146 T.C. 84
United States Tax Court.

WHISTLEBLOWER 22716–13W, Petitioner
v.
COMMISSIONER OF INTERNAL
REVENUE, Respondent

Docket No. 22716–13W
|
Filed March 14, 2016

Synopsis

Background: After IRS collected multi-million-dollar civil penalty from two Swiss bankers for failing to file Form TD F 90–22.1, Report of Foreign Bank and Financial Accounts (Foreign Bank Account Report or FBAR), whistleblower applied for nondiscretionary award related to his assistance during criminal investigation of bankers. IRS moved for summary judgment.

[Holding:] The Tax Court, Lauber, J., held that term "additional amounts," as used in statutory provision establishing threshold collected amount for nondiscretionary awards did not include FBAR civil penalty.

Decision for IRS.

Attorneys and Law Firms

Robert F. Katzburg and William M. Sharp, for petitioner.[*]

Ashley M. Bender and John T. Arthur, for respondent.

P filed Form 211, Application for Award for Original Information, with the IRS Whistleblower Office with respect to TP1. By guilty plea, TP1 agreed to pay an FBAR civil penalty substantially in excess of $2,000,000 and a small amount of restitution, reflecting unpaid Federal income tax on income derived from Swiss bank accounts.

A whistleblower is eligible for a nondiscretionary award under I.R.C. sec. 7623(b) only "if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." I.R.C. sec. 7623(b)(5)(B). FBAR civil penalties are imposed and collected under 31 U.S.C. sec. 5321 (2006), not under the Internal Revenue Code. R contends that FBAR payments do not constitute "additional amounts" for purposes of ascertaining whether the $2,000,000 threshold has been met.

1. *Held:* The term "additional amounts" as used in I.R.C. sec. 7623(b)(5)(B) means the civil penalties set forth in c. 68, subch. A, of the Internal Revenue Code, captioned "Additions to the Tax and Additional Amounts."

2. *Held, further,* FBAR civil penalties are not "additional amounts" within the meaning of I.R.C. sec. 7623(b)(5)(B), and they are not "assessed, collected, * * * [or] paid in the same manner as taxes." I.R.C. sec. 6665(a)(1). FBAR payments must therefore be excluded in determining whether the $2,000,000 "amount in dispute" requirement has been satisfied.

OPINION

LAUBER, Judge:

***85** This whistleblower award case is before the Court on a motion for summary judgment filed by the Internal Revenue Service (IRS or respondent). A whistleblower is eligible for a nondiscretionary award under section 7623(b) only "if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." Sec. 7623(b)(5)(B).[1] The IRS collected from the taxpayer who is the subject of this whistleblower claim a multi-million-dollar civil penalty for failing to file Form TD F 90–22.1, Report of Foreign Bank and Financial Accounts (Foreign Bank Account Report or FBAR), under 31 U.S.C. sec. 5321(a) (2006). The question we must decide is whether this FBAR payment constitutes an "additional amount" for purposes of ascertaining whether the $2,000,000 threshold has been met. We hold that it does not. We will accordingly grant respondent's motion for summary judgment.

Background

Petitioner in 2010 filed Form 211, Application for Award for Original Information, with the IRS Whistleblower Office (Office).[2] On the application he asserted that he was cooperating with the Department of Justice and the IRS Criminal Investigation Division in connection with the ongoing investigation of two Swiss bankers, Martin Lack and Renzo Gadola. Petitioner alleged that his cooperation with those ***86** agencies had led to, and would lead to more, information about these bankers' involvement in tax evasion by U.S. persons having undeclared offshore financial accounts. The Office notified petitioner that it had received the Form 211 and had assigned unique claim numbers to his claims regarding the two bankers.

On August 23, 2011, petitioner filed with the Office a third claim for an award, which is the subject of the present controversy. Petitioner filed this claim after learning that Taxpayer 1 had agreed to pay a substantial penalty in conjunction with a guilty plea for filing a false tax return. Taxpayer 1 admitted that Gadola had helped him open Swiss bank accounts to conceal his income and assets from U.S. authorities. By the guilty plea, Taxpayer 1 agreed to pay an FBAR civil penalty substantially in excess of $2,000,000 and a small amount of restitution, reflecting unpaid Federal income tax on income derived from the Swiss bank accounts. Petitioner claimed entitlement to an award based upon the aggregate amount paid by Taxpayer 1, given petitioner's alleged involvement in Gadola's arrest, which allegedly led to Taxpayer 1's arrest.

