for 1991 through 1993 [REDACTED].

The income for tax purposes, for 1989 and 1990, was calculated based on the bank deposits by [REDACTED] an accountant working for Gonzalez [REDACTED]. Gonzalez' workpapers indicate [REDACTED] asked for the information to identify any deposits not previously identified and asked for the remaining bank account information to finish the 1991 financial statements.

CISNEROS did not inform Gonzalez' firm that all income was not deposited [REDACTED]. If an income check was not deposited, there was no way for Gonzalez or [REDACTED] to include it in income [REDACTED].

Gonzalez [REDACTED] relied on the fact CISNEROS and his office employees all knew income needed to be deposited into the

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business accounts [REDACTED]
[REDACTED]

Gonzalez could have prepared an accurate return for CISNEROS for the year 1991, if CISNEROS had provided the information he was asked for by [REDACTED]. Bank deposits had already been identified to Gonzalez and the financial statements could have been completed once the requested records from CISNEROS were received by Gonzalez for 1991. [REDACTED]

Instead, CISNEROS and Ramirez provided Hernandez with a one page Quicken Profit and Loss form and Forms 1099 for the 1991 income and expense information. [REDACTED]
[REDACTED]

The workpapers from Gonzalez were not delivered until August 1992. [REDACTED]. In the meantime, CISNEROS told Hernandez the 1991 records from Gonzalez were incomplete and Hernandez could not use them. [REDACTED]

CISNEROS and Ramirez told Hernandez what made up the income and expense categories on the one page Quicken sheet. [REDACTED]. Hernandez understood the income reported on the Quicken sheet was inaccurate because CISNEROS and Ramirez told Hernandez transfers from CISNEROS' accounts were improperly included in income and, as a result, income was overstated on the Quicken sheet. [REDACTED]. Hernandez utilized the only other information given to him by CISNEROS, the Forms 1099 plus certain income categories for the 1991 tax return. [REDACTED]

Due to CISNEROS not providing complete records, for 1991, and not having the bank statements available for 1991, Hernandez was also unable to recognize that taxable income was not always deposited as CISNEROS had told him. [REDACTED]. Hernandez discussed the 1991 return with CISNEROS and told CISNEROS he wanted to go back through any and all available records for 1991 to make sure it was accurate. CISNEROS told him not to do it. [REDACTED]

In summary, for 1991, Hernandez did not have the 1991 bank statements available to him. He did not have any backup documentation for the 1991 Quicken statement. He did not have Arce-Garcia's green ledgers to use for 1991, and he had already

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determined, in his 1992 work, the ledgers could not be reconciled to the information he was given. Hernandez was given Forms 1099, a one page Quicken statement, and told he could not use the prior accountant's workpapers because they were incomplete.

Tax Return Preparation 1992:

The ACC's office asserts Forms 1099 were used to prepare the 1992 return. This is incorrect. The 1992 return was prepared by Hernandez using only the bank deposits [REDACTED]; [REDACTED]. No personal household or joint bank accounts from Westside Bank or City Employees Federal Credit Union were included in Hernandez' analysis because CISNEROS told Hernandez those accounts were only used by MARY ALICE [REDACTED]. However, CISNEROS did deposit income items into those accounts [REDACTED].

The deposit slips were not identified with the source of the deposits, so Hernandez treated all unidentified deposits as income for the year 1992 [REDACTED]. As was already discussed above, Hernandez only used Arce-Garcia's green ledgers in his attempt to find out why there was a difference between the bank deposits and the cash flow income projections.

Since Hernandez could not get Arce-Garcia, Ramirez, and CISNEROS, to identify the source of the income on the bank deposits or change the way the green ledgers were noted, he relied on CISNEROS' statement that all income was deposited. Hernandez had no reason to believe it was not true [REDACTED].

The Forms 1099, for 1992, could not be individually compared to the bank deposits since the deposits were not identified [REDACTED]. Therefore, Hernandez compared the total of the Forms 1099 to the total from the bank deposits for the year and used the larger figure for income which was the bank deposits for the year [REDACTED].

