

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

FROM: Barry J. Finkelstein
Assistant Chief Counsel (Criminal Tax)

SUBJECT: Tax Evasion - Interest and Penalties

This is to apprise you of a recent decision which appears to be the first criminal tax case to specifically hold, albeit dicta,¹ that interest and penalties are not included within the meaning of the term "tax deficiency" for purposes of 7201 violations. See, United States v. Wright, No. 98-50554, 2000 U.S. App. LEXIS 8192 (5th Cir. April 27, 2000) (copy attached). While the import of this decision is debatable, the court sets out a persuasive argument that the existence a tax deficiency cannot be predicated on outstanding interest and penalties. Accordingly, there must be some amount of tax due and owing. In our view, this novel decision should not affect the vast majority of evasion cases which generally involve substantial amounts of tax due and owing.

Theoretically, this decision could preclude an evasion charge in the rarest of cases, i.e., where all the taxpayer had attempted to evade was outstanding interest and/or penalties. We are not aware of this situation ever arising. We further note the Service's administrative procedures for applying payments for tax and additions to tax may preclude the possibility that a taxpayer could pay off the underlying tax in full and still have amounts of interest and/or penalties due.

U.S. v. Wright

In Wright, supra, Franklin Wright had an outstanding tax liability of \$419,000.00, not including penalties and interest, for tax years 1986, 1987 and 1988. In 1992, he submitted an offer in compromise and began paying \$5,000.00 a month until December 1994. During the pendency of the offer in compromise, Wright and his wife, with the assistance of their attorney and a friend, purchased a new home in the name of the friend. The Wrights gave their friend \$150,000.00 in cash for the purchase of the house. An amended offer in compromise was filed stating the Wrights sold their home because they could not afford the payments and were now renting. The new house

¹ This holding has no precedential value because it was not relied upon to dispose of the issue of an actual tax deficiency in the case (see discussion below).

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was not listed in the amended offer. The offer ultimately was rejected because Wright failed to provide required additional information. Through seizures and voluntary payments, Wright paid about \$490,000.00 towards his tax liability. The Wrights, the attorney and the friend were convicted of conspiracy to defraud under 18 U.S.C. § 371. Wright was convicted for tax evasion in violation of 26 U.S.C. § 7201 and the attorney was convicted for making false statements in violation of 18 U.S.C. § 1001.

On appeal to Fifth Circuit, the defendants argued there was no underlying tax deficiency to predicate the conspiracy and evasion convictions. They contended Wright only owed interest and penalties and had paid off the \$419,000.00 tax liability. The Fifth Circuit agreed that section 7201 requires a tax deficiency and that interest and penalties are excluded from a tax liability for purposes of section 7201. While section 7201 does not define “tax deficiency,” the court relied on its definition elsewhere in the Internal Revenue Code. Specifically, the deficiency procedures set forth in I.R.C. § 6211 define the term as the amount by which the tax exceeds the tax reported on the return plus the amounts previously assessed. Further, I.R.C. § 6601(e) expressly excludes interest from being treated as tax for purposes of deficiency procedures. Thus, the determination of a tax deficiency under these civil procedures do not recognize interest or penalties as part of the tax. Although the deficiency procedures are separate from the criminal liability provisions of the Code, the court refused to assume a broader meaning for a “tax deficiency” under section 7201 than under the deficiency proceedings provision – especially when section 7201 attaches criminal liability to the debt owed. The court also relied on the Sentencing Guidelines exclusion of interest and penalties in assessing the penalty for tax evasion to bolster its interpretation that interest and penalties are not part of a tax deficiency for 7201 purposes.

The Fifth Circuit was still able to uphold the convictions in this case. The court concluded Wright failed to prove he owed no tax. Although his total payments exceeded the tax owed, the Service collected a substantial portion of the payments through seizure. The IRS applied the seized amounts according to its normal procedure, which is to first extinguish the taxpayer's total tax, interest and penalties for the earliest years owed. Since the seized amounts were not first applied to his tax liability, Wright did have a tax deficiency. Consequently, the convictions were affirmed.