During its review of the Taxpayer 1 claim, the Office informed petitioner that it had received a legal opinion from the IRS Office of Chief Counsel concluding that FBAR penalty payments, because they are made pursuant to Title 31 rather than Title 26 of the U.S. Code, are not “collected proceeds” eligible for a non-discretionary award under section 7623(b)(1). *See* Scope of Awards Payable Under I.R.C. Section 7623, PMTA 2012–10. Viewing this as a de facto denial of his Taxpayer 1 claim, petitioner sought immediate review in this Court. We granted respondent's motion to dismiss that case for lack of jurisdiction, concluding that the Office had not made, as of the time petitioner filed that petition, a “determination regarding an award” sufficient to confer jurisdiction on this Court. *See Whistleblower 22231–12W v. Commissioner,* T.C. Memo.2014–157.

On September 6, 2013, the Office issued petitioner a final determination letter informing him that his Taxpayer 1 claim had been denied. The letter stated two grounds for the denial: (1) the Government had obtained complete information about Taxpayer 1's offshore accounts directly from the Swiss bank, without any assistance from petitioner; and (2) ***87** petitioner in any event could not qualify for a nondiscretionary award because his claim did not meet the $2,000,000 threshold. Believing that FBAR payments do not constitute “tax, penalties, interest, additions to tax, * * * [or] additional amounts” within the meaning of section 7623(b)(5)(B), the Office concluded that the amount in dispute with respect to the Taxpayer 1 claim, resolving all doubts in petitioner's favor, could not exceed $50,000.

Petitioner timely petitioned this Court for review of this determination denying his award. Respondent filed an answer raising the section 7623(b)(5)(B) dollar threshold as an affirmative defense.[3] On May 29, 2015, respondent moved for summary judgment on the basis of petitioner's alleged failure to satisfy section 7623(b)(5)(B). The Court has received thorough briefing from the parties on this subject, as well as a brief amicus curiae from the National Whistleblowers Center (NWC), to which both parties have responded.

Discussion

I. *Standard of Review*

[1] The purpose of summary judgment is to expedite litigation and avoid unnecessary and expensive trials. *See FPL Grp., Inc. & Subs. v. Commissioner,* 116 T.C. 73, 74 (2001). We may grant summary judgment when there is no genuine dispute concerning any material fact and a decision may be rendered as a matter of law. Rule 121(b); *Elec. Arts, Inc. v. Commissioner,* 118 T.C. 226, 238 (2002). The parties agree on all questions of fact affecting the application of section 7623(b)(5)(B), and the proper interpretation of that provision presents a pure question of law. We conclude that the question ***88** presented by respondent's motion is appropriate for summary adjudication.[4]

II. *Governing Statutory Framework*

A. *The Whistleblower Statute*

[2] The IRS has long had authority to pay awards to persons, now called "whistleblowers," who provide information leading to the recovery of unpaid taxes. The Code now provides for two types of whistleblower awards: discretionary and non-discretionary. The former derive from legislation enacted in 1867, which authorized the Secretary "to pay such sums * * * as may in his judgment be deemed necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same." Act of Mar. 2, 1867, ch. 169, sec. 7, 14 Stat. at 473. This provision, reenacted without much change as section 7623(a), authorizes the IRS to pay such sums as it "deems necessary" and mandates that such payments "shall be paid from the proceeds of amounts collected." The IRS' determinations with respect to these discretionary awards are not subject to judicial review. *See, e.g., DaCosta v. United States,* 82 Fed. Cl. 549 (2008); *Conner v. United States,* 76 Fed. Cl. 86 (2007); *Destefano v. United States,* 52 Fed. Cl. 291 (2002); *see also Lippolis v. Commissioner,* 143 T.C. 393, 399 (2014); *Whistleblower 11332–13W v. Commissioner,* 142 T.C. 396, 400 (2014).