If income was not deposited, Hernandez would not know unless CISNEROS, Ramirez, or Arce-Garcia informed him [REDACTED]. Hernandez stated no one ever told him that any income checks were being cashed and/or not deposited [REDACTED].

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The itemized category report for 1992 generated by Hernandez' Quickbooks information revealed there were no deposits after 10/5/92 [REDACTED]. The understatement of income for the last quarter of 1992 was not addressed in the ACC's declination memorandum (Attachment 5).

CISNEROS told Hernandez, approximately September 1992, there would be no more income after the first part of October 1992, because CISNEROS was heavily involved in President Clinton's campaign [REDACTED]. Hernandez asked for the bank statements for the last quarter of 1992, but he did not receive them [REDACTED], and SubExhibit 4). Therefore, Hernandez took CISNEROS' word that there was no income in the last quarter of 1992 [REDACTED].

CISNEROS explained the makeup of his annuities to Hernandez [REDACTED]. CISNEROS told Hernandez the contributions to Lincoln Benefit were for a SEP retirement plan. As a result, Hernandez deducted payments from CISNEROS as a Self-Employment Plan (Attachment 6: [REDACTED]).

Tax Return Preparation 1993:

CISNEROS divested himself of his assets and ownership in corporations during 1993 as a result of his appointment as Secretary of HUD [REDACTED]

Hernandez used the Forms 1099, Forms 1099R, annuity closing statements, discussions with the broker on stock sales, and information provided by CISNEROS regarding distributions, to prepare the 1993 tax returns with regard to assets sold [REDACTED]. Hernandez used the Forms 1099 provided by CISNEROS to determine Schedule C income from director's fees and speaking fees for 1993 [REDACTED]). CISNEROS did not provide the bank statements for any account to Hernandez for the 1993 return.

Corrected Taxable Income:

In this section, it is necessary to point out the false presumptions used by the ACC to arrive at an incorrect premise regarding what makes up the case against CISNEROS (Attachment 5, Pg. 12). To explain the significance of the difference between ACC's focus and the reality of what happened, it is

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imperative to have a factual understanding of how the correct income was computed by the agents. For 1991 and 1992, a bank deposits method was used to compute corrected taxable income (Attachment 1, SAR, pp. 29 - 32; Appendix B-1 - B-4; [REDACTED]). The bank deposits method was used because that was the system used by the accountants who kept the books and records since 1989. The bank deposits computation used is as follows:

Add all deposits
Plus all items which did not go into the bank accounts
Plus all cash expenditures
Minus all cash withdrawals up to the amount of cash deposited plus cash expenditures
Minus loans deposited, transfers between accounts, and other non-business deposits
Equals Correct Gross receipts for Schedule C

The calculation of corrected gross receipts is the first step to determine if there is a false matter and if the matter is material. The establishment of those two facts is the only question the bank deposits computation is designed to answer. The list of specific income items cashed is only a part of the calculation.

A comparison of the total of correct gross receipts to reported gross receipts reveals there is over \$107,000 for 1991, and over \$111,000 for 1992, in unreported gross receipts. The CID investigation revealed that CISNEROS willfully and knowingly filed a tax return where gross receipts were substantially understated by those amounts.

Contrary to what ACC suggests, CID does not propose that the evidence of a false material matter lies squarely on CISNEROS' actions to cash checks. To focus narrowly on cashed income checks ignores the larger part of the evidence and it also ignores the largest part of what makes up the amount of the false matter. Specifically, the false material matter for 1991 was \$107,052.66 and the cashed checks amount to \$37,893.12. In 1992, the false material matters (unreported receipts and a \$30,000.00 false deduction) amount to \$141,290.78 and the cashed checks total \$32,015.00.

CISNEROS knew all of his income was tracked through his bank accounts for tax purposes. This was the only system, known by the CPAs since 1989, where CISNEROS' income was recorded. The

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CID investigation included detailed analysis and over 180 organization contacts that determined CISNEROS had cashed income checks. CISNEROS knowingly and willfully cashed income checks that he knew would bypass the bank deposits used by the CPAs to report gross receipts. This is only one way in which CISNEROS bypassed the system and caused the returns to be false.