If you have any questions or comments, please feel free to contact Brian Townsend on (202) 622-4470.

cc: Assistant Regional Counsel (CT)

Attachment

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UNITED STATES OF AMERICA, Plaintiff-Appellee, versus FRANKLIN Y WRIGHT, JR; ANNETTE RYAN WRIGHT, also known as Annette S Wright, also known as Annette Kaufman Wright; ROBERT E BARGER, Defendants-Appellants.
No. 98-50554

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

211 F.3d 233; 2000 U.S. App. LEXIS 8192; 2000-1 U.S. TaxCas. (CCH) P50,438; 85 A.F.T.R.2d (RIA) 1791

April 27, 2000, Decided

SUBSEQUENT HISTORY: [**1] As Revised April 28, 2000. Rehearing Denied May 24, 2000, Reported at: 2000 U.S. App. LEXIS 14955. Certiorari Denied October 2, 2000, Reported at: 2000 U.S. LEXIS 6501, 2000 U.S. LEXIS 6500.

PRIOR HISTORY: Appeals from the United States District Court For the Western District of Texas. SA-97-CR-112-1. Orlando L Garcia, US District Judge.

DISPOSITION: AFFIRMED AS TO FRANKLIN WRIGHT AND ANNETTE WRIGHT; REMANDED FOR THE RE-SENTENCING OF ROBERT BARGER.
CASE SUMMARY

PROCEDURAL POSTURE: Defendants appealed their convictions, in the United States District Court for the Western District of Texas, of various tax evasion-related offenses; defendant tax preparer also appealed his sentence on grounds that it was disproportionate to sentence given to primary taxpayer.

OVERVIEW: Defendant husband and wife concealed assets, with the advice of defendant attorney and tax adviser, while purporting to follow plan to pay off tax deficiencies. All three appealed convictions of tax evasion and conspiracy. The court held that while interest and penalties were not part of a tax deficiency, evasion of which was a crime under I.R.C. § 7201, there was evidence that payments under the payment plan did not eliminate the whole deficiency. This was the only arguable element of evidence used to find defendants guilty of tax evasion crimes, so their convictions were

upheld. However, after an enhancement for special skills, defendant attorney ended up with a more severe sentence than either taxpayer, and record at sentencing indicated court did not know it could depart downward from guidelines to prevent an unjust discrepancy, so the court remanded for resentencing of this defendant.

OUTCOME: The court affirmed all convictions, as evidence was sufficient to convict of tax evasion and conspiracy. However, evidence that court was unaware that it could depart downward from guidelines to prevent unfair sentencing discrepancy required remand for resentencing.

CORE TERMS: sentence, tax deficiency, departure, evasion, conspiracy to defraud, discrepancy, downward, owed, indictment, enhancement, conspiracy, mortgage, involvement, special skill, tax liability, down payment, sentencing, re-sentencing, co-defendants, seized, depart, insufficient evidence, defrauding, prong, sufficient evidence to support, criminal liability, community property, specific notice, crimes charged, tax evasion

CORE CONCEPTS -

Criminal Law & Procedure: Criminal Offenses: Fraud: Tax Fraud
Tax Law: Federal Tax Administration & Procedure: Audits & Investigations: Criminal Procedure & Penalties (IRC secs. 7201-7217, 7231-7233, 7240-7242, 7261-7262, 7268-7273, 7375)
The elements of I.R.C. § 7201, the provision criminalizing the evasion of taxes, include the existence of a tax deficiency.

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Criminal Law & Procedure: Criminal Offenses: Fraud:
Tax Fraud

Tax Law: Federal Tax Administration & Procedure:
Audits & Investigations: Criminal Procedure & Penalties
(IRC secs. 7201-7217, 7231-7233, 7240-7242, 7261-
7262, 7268-7273, 7375)

Tax Law: Federal Tax Administration & Procedure: Tax
Liabilities & Credits: Interest (IRC secs. 6601-6631)
While I.R.C. § 7201 does not describe "tax deficiency,"
it is defined at I.R.C. § 6211 as the amount by which the
tax exceeds the tax reported on the return plus the
amounts previously assessed as a tax deficiency. I.R.C.
§ 6601(e) specifically excludes interest from being
treated as tax for purposes of deficiency procedures.