The second type of whistleblower award, set forth in section 7623(b), was introduced by the Tax Relief and Health Care Act of 2006, Pub.L. No. 109–432, sec. 406, 120 Stat. at 2958–2960. Section 7623(b) provides for nondiscretionary (i.e., mandatory) awards if specified dollar thresholds and other requirements are met. Under section 7623(b)(5), a ***89** whistleblower is eligible for a nondiscretionary award with respect to any action—

> (A) against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds $200,000 for any taxable year subject to such action, and
>
> (B) if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000.

[3] If these monetary thresholds are met and the Government recovers "collected proceeds" attributable to the whistleblower's information, the whistleblower 15 percent but not more than 30 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions) or from any settlement in response to such action." Sec. 7623(b)(1); *see Cooper v. Commissioner,* 136 T.C. 597, 600 (2011). If a claim does not satisfy the dollar thresholds of section 7623(b)(5), the IRS retains discretion to pay an award under subsection (a), but it is not required to pay an award under subsection (b).

B. *FBAR Civil Penalties*

Congress passed the Bank Secrecy Act (BSA), 31 U.S.C. secs. 5311–5332 (2006), to advance a variety of regulatory and investigative objectives, including detection and prosecution of criminal activity and enforcement of laws under the jurisdiction of the Department of the Treasury. *See id.* sec. 5311; *United States v. Simonelli,* 614 F.Supp.2d 241, 241 (D.Conn.2008). The BSA requires (among other things) that U.S. persons who have interests in (or authority over) bank or financial accounts in foreign countries must report information about those accounts to the Federal Government. An FBAR is the required vehicle for making this disclosure. As relevant here, U.S. persons who hold one or more foreign financial accounts with an aggregate value exceeding $10,000 must file an FBAR with the Commissioner reporting the existence and value of the accounts. *See* 31 U.S.C. sec. 5314(a); 31 C.F.R. secs. 1010.350, 1010.306(c) (2011).

While "the obligation to file an FBAR arises under Title 31, individual taxpayers subject to the FBAR reporting requirements are alerted to this requirement in the preparation of annual Federal income tax returns." Staff of J. Comm. ***90** on Taxation, Technical Explanation of H.R. 4213, JCX–60–09, at 144 (Dec. 8, 2009). The Form 1040, U.S. Individual Income Tax Return, currently includes at the bottom of Schedule B, Interest and Ordinary Dividends, the following question: "At any time during * * * [the taxable year] did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?" A taxpayer who checks the "yes" box is directed to instructions concerning his obligation "to file * * * Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority." [5]

The BSA requires covered persons to file the FBAR with the Department of the Treasury, but not to remit money or property. The FBAR form specifically instructs filers:

"Do NOT file with your Federal Tax Return." As relevant here, the BSA imposes no pecuniary burden on covered persons, only the requirement that they file an FBAR.

A person who fails to file a required FBAR may be assessed a civil monetary penalty. 31 U.S.C. sec. 5321(a)(5)(A). The amount of the penalty is capped at $10,000 unless the failure was willful. *See id.* subparas. (B)(i), (C). If the failure was willful, the maximum penalty increases to $100,000 or half the value of the foreign bank account at the time of the violation, whichever is greater. *Ibid.* In either case, whether to impose the penalty and the amount of the penalty are committed to the discretion of the Secretary. *See id.* subpara. (A) ("The Secretary of the Treasury may impose a civil money penalty [.]"); *id.* subpara. (B) ("the amount of any civil penalty * * * shall not exceed" the statutory ceiling).

The FBAR civil penalty may be assessed "at any time before the end of the six-year period beginning on the date of the transaction with respect to which the penalty is assessed." 31 U.S.C. sec. 5321(b)(1). The Government may commence a civil action to recover an assessed FBAR penalty ***91** at any time before the end of the two-year period beginning on the later of (a) the date the penalty was assessed or (b) the date any judgment becomes final in a related criminal action. *See id.* para. (2); *United States v. Williams,* 489 Fed.Appx. 655 (4th Cir.2012); *Moore v. United States*, 2015 WL 1510007 (W.D.Wash. Apr. 1, 2015); *United States v. McBride*, 908 F.Supp.2d 1186 (D.Utah 2012).