CISNEROS' act of cashing income checks in 1991 resulted in the cashed items of income not being reported in the records provided to Gonzalez. If CISNEROS had provided Gonzalez the final records for 1991 and Gonzalez had actually prepared a 1991 tax return, then the unreported income could have been calculated using the specific items method. Gonzalez never used Forms 1099 to report income for tax purposes since the total of Forms 1099 was always substantially less than income deposited in the bank accounts. Therefore, the specific items unreported would have been the items which had been cashed since they were not included in the bank deposits used by Gonzalez.

However, as discussed above, CISNEROS did not allow Gonzalez to prepare the 1991 return. His acts and words led Hernandez to believe the bank deposits on the one page Quicken P&L were overreported and caused Hernandez to have to rely on Forms 1099 and other income items to arrive at gross receipts. CISNEROS never put Hernandez in a position to allow him to prepare a correct 1991 tax return. CISNEROS allowed Hernandez to believe Forms 1099 would account for the bulk of his income when he well knew that he had substantially more income.

Hernandez' reliance on CISNEROS' words about the Forms 1099 resulted in some of CISNEROS' cashed income to appear to be reported on the 1991 return. Since there is no actual 1991 records to show exactly how the 1991 income was calculated, there is some question about exactly what item is and is not on the tax return. How does ACC know that an item was reported on the 1991 return? The answer is that they don't know.

The ACC is factually incorrect when he says the 1992 return was prepared using the Forms 1099. The 1992 return was prepared by using only the bank deposits. As discussed above, there was no ability for Hernandez to arrive at a correct income using the Forms 1099 or the green ledgers. This means that the ACC is wrong when he suggests individual cash items were actually

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reported on the 1992 return. Unlike the obfuscation that existed in 1991, 1992 was clear, Hernandez could only use what was in the bank deposits to calculate gross receipts.

In addition, when the ACC stated the 1993 specific items cashed were already, and properly reported in 1992, he is incorrect. The 1993 specific items were not included in the 1992 bank deposits and therefore, were not on the 1992 return. Further, since CISNEROS is a cash basis taxpayer and the evidence shows he received and negotiated the items in 1993, the items are properly reportable in 1993 not in 1992, or in 1991 as in the example of the \$1,000 Harvard item. The year in which an organization reported the Form 1099 is of no consequence to a cash basis taxpayer who does not actually receive the income until a subsequent year.

An additional false material matter on the 1992 return is the deduction of \$30,000 a Self-Employed Pension Plan. This will be discussed later.

One of the false material matters on the 1993 tax return is the gross receipts on CISNEROS' Schedule C, caused by CISNEROS' failure to include all business receipts in the information provided to his CPA. An additional false material matter on the 1993 return is the total pensions and annuities distributions on CISNEROS' first page of the return, caused by CISNEROS' failure to include all taxable annuity distributions in the information provided to Hernandez. This will also be discussed later.

Additional Items Relating to Willfulness:

While failure to report income is not, by itself, proof of intent to defraud, consistent failure to report substantial amounts of income over the years is significant proof of intent to defraud (Gromacki, 361 F.2d 727 (7th Cir. 1966)). As for CISNEROS' reliance on others, if a taxpayer does not supply all relevant information to the preparer, there can be no innocence claimed due to reliance on the preparer (Korecky, F.2d 1566 (11th Cir. 1986)).

The ACC's office asserts CISNEROS had a good faith reliance on others (i.e. employees and CPAs). This is false because the "others" all say very clearly that it was CISNEROS who directed their actions. CISNEROS was the one person with a duty to

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provide his accountants with all relevant information and failed to do so.