Criminal Law & Procedure: Criminal Offenses: Fraud:
Tax Fraud

Criminal Law & Procedure: Sentencing: Sentencing
Guidelines

Tax Law: Federal Tax Administration & Procedure:
Audits & Investigations: Criminal Procedure & Penalties
(IRC secs. 7201-7217, 7231-7233, 7240-7242, 7261-
7262, 7268-7273, 7375)

Tax Law: Federal Tax Administration & Procedure: Tax
Liabilities & Credits: Interest (IRC secs. 6601-6631)
U.S. Sentencing Guidelines Manual § 2T1.1 and
application notes exclude interest and penalties in
assessing the penalty for tax evasion.

Criminal Law & Procedure: Criminal Offenses: Fraud:
Tax Fraud

Criminal Law & Procedure: Criminal Offenses: Inchoate
Crimes: Conspiracy

18 U.S.C.S. § 371 prohibits the defrauding of the United
States, not just the evasion of taxes.

Criminal Law & Procedure: Criminal Offenses: Fraud:
Tax Fraud

Criminal Law & Procedure: Criminal Offenses: Inchoate
Crimes: Conspiracy

18 U.S.C.S § 371 has two prongs: it prohibits a
conspiracy to commit an offense against the United
States, or one to defraud the United States.

Criminal Law & Procedure: Criminal Offenses: Inchoate
Crimes: Conspiracy

To establish a conspiracy under 18 U.S.C.S. § 371, the
Government must prove: (1) an agreement; (2) to
commit a crime; and (3) an overt act committed by one

of the conspirators in furtherance of the agreement.

Criminal Law & Procedure: Criminal Offenses: Fraud:
Tax Fraud

Tax Law: Federal Tax Administration & Procedure:
Audits & Investigations: Criminal Procedure & Penalties
(IRC secs. 7201-7217, 7231-7233, 7240-7242, 7261-
7262, 7268-7273, 7375)

A conviction under I.R.C. § 7201 requires a showing of
willfulness, a tax deficiency, and an affirmative act
constituting evasion.

Criminal Law & Procedure: Criminal Offenses: Fraud:
Tax Fraud

To establish a violation of 18 U.S.C.S. § 1001(a)(3), the
Government must show a statement that is false and
material and made knowingly and willfully.

Criminal Law & Procedure: Sentencing: Sentencing
Guidelines

Downward departure factors should normally not be
ruled out on a categorical basis; courts may depart if the
case is outside the heartland of U.S. Sentencing
Guidelines Manual.

Criminal Law & Procedure: Sentencing: Sentencing
Guidelines

Criminal Law & Procedure: Sentencing: Appeals

A United States Court of Appeals may review a federal
district court's refusal to grant a downward departure
only if the district court mistakenly concluded that the
U.S. Sentencing Guidelines Manual did not permit the
departure.

COUNSEL: For UNITED STATES OF AMERICA,
Plaintiff - Appellee: Joseph H Gay, Jr, Assistant US
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For FRANKLIN Y WRIGHT, JR, Defendant -
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For ANNETTE RYAN WRIGHT, Defendant -
Appellant: Lucien B Campbell, Philip J Lynch, Federal
Public Defender's Office, San Antonio, TX.

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For ROBERT E BARGER, Defendant - Appellant: Roy R Barrera, Sr, Nicholas & Barrera, San Antonio, TX.

JUDGES: Before REYNALDO G. GARZA, HIGGINBOTHAM, and BENAVIDES, Circuit Judges.

OPINIONBY: PATRICK E. HIGGINBOTHAM,

OPINION: [*235]

PATRICK E. HIGGINBOTHAM, Circuit Judge:

This appeal presents various challenges to the tax evasion-related convictions of Franklin Wright, his wife Annette Wright, and Franklin's attorney and tax preparer, Robert Barger. Barger also appeals his sentence. We reject the defendants' legal challenges to the convictions and find that the evidence was sufficient to support each of the verdicts. Because it appears that the district court believed it could not downward depart under the Sentencing Guidelines based on a discrepancy in sentences among the co-defendants, we remand for the re-sentencing of Barger.

I

The charges against all of the defendants stem from tax deficiencies owed by Franklin Wright for 1986, 1987 and 1988. Collection proceedings began in 1988, and the Internal Revenue Service ("IRS") and Franklin began a long period of negotiation.