Authority to enforce BSA requirements, including imposition of FBAR civil penalties, was initially delegated to the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury. FinCEN's overall mission is to collect and analyze information about financial transactions in order to combat money laundering, terrorist financing, and other financial crimes. *See* 31 U.S.C. sec. 5311; *Simonelli,* 614 F.Supp.2d at 241. Through a memorandum of agreement between FinCEN and the IRS, authority to administer the FBAR regime has been redelegated to the Commissioner. *See* 31 C.F.R. sec. 1010.810(g) (2011). The Secretary recommended this redelegation in part because "the FBAR is directed more towards tax evasion, as opposed to money laundering or other financial crimes, that lie at the core mission of FinCEN." FinCEN, Report to Congress in Accordance with Section 361(b) of the USA PATRIOT Act, at 4 (Apr. 24, 2003).

The authority thus delegated to the Commissioner is broad, giving the IRS the power to assess and collect civil penalties for noncompliance with FBAR requirements, investigate possible violations, employ summons power, issue administrative rulings, and take "any other action reasonably necessary" to implement and enforce the FBAR regime. 31 C.F.R. sec. 1010.810(g); *see also* FinCEN, Report to Congress in Accordance with Section 361(b) of the USA PATRIOT Act, at 5 (Apr. 8, 2005) (delegation allows IRS "to create interpretive education outreach materials for the FBAR, revise the form and instructions, examine individuals and other entities, and assess civil penalties for violations").

III. *Analysis*

A. *"Additional Amounts"*

Section 7623(b)(5) makes a whistleblower eligible for a nondiscretionary award only if his claim satisfies two monetary ***92** thresholds. The parties appear to agree that Taxpayer 1's gross income exceeded $200,000. *See* sec. 7623(b)(5)(A). In order to prevail, therefore, petitioner must show that "the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000" with respect to his Taxpayer 1 claim. *See* sec. 7623(b)(5)(B). Petitioner does not contend that FBAR payments constitute "tax," "interest," or "additions to tax," nor does he contend that they are "penalties" under the Internal Revenue Code. The focus of the parties' dispute, and the question we must decide, is whether FBAR payments constitute "additional amounts" within the meaning of section 7623(b)(5)(B). [6]

[4] **[5]** **[6]** In deciding the proper interpretation of "additional amounts" as used in this section, the starting point is the language of the statute. *Greyhound Corp. v. Mt. Hood Stages, Inc.,* 437 U.S. 322, 330 (1978). Where Congress uses a term of art that has acquired an established meaning over a long period, Congress presumably intends that meaning when it uses that term. *See, e.g., Morissette v. United States,* 342 U.S. 246, 263 (1952); *cf. Direct Mktg. Ass'n v. Brohl,* 571 U.S. ——, ——, 135 S.Ct. 1124, 1129–1130 (2015) (applying this principle to define for tax purposes the terms "assessment," "levy," and "collection"); *1836 S St. Tenants Ass'n, Inc. v. Estate of B. Battle,* 965 A.2d 832, 839

(D.C.2009) ("When a legislature borrows common law terms of art in writing legislation, 'it presumably knows and adopts the cluster of ideas that were attached to [the] borrowed word [s].' " (alteration in original) (quoting *1618 Twenty–First St. Tenants' Ass'n v. The Phillips Collection*, 829 A.2d 201, 203 (D.C.2003)). Where the same word or phrase appears multiple times within a ***93** statutory text, it is generally presumed to have the same meaning each place it appears. *See, e.g., Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932) ("Undoubtedly, there is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning."); *Rand v. Commissioner*, 141 T.C. 376, 385 (2013) (same).

The term "additional amounts," when used in a series that also includes the words "tax" and either "additions to tax" or "additions to the tax," appears nearly 40 times in the Internal Revenue Code. [7] Elsewhere in the U.S.Code, the term "additional amount" appears in a series of this sort only twice; in both instances, the provision in which it appears is captioned "Taxes." *See* 22 U.S.C. sec. 1631k(d) (2006) (defining "tax[es]" to include specified taxes "and also any interest, penalty, additional amount, or addition thereto"); 50 U.S.C. sec. 4333 (2006) (same).