CISNEROS' state of mind, to have acted willfully, must be determined from all evidence available. Chief Counsel's Office only appears to be considering the "facts" which the defendant's attorneys are putting forth. This investigation has established CISNEROS' willfulness by showing that his words and acts constitute lies, misstatements and acts of concealment. Consider the following examples:

1. The ACC excludes CISNEROS from any process involving the creation of his financial records, communication to Hernandez, and preparation and filing of the tax returns. However, the evidence shows CISNEROS was involved in the daily direction and control of his employees and his financial matters. The evidence also shows CISNEROS has a working knowledge of his tax returns.
2. Testimony of numerous witnesses and corroborating documents show that CISNEROS knew under the system, established by Gonzales, all income checks had to be deposited into his bank account in order to be included on his income tax returns. Knowing this he subverted and bypassed the system.
3. The investigating agents specifically asked if he had reported all of his income. CISNEROS stated he was "meticulous, scrupulous, and uncompromising in making sure everything was reported for taxes." The evidence shows that this was a false statement. In an evasion case, this lie would be construed as an overt act.
4. CISNEROS also admitted to carefully reviewing his own returns [redacted]; and yet, the returns, as filed, contained items which were materially false.
5. CISNEROS started cashing income checks in mid-1991. He concealed this fact from Gonzalez and Hernandez. In 1989 and 1990, the deposited income was greater than the total of Forms 1099 received. Gonzalez used bank deposits to report income and CISNEROS knew it.

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6. The taxable income on the returns for 1991 and 1992 equaled substantially all the income CISNEROS had available to pay for his nondeductible expenditures. CISNEROS had the knowledge and detailed control of his financial matters. The result is CISNEROS, after carefully reviewing his tax returns, filed returns which did not report enough NET to cover his own personal expenditures plus payments to Medlar.
7. CISNEROS changed accountants during the 1991 filing season and did not provide Gonzalez with the records needed to finish the 1991 financial statements and tax returns. Instead of allowing Gonzalez to finish the 1991 records, CISNEROS hired Hernandez in April 1992. CISNEROS explained how income was handled to Hernandez as discussed below:
 - a. What CISNEROS said, was that he and all the employees knew income had to be deposited in order to be reported for tax purposes. He did not tell Hernandez that not all income was deposited and Hernandez would have to use additional records. It was CISNEROS who explained Arce-Garcia's green ledgers as being a method she used to ensure receivables were collected.
 - b. It was CISNEROS and Ramirez who met with Hernandez to explain the one page Quicken Profit and Loss form to Hernandez. It was CISNEROS and Ramirez who explained that transfers between accounts had been included in income on the Quicken page causing it to be overstated. It was CISNEROS who told Hernandez that Gonzalez' workpapers could not be used because "they didn't really have a CPA in 1991" and the records were incomplete.
 - c. Therefore, Hernandez could not use the one page Quicken for income, could not use Gonzalez' "incomplete" records, knew Arce-Garcia's green ledgers were for receivables only, had not even seen the green ledgers at the time he was meeting with CISNEROS and Ramirez, and did not have the bank statements for 1991. Hernandez had the 1990 and 1989 return and the 1991 P&L and Forms 1099. Hernandez was left with being able to only use the

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Forms 1099 plus additional figures to make a good faith estimate of income for 1991. It was fully within CISNEROS' power to have had a correct return prepared.

- d. Hernandez then told CISNEROS he wanted to go over everything for 1991 and CISNEROS would not authorize it (Attachment 4, P. 33). Based on what CISNEROS told him about the Quicken P&L, Hernandez understood that income was probably overreported.
8. CISNEROS told Hernandez he never deposited any income into the household account [REDACTED]. Yet, CISNEROS did deposit income into the household account [REDACTED]. This is an outright lie by CISNEROS.
9. CISNEROS did not tell Gonzalez and Hernandez he was making payments to MEDLAR. Gonzalez and Hernandez did not know, from all the systems available, about the payments to MEDLAR [REDACTED].
10. CISNEROS had shared intimate details with Hernandez regarding the possibility of divorcing MARY ALICE and child custody (Attachment 7). It appears CISNEROS was not concerned with Hernandez not keeping the details of CISNEROS' business and personal life confidential. Since confidentiality was not the problem, there is no other reason to conceal the payments to Medlar from Hernandez other than to conceal it from the tax return calculation of income.
11. CISNEROS circumvented the bookkeeping system in many ways and did not tell Hernandez about it. He did not tell him that income checks were not being deposited into the business accounts; that income checks were deposited to Medlar's accounts; that income checks were deposited to personal accounts; that income checks were used to make note payments; or even that CISNEROS was making payments to Medlar [REDACTED].
12. CISNEROS also asked Hernandez to help him with his cash flow problem, but never revealed the large expenditures he was making to Medlar, thus making it impossible for