In August[*2] 1992, Barger submitted an Offer in Compromise to the IRS and set up a \$5,000-a-month payment plan for Franklin, which Franklin followed until December 1994. Although the offer was substantial, the IRS eventually rejected it because Franklin failed to provide required additional information. Through seizures and voluntary payments, however, Franklin eventually paid about \$490,000 toward his tax liability of \$419,000, not including penalties and interest.

Franklin and Annette married in 1989, after Franklin accumulated his deficiency. The government charged Annette with assisting Franklin in hiding assets from the IRS. In August 1992, while the Offer in Compromise was pending, Annette decided to sell the home she had owned before her marriage to Franklin and buy a new

house. Annette claims that she was unable to secure financing for the home because of Franklin's tax problems. She asked a friend, Caroline Haggard, to buy the home in Haggard's name and stated that she would assume the mortgage once the tax issues had been resolved. Haggard agreed to this arrangement.

[*236] Franklin and Annette brought her almost \$150,000 for the house in a bag containing \$100 bills. Franklin told Haggard[*3] that the cash was money from his law practice. Haggard testified at trial that the Wrights assured her that the taxes had been paid on the money but warned that she should avoid depositing the funds in the bank to avoid problems with the IRS.

Haggard decided to deposit the money anyway, resulting in a report to the IRS. She called Barger for advice, and Barger asked her why she had deposited the money when she had been told not to. Barger also participated in the home purchase in other ways: he assisted Haggard in gathering financial records in order to qualify for the mortgage; drew up papers transferring the mortgage to Annette; and loaned Franklin \$64,000 for the remainder of the down payment. In April 1993, Barger submitted an amendment to the Offer in Compromise stating that the Wrights had sold their house because they could no longer make mortgage payments and were now renting. The form did not list the new home as potential community property.

The government indicted the Wrights, Barger and Haggard for conspiracy to defraud, Franklin for tax evasion, and Barger for making false statements. Haggard, also facing prosecution on unrelated Medicaid fraud charges, plead guilty[*4] to all charges and testified on behalf of the government. A jury found all three of the others guilty. n1 The district court sentenced Franklin to concurrent 12-month terms. Annette received five years' probation so that she could care for the couple's small children. Barger received concurrent 18-month terms; his sentence included a two-point enhancement for use of a special skill. Haggard attempted to withdraw her plea after the trial, claiming that she was innocent of the tax charges; her appeal proceeded separately and was rejected by a panel of this court. At issue today are the appeals of the other three defendants.

n1 Barger was acquitted on one of the counts of making

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false statements.

II

All three defendants raise several legal challenges to the convictions. First, they claim that the convictions are improper because Franklin had no underlying tax deficiency. Franklin contends that he owed only interest and penalties and could not be prosecuted for evasion if no tax was owed.

The Supreme Court has^[**5] held that the elements of Internal Revenue Code ("I.R.C.") § 7201, the provision criminalizing the evasion of taxes, include the existence of a "tax deficiency." n2 While § 7201 does not describe "tax deficiency," it is defined elsewhere in the IRC as the amount by which the tax exceeds the tax reported on the return plus the amounts previously assessed as a tax deficiency. n3 The IRC specifically excludes interest from being treated as tax for purposes of deficiency procedures. n4 The Sentencing Guidelines also exclude interest and penalties in assessing the penalty for tax evasion. n5

n2 See *Sansone v. United States*, 380 U.S. 343, 351, 13 L. Ed. 2d 882, 85 S. Ct. 1004 (1965).

n3 See I.R.C. § 6211.

n4 See § 6601(e).

n5 See U.S. SENTENCING GUIDELINES MANUAL § 2T1.1 & App. Notes; *United States v. Clements*, 73 F.3d 1330, 1339 (5th Cir. 1996).

Although the deficiency procedures are separate from the criminal liability provisions, we are persuaded^[**6] that the definition of "tax liability" excluding penalties and interest extends to § 7201. We decline to assume a broader meaning for a "tax deficiency" under § 7201 than under the deficiency proceedings provision, especially when § 7201 attaches criminal liability to the debt owed. The Guidelines merely confirm our conclusion.