"Additional amounts" and "additions to the tax" are terms of art in the Internal Revenue Code. Chapter 68 of the Code is captioned "Additions to the Tax, Additional Amounts, and Assessable Penalties." Subchapter A of chapter 68 is captioned "Additions to the Tax and Additional Amounts." This subchapter includes 13 sections, including the additions to tax for failure timely to file a return or timely pay tax, the accuracy-related penalty under section 6662, and the fraud penalty under section 6663. Section 6665, the last section in this subchapter, is captioned "Applicable Rules." It states that, except as otherwise provided in Title 26, "the additions to the tax, additional amounts, and penalties provided by this chapter shall be * * * assessed, collected, and paid in the same manner as taxes" and that "any reference in this title to 'tax' imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter."

Given this statutory structure, we have repeatedly held that the term "additional amounts" has a technical meaning in the Code, referring specifically to penalties set forth in ***94** chapter 68, subchapter A. For example, in *Bregin v. Commissioner,* 74 T.C. 1097, 1101 (1980), we had to determine whether we had jurisdiction in a deficiency case to consider an IRS claim for an erroneous refund. Under section 6214(a), this Court has jurisdiction "to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency * * * and to determine whether any additional amount, or any addition to the tax should be assessed, if claim therefor is asserted by the Secretary at or before the hearing." The IRS urged that the term "additional amount" be construed broadly enough to include the erroneous refund it sought to recover from the taxpayer.

We disagreed. We noted that "[t]he term 'additional amount' appears in chapter 68 of the Internal Revenue Code of 1954, which relates to 'Additions to the Tax, Additional Amounts, and Assessable Penalties.' " 74 T.C. at 1102–1103. We concluded that the term "additional amounts" as used in chapter 68 means one of the civil penalties referred to in that chapter and "that the same meaning was intended in section 6214(a), especially since it refers to both additional amounts and additions to the tax." *Id.* at 1103. Our review of the legislative history confirmed that the term "additional amounts" as used in section 6214(a) was "intended only to refer to claims for the civil penalties." *Ibid.*

In *Pen Coal Corp. v. Commissioner,* 107 T.C. 249 (1996), we had to decide whether we had jurisdiction to redetermine a corporate taxpayer's liability for interest computed at the increased rate prescribed by section 6621(c). The taxpayer contended that section 6214(a) gave the Court jurisdiction on the theory that "such interest constitutes an 'additional amount' within the meaning of section 6214(a)." *Id.* at 255–256. Relying on our analysis in *Bregin* we rejected this argument, concluding: "Congress used the phrase 'any additional amount, or any addition to the tax' in section 6214(a) to ensure an understanding that this Court's jurisdiction encompasses items that are to be assessed, collected, and paid in the same manner as taxes, including the additions to tax and other additional amounts * * * described in chapter 68." *Id.* at 258; *cf. El v. Commissioner,* 144 T.C. 140, 148 (2015) (holding that the "additional tax" imposed by ***95** section 72(t)(1) is not a "penalty, addition to tax, or additional amount" within the meaning of section 7491(c)).

In *Williams v. Commissioner,* 131 T.C. 54 (2008), we ruled that FBAR penalties do not constitute "additional amounts" for purposes of our deficiency or CDP jurisdiction. The taxpayer there sought redetermination of tax deficiencies for certain years and also asked us to "abate" FBAR penalties allegedly imposed for his failure to disclose Swiss bank accounts. *Id.* at 55. We held that we lacked jurisdiction over the FBAR penalties, noting that they "are authorized in Title 31 ('Money and Finance') of the United States Code, not Title 26 (the Internal Revenue Code)." *Id.* at 56. The taxpayer "d[id] not point to any grant of jurisdiction to this Court that would extend to FBAR penalties," and we found none. *Id.* at 57. We noted that the term "tax" is defined for purposes of our CDP jurisdiction "to include 'additions to the tax, additional amounts, and penalties provided by' " chapter 68. *Id.* at 59 n.6 (quoting section 6665(a)(2)). But "we * * * [were] aware of no statute that would expand 'tax' as used in the lien and levy statutes in Title 26 to include the FBAR penalty of Title 31." *Ibid.*