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Hernandez to figure out why the income projections did not cover the expenditures CISNEROS had revealed. Hernandez was at a loss to explain why there would be a cash flow problem since the income projections that totaled over \$400,000 per year were enough to cover the expenditures CISNEROS said he had. What Hernandez did not realize was that CISNEROS had not informed him of all his obligations (i.e. Medlar).

13. When Hernandez started checking up on what was used to arrive at the income projections, he discovered the records used for income projections did not tie to the bank deposits. Although Hernandez was supposedly hired by CISNEROS to improve the system, when Hernandez discussed the problems with CISNEROS, CISNEROS refused to make any change. In fact, CISNEROS never made one change, suggested by Hernandez, to any of his procedures to improve the quality of the system.
14. CISNEROS intentionally omitted approximately \$100,000 from the 1992 return by telling Hernandez no income existed during the later part of the year and by not providing the bank statements. CISNEROS was singularly responsible for this omission.
15. When CISNEROS was recorded by Medlar in 1992, the concealment and underreporting had already begun. CISNEROS' own words in 1992 reveal he was thinking of the IRS and taxes in continuing the concealment when he was considering the movement of money to pay Medlar

16. Recorded statements by CISNEROS include many comments to evidence CISNEROS' bad purpose and state of mind. Such phrases include: "It gets to you before it gets to the system," "...can't move large sums of money around without the IRS and bank examiners or somebody taking note of those volumes...", "...there are problems with large amounts because of the drug laws...", "the accountant would not know...", "...whether he (Hernandez) knew of any payments, and he said he didn't because he doesn't, he doesn't get involved in that, he accounts with the accounts for the money that we put into the system and the money I help you with comes

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before that, comes out of that before it gets to him...," "... I'm sure it's a big tax problem for me...," "need to make at least 65 to 80 to net the 48...," "...told him it came to 10 or 15,000 a year (lie to the Presidential Transition Team)...," regarding an argument between CISNEROS and his wife about the FBI questions, "...she played along like she knew..."

17. The ACC's office asserts the conversation where CISNEROS tells Medlar the payments get to Medlar before they get to the accountants only serves as evidence that payments to Medlar existed. The ACC's interpretation is the statement does not mean by concealing the payments from the accountants it would also cause the tax returns to be materially false (Attachment 5, Footnote 5; [REDACTED]). This is an incredible conclusion. In light of all the other evidence, the statement means what it says. The meaning is that money that went to Medlar came from funds that did not get to the system, and therefore, the accountants could not account for it. Neither accountant ever knew, from all the records available to them, the expenditure to Medlar existed.

Additional Inaccuracies in Declination Memorandum:

1. The ACC's office has fixated on Appendix B 4, Specific Items Not Deposited, and espoused the view that this schedule summarizes the totality of the unreported income accusation against CISNEROS. This is incorrect. Appendix B-4 is no accusation, it is one example, among many, of CISNEROS' willfulness by his failure to deposit all income, and it is simply a part of the calculation of correct income for 1991. The specific income items that were not deposited are only one part of the computation for total corrected gross receipts. It is the total understatement of gross receipts, not any one particular item, which makes up the false material matter.
3. The ACC's office is incorrect in their assertion that the 1992 return was prepared using the Forms 1099. The 1992 return was prepared by Hernandez based on the bank deposits only. Hernandez could only compare the totals of the Forms 1099 to the total of the bank deposits because CISNEROS would not direct his employees to identify the source of income on the deposit slip when

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asked to do so by Hernandez. In addition, as discussed above, Hernandez could not use the green ledgers and CISNEROS knew it.