[*237] Franklin fails to demonstrate, however, that he owed no tax during the alleged period of evasion. Although his total payments eventually exceeded his tax owed, the IRS collected a significant portion of the paid amounts through seizure. The IRS applied the seized amounts according to its normal procedure, which is first to extinguish the taxpayer's total tax, interest and penalties for the earliest year owed. n6 Franklin cites no authority for the proposition that his requests as to how the IRS should apply his voluntary payments must also have been honored as to the seized amounts. n7 Without having all of the seized amounts first applied to his tax liability, Franklin continued to have a tax deficiency. n8

n6 See Rev. Ruling 73-305, 1973-2 C.B. 43, amended by Rev. Ruling 79-284, 1979-2 C.B. 83.

[**7]

n7 We are unpersuaded that Franklin had such a right under the Due Process Clause of the Constitution.

n8 Even if successful, this argument would affect only the I.R.C. § 7201 conviction and not the convictions based on conspiracy under 18 U.S.C. § 381. The latter provision prohibits the defrauding of the United States, not just the evasion of taxes.

The defendants also argue that the indictments under 18 U.S.C. § 371 impermissibly varied from the proof presented at trial. Section 371 has two prongs: it prohibits a conspiracy to commit an offense against the

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United States, or one to defraud the United States. The first prong refers to specific offenses criminalized elsewhere in the federal code; the second stands independently. The government charged the defendants with conspiracy to defraud. Franklin argues that the defrauding indictment was impermissible because the alleged conduct could have been charged as a specific offense: concealing income or assets from the IRS.

Franklin relies on *United States v. Minarik*, which held that the government ⁿ⁸ must proceed under the more specific clause of § 371 if it applies. ⁿ⁹ *Minarik*, however, has since been limited: it now applies only when the taxpayer's duties are technical, the violation was too isolated to comprise a "conspiracy to defraud," and the defendant receives no specific notice of the crimes charged. ⁿ¹⁰ Here, the conduct was not a mere technical violation of the tax code, the allegations went beyond a single incident of violation, and the indictment, which exhaustively set forth the government's allegations, gave specific notice of the crimes charged.

ⁿ⁹ 875 F.2d 1186, 1193-94 (6th Cir. 1989).

ⁿ¹⁰ See *United States v. Khalife*, 106 F.3d 1300, 1304-06 (6th Cir. 1997). Other courts also follow this rule. See *United States v. Goulding*, 26 F.3d 656, 663 (7th Cir. 1994); *United States v. Notch*, 939 F.2d 895, 901 (10th Cir. 1991).

Finally, the three defendants seek a motion for new trial based on Haggard's post-trial attempts to withdrawⁿ⁹ her plea. ⁿ¹¹ Haggard told several individuals that she believed she was not guilty of conspiracy to defraud the IRS but had been pressured into pleading to avoid a more severe penalty regarding the Medicaid fraud. Because Haggard has never denied the truthfulness of her testimony regarding the three other defendants, however, her assertion of her own innocence is immaterial to the other three convictions. The denial of a new trial was not an abuse of discretion.

ⁿ¹¹ The defendants concede that their Singleton

argument regarding Haggard's testimony is foreclosed by *United States v. Webster*, 162 F.3d 308 (5th Cir. 1998).

III

Franklin and Annette each challenge the sufficiency of the evidence to support the jury verdicts. To establish a conspiracy under 18 U.S.C. § 371, the government must prove (1) an agreement (2) to commit a crime and (3) an overt act committed by one of the conspirators in ⁿ¹² furtherance of the agreement. ⁿ¹² A conviction under I.R.C. § 7201 requiresⁿ¹⁰ a showing of willfulness, a tax deficiency, and an affirmative act constituting evasion. ⁿ¹³

ⁿ¹² See *United States v. Gray*, 96 F.3d 769, 772-73 (5th Cir. 1996).

ⁿ¹³ See *Sansone*, 380 U.S. at 351.

There was sufficient evidence to support Franklin's and Annette's convictions. Key evidence included Haggard's testimony regarding the delivery of the cash. While Annette's purchase of the home could have been bona fide, even if she accepted money from Franklin for the house, the manner of payment, including the bag of cash and Franklin's comments, gave rise to an inference of illegal activity. In addition, Annette's claims that she wanted the house to be hers alone are contradicted by Franklin's funding of the down payment. The jury could reasonably have inferred from this account that Franklin and Annette conspired to hide assets from the IRS, and that Franklin thus attempted to evade the payment of his tax deficiency.