4. The ACC's office is incorrect in their assertion the 1993 return income is overstated by the agents because some of the items were already reported in 1992. Since 1992 was prepared using only the bank deposits, the income listed on Forms 1099 for items negotiated in 1993 were not reported on the 1992 return. Additionally, CISNEROS is a cash basis taxpayer and did not negotiate any of the items of income until 1993, therefore, the items are properly reportable in 1993.
5. CISNEROS is a cash basis taxpayer. As such, his correct gross receipts should reflect the income he actually received and had unrestricted access to in each calendar year. If an income item is dated 12/31/92, but not received until 1993, as evidenced by the dates the funds were negotiated and distance between the payer and CISNEROS, then it is properly reportable in 1993. Even if the payer sent a Form 1099 in 1992, it is still reportable in 1993 under the cash basis system and in this example.
6. The ACC's office maintain the sources of funds for payments to Medlar existed in either the bank deposits, Forms 1099, or the green ledgers. The ACC states this means Hernandez had reason to know and is at fault and not CISNEROS. The ACC's office also asserts if an item is in one of the three places, CISNEROS is not at fault. As discussed above, it is only correct to say that Hernandez did not know, and could not have known, by any of the records in existence that funds were not reported.
8. The ACC's office contend that the SAR states CISNEROS tried to hide the transactions from his employees. This is wrong. The SAR is quick to point out that without loyal employees, who are currently provided legal counsel hand-picked by CISNEROS' attorneys, the CPAs might have been able to discover the unreported income.
9. The ACC's office is incorrect in their assertion Gonzalez used Forms 1099 to prepare the income on the

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tax returns for prior years. Gonzalez always prepared the tax returns based on the bank deposits since CISNEROS went into business in 1989. CISNEROS was fully aware of this fact.

Defense Counsel's "Analysis":

Defense counsel analyzed Medlar's bank deposits and argued that all the money to Medlar was either in Arce-Garcia's log or in the Forms 1099, or the bank deposits (Attachment 8, Defense Conference Memorandum, P. 3; Attachment 9 and 10, Defense analysis of payments to Medlar). The schedules first identify deposits to Medlar's bank accounts which defense identifies as from or on behalf of CISNEROS. The defense also notes who made the deposit and has a column to identify, based on their version of "the system," the source of the deposits.

The agents analyzed the green ledgers, Forms 1099, and bank deposits, in the same format as was available to Hernandez, to determine the possibility of accurately and reasonably arriving at unreported income and to check the defense exhibits' accuracy.

The agents' analysis reveals the green ledgers do not support any correct calculation of income (Attachment 11). The defense schedules are inaccurate as to items identified as the source of CISNEROS' payments to Medlar, as to amounts, and double counted income items which had been overlooked. Hernandez could not have used the green ledgers to compare with the bank deposits, as they existed, to arrive at a correct income calculation.

It took CID over 180 interviews and many months of obtaining source documents to be able to identify the specific items that had been cashed. It was not the green ledgers which identified the items.

Distributions from Massachusetts Mutual IRA Account:

Regarding the Mass Mutual distribution in 1993, CISNEROS directed that the money from the annuities, be Federal expressed to Frank Wing at HMD. to ensure no one opened the mail and CISNEROS would get the money [REDACTED]. CISNEROS was reminded by Ornelas to give the information to his accountant in a memo [REDACTED]. When the transaction occurred in 1993, Hernandez

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was still working on collecting the information for the 1992 return. CISNEROS could have faxed the information for 1993 at the same time he received the money.

In addition, the public financial statements don't show Hernandez had notice of the distribution or notice he should have questioned anything. The public financial statement asks for a list of all assets and sources of income over \$200 for the year 1993. There is no disclosure of any of the items of income over \$200. In addition, the only statement Hernandez had to tell him anything about Mass Mutual was a FMV statement as of 1/24/94, which showed a value in one of the accounts. This FMV notice had been sent to the same address used for the Forms 1099, CISNEROS' San Antonio residence, and Hernandez got this form.

The ACC's office asserted the Forms 1099 were not received by CISNEROS since the address used to send the Forms 1099 were the [REDACTED] address and the CISNEROS BENEFIT GROUP, INC., address [REDACTED]. However, every other 1099, W-2, and miscellaneous item related to income seemed to get into the hands of Hernandez, regardless of the address where the forms were sent. MARY ALICE's sister, [REDACTED] watched the house on [REDACTED] for CISNEROS. [REDACTED] and Anna Marie Cornelias were at CISNEROS Benefit Group and served to gather mail for CISNEROS. There is no defense in the fact the forms that Hernandez did not get were sent to his San Antonio residence (Attachment 12, PP. 1 - 8).

Self Employment Pension Plan Deduction:

Regarding the deduction of \$30,000 as a Self-Employment Pension Plan on the 1992 returns, Hernandez' affidavit signed 2/4/97, stated he deducted the Lincoln Life payments on his incorrect assumption that there was a retirement account (Attachment 6).

In contrast, Hernandez told agents he asked CISNEROS, Arce-Garcia, and Ramirez about the Lincoln Life payments and was told by all three that it was a retirement plan. Hernandez said it would have also been covered in the tax planning meeting with CISNEROS [REDACTED]

The statements are in direct conflict. The only way to resolve this issue is to have Hernandez testify in a grand jury.

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Tape Recordings

The ACC's office expressed doubt on the use of the tapes and use of Medlar as a witness. The declination memorandum asserts the tapes will be admissible only to the extent state laws where CISNEROS was located would allow for admissibility.

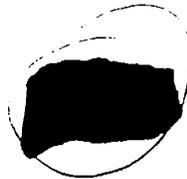
The ACC's office states their analysis of the conversations on the tapes impress them with the statements CISNEROS made indicating he is paying his taxes. They assert the tape in which CISNEROS is explaining how the money gets to Medlar before it gets to the system only means that there were payments to Medlar and in no way suggests the money was not reported for tax purposes, or not part of the accountant's information.

The single statement CISNEROS made, which says anything about the money being his and that he paid taxes on it, is in the context of explaining the conversation he had with Senator Reagal concerning the Medlar payments, 1/21/93 [REDACTED]. In this regard, CISNEROS had already lied to the FBI and concocted a story he wanted Medlar to go along with. His conversations with a senator who had the power to influence whether CISNEROS would be confirmed or not are self serving and in no way indicate the truth. He did not tell Medlar he paid his taxes. He told Medlar that he had told Senator Reagal he had paid his taxes. There is a big difference and the tape does not serve as exculpatory material.

The use of the surreptitiously recorded conversations has been considered in depth. Medlar has been cooperative in the investigation of this tax case. Medlar has already made statements explaining the tapes, and she will testify either voluntarily or by being compelled to testify. Whether or not Medlar was ever advised to seek immunity by her attorney in no way suggests that she would be unavailable as a witness. We have no reason to believe that Medlar will not appear as a witness.

The Office of Independent Counsel ~~has~~ informed the agents that the tapes have been analyzed, and after extensive research, they have determined the tapes to be admissible in Federal courts. No specifics about the results of the analysis were made available to CID. However, we have been told that they

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have authenticated the voices and that the conversations were not spliced together.

We have also consulted with an Assistant US Attorney in the Western District of Texas and have been advised that these tapes will be admissible in federal court despite the fact that they may have been made in violation of the law in some states. As long as the monitoring is allowed under federal statutes, then it may be used as evidence in federal court.

The conversations between CISNEROS and Medler consistently show CISNEROS' knowledge and intent to hide the money and prevent his accountants from knowing about the payments, and to keep the money out of the system which existed to cause income to be properly recorded.

Hernandez as a Witness

The ACC implied Hernandez is incompetent and is a grudge bearing man who was out to get CISNEROS. However, the evidence in all the interviews conducted with Hernandez indicates he did the best he could with the cooperation he got from CISNEROS. There has never been any suggestion during the course of this investigation that Hernandez currently, or in the years as CISNEROS' accountant, holds a grudge against CISNEROS. If he holds a grudge, he could have made many damaging statements during the interviews to cause CISNEROS trouble. But, the opposite occurred, he was reluctant to even believe CISNEROS was not depositing all income when the agents pointed this out to him. Finally, if he holds that much of a grudge against Cisneros, why would he have given an affidavit to Cisneros' defense counsel claiming responsibility for the SEP deduction?