IV

Barger challenges the sufficiency of the evidence againstⁿ¹¹ him, as well as his sentence. He argues that there is insufficient evidence of his involvement in

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the conspiracy because his assistance with the purchase of the home was innocent. Barger further argues that there was insufficient evidence regarding his false statement conviction. To establish a violation of 18 U.S.C. § 1001(a)(3), the government must show a statement that is false and material and made knowingly and willfully. n14

n14 See *United States v. Puente*, 982 F.2d 156, 158 (5th Cir. 1993).

We find support for both counts of Barger's conviction. On the amended Offer in Compromise form, he omitted any reference to Franklin's possible ownership interest in the home and stated that the Wrights were renting their residence because they could not make house payments. Barger's involvement with the home purchase was sufficient to infer that he knew that some of the down payment might be Franklin's funds, thus requiring him to list the home as potential community property,[**12] and that he knew that the Wrights were able to make payments on a house. His involvement also provides sufficient evidence to support the conspiracy conviction. His reproach to Haggard after she had deposited the money indicated his intimate knowledge with the details of the transaction.

Barger raises two challenges to his sentence. He argues that the district court clearly erred in applying a two-level enhancement for the use of a special skill and that it erred in failing to recognize that it could shorten Barger's sentence based on sentencing disparities.

The district court found that Barger's special skills as a Certified Public Accountant and tax attorney were essential to the evasion scheme. While Barger's contribution to the scheme was not particularly sophisticated, part of it did involve his preparation of the Offer in Compromise and other legal documents. Because this use of special skills did further the conspiracy, it was not clearly erroneous for the district court to apply the enhancement.

Barger argues for a downward departure based on the sentencing disparity between Franklin, the taxpayer, and Barger, who played a much more peripheral role and did

not profit from[**13] the crime. n15 In *Koon v. United States*, the Supreme Court held that departure factors should normally not be ruled out on a categorical basis and that courts may depart if the case is outside the Guidelines' heartland. n16 [*239] After the Seventh Circuit categorically denied departures based on discrepancies among co-defendants' sentences, the Supreme Court remanded the case for reconsideration in light of *Koon*. n17

n15 Franklin will serve his time in a halfway house. With an 18-month sentence, Barger is ineligible for the halfway program.

n16 See 518 U.S. 81, 116 S. Ct. 2035, 2051, 135 L. Ed. 2d 392 (1996).

n17 See *United States v. Meza*, 127 F.3d 545, 547-48 (7th Cir. 1997).

This court may review a district court's refusal to grant a downward departure only if the district court mistakenly concluded that the Guidelines did not permit the departure. n18 From our review of the sentencing transcript, it is evident that the district court was troubled by the discrepancy in sentences between Franklin[**14] and Barger. The district court concluded, "I still don't like how [Barger] can be assessed more time. And I'm already giving him time for the attorney role, but I find no - I don't have a basis here to depart, though." Although this candid comment was doubtless not intended to be a full explication of the court's rationale, the court appears to have believed that the discrepancy could not be a basis for a downward departure. We remand to the district court for re-sentencing.

n18 See *United States v. Palmer*, 122 F.3d 215, 222 (5th Cir. 1997).

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We find no legal grounds warranting reversal of any of the convictions: Franklin had a tax deficiency for purposes of I.R.C. § 7201; the indictment was proper; and Haggard's recantation is not material to any of the defendants' convictions. There was sufficient evidence to convict the Wrights and Barger of conspiracy to defraud, Franklin of evasion, and Barger of making false statements. The district court did not clearly err in

applying the special skill [**15] enhancement to Barger's sentence. As it appears that the district court believed that the Sentencing Guidelines did not permit a downward departure based on discrepancies in sentences among co-defendants, we REMAND for the re-sentencing of Barger.

AFFIRMED AS TO FRANKLIN WRIGHT AND ANNETTE WRIGHT; REMANDED FOR THE RE-SENTENCING OF ROBERT BARGER.