Character Evidence

The ACC's office contends the character testimony by many "dignitaries" will be harmful to the possibility of conviction. Cisneros may very well be able to produce numerous "dignitaries" to cite his alleged high moral character. However, their testimony may be restricted and the court will probably limit the number of such witnesses. What will also come out during the trial will be the extra-marital affair, the circumvention of the recordkeeping system, six figure understatements of income, concealment of significant facts from the accountants and outright lies to the FBI and the Presidential transition team.

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Alleged Disclosure Violations

The ACC's office also claims concern with apparent disclosure violations in this case. It is important to note that all disclosures made in this case to Independent Counsel were made under the direction and counsel of the District Disclosure Officer. As soon as a technical mistake was discovered, it was corrected as recommended by Assistant Chief Counsel, Disclosure Litigation in the National Office. The issue was also reported to Inspection in Austin, who advised that no willfulness, or criminal intent, or actions existed to cause a need for investigation. This issue is separate from the consideration of whether there is evidence to prove the elements of the tax crime (Attachment 13, Memo 2/24/97). ACC, in fact, acknowledges that this issue will not lead to dismissal of charges or suppression of evidence.

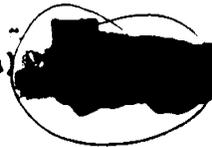
Witness Testimony

Initially, Mr. Finkelstein indicated he strongly believed the witnesses should be brought before a grand jury to solidify their testimony. In the declination memorandum, he reverses his view, now stating, "There is no reason to believe that the witnesses will change their testimony."

We believe there is direct evidence to the contrary. The ACC's office cites a defense counsel obtained affidavit from Hernandez, dated February 7, 1997. Hernandez had previously made a statement that is in direct conflict with this newly obtained affidavit. It has been IRS-CID's observation that Defense Counsel's presence at nearly every witness interview has influenced the witnesses' statements. In addition, several pertinent witnesses who remained employed by CISNEROS had stated they felt compelled to allow Defense Counsel to be present during the interviews.

Even with Defense Counsel present, the pertinent witnesses have furnished sufficient testimony which, when coupled with the documentary evidence, make out a prima facie case against CISNEROS. Before the grand jury, and in the absence of CISNEROS' hired counsel, these and other witnesses will be even more candid and forthcoming with information about CISNEROS' crimes.

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CONCLUSION

This is a simple case that the defense counsel and Assistant Chief Counsel (Criminal Tax) have convoluted and tried to make complex. All CISNEROS had to do was deposit all his income and let the accountants have the bank statements and do their job. Instead, CISNEROS lied to Hernandez, lied to Gonzalez, lied to the IRS, lied to the FBI, and lied to the Presidential transition team. CISNEROS was in full control of his own financial affairs. His employees only acted when directed by him.

CISNEROS chose his actions. He knew he was earning a substantially greater amount of income than he reported. In 1991, he changed the system and never told his return preparer. That is concealment. He continued his concealment throughout 1992. His words recorded in late 1992 and early 1993 reveal he had been thinking of his taxes when he was acting in prior years.

This is not a case that hinges on one witness, one mistress, one employee, or one accountant. It is not a case about timing of income or taking a few checks. It is about a man who concealed a substantial amount of income from his accountants, concealed where his largest single cash expenditures were going, and then lied to cover his past and his actions. Willfulness can be inferred from one's conduct. CISNEROS has lied, concealed, defused, acted without justifiable purpose, and chosen conduct which would likely cause people to be misled.

In conclusion, the analysis of this case and the conclusions drawn by Assistant Chief Counsel (Criminal Tax) are just plain wrong. The evidence in this case clearly proves CISNEROS knowingly and willfully signed and filed false and fraudulent income tax returns for each of the years 1991, 1992, and 1993, in violation of Title 26, United States Code, Section 7206(1).

A handwritten signature in cursive script that reads "John J. Filan".

John J. Filan