As these cases show, we have consistently held that "additional amounts," particularly when it appears in a series that also includes "tax" and "additions to tax," is a term of art that refers exclusively to the civil penalties enumerated in chapter 68, subchapter A. "Additional amounts" appears in section 7623(b)(5)(B) in conjunction with "tax" and "additions to tax," and we find no reason to give that term a different meaning in this section than it has elsewhere. In *Williams,* we ruled that an FBAR civil penalty is not an "additional amount" for purposes of our deficiency or CDP jurisdiction. Petitioner has supplied no textual basis, either in the language of the statute or the structure of the Code, for reaching a different conclusion with respect to the whistleblower provision at issue here.

[7] FBAR civil penalties are not among the tax-related penalties enumerated in chapter 68, and they are not "assessed, collected, and paid in the same manner as taxes." Sec. 6665(a)(1); *see Moore,* 2015 WL 1510007, at *8 ("In contrast to well-worn procedures for assessing tax deficiencies, a person searching the Code of Federal Regulations or United States Code for information on the procedure for FBAR penalty ***96** assessment will come up nearly empty-handed."). FBAR penalties are not "additional amounts" within the meaning of section 7623(b)(5)(B), and they must be excluded in determining whether the $2,000,000 "amount in dispute" requirement has been satisfied.[8]

B. *Petitioner's Contentions*

1. *"Structural" Arguments*

Petitioner and amicus curiae NWC argue that the term "additional amounts" as used in section 7623(b)(5)(B) means, in essence, "other sums of money." But they point to no other Code section in which "additional amounts" has this broad and virtually limitless meaning. And they offer no convincing rebuttal to the canons of construction dictating that terms of art be given a consistent meaning in a statutory text and that a technical word or phrase is presumed to have the same meaning each place it appears. Rather than focus on the subparagraph at issue, petitioner and NWC emphasize language appearing elsewhere in the statute, urging that these broader meanings be imported into section 7623(b)(5)(B). But they provide no textual support for doing this, only vague appeals to the statute's "overall structure."

Petitioner and NWC note that section 7623(a) authorizes the Secretary to pay such sums as he deems necessary, from the "proceeds of amounts collected," to detect persons guilty of violating the tax laws "or conniving at the same." FBAR civil penalties, they urge, are reasonably embraced within "proceeds of amounts collected" from persons "conniving at" such violations. Indeed, the record in this case indicates that ***97** the Office, prior to 2009, did pay discretionary awards under section 7623(a) based on FBAR recoveries, and nothing in this Opinion would prevent the Secretary from doing so in the future. The question at hand is whether petitioner is eligible for a nondiscretionary award under section 7623(b), and that depends on whether "the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." The broader language of section 7623(a) provides no justification for giving the term "additional amounts" in section 7623(b)(5)(B) a meaning that it has nowhere else in the Code.

Petitioner next observes that section 7623(b)(1) computes nondiscretionary awards as a percentage of "the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action." Congress' use of the word "including" shows that the ensuing list (which notably omits the word "tax") is not exhaustive. *See* sec. 7701(c); *Dunaway v. Commissioner,* 124 T.C. 80, 91–92 (2005). And the Supreme Court observed long ago that the word "proceeds" is "of great generality." *Phelps v. Harris,* 101 U.S. (11 Otto) 370, 380 (1879). Petitioner urges that the term "collected proceeds" is broad enough to include FBAR penalties collected by the IRS, even though they are paid under Title 31 and even if they do not constitute tax, penalties, interest, additions to tax, or additional amounts under Title 26.

While this argument is not without force, we do not see how it affects the proper textual analysis of section 7623(b)(5)(B). Congress could have employed, but did not employ, the term "collected proceeds" when drafting the $2,000,000 monetary threshold. And it did not use the word "including." Instead, Congress explicitly and unambiguously provided that a whistleblower is eligible for a non-discretionary award only "if the tax, penalties, interest, additions to tax, and additional amounts in dispute" exceed $2,000,000.

[8] "[W]hen the legislature uses certain language in one part of the statute and different language in another, the court assumes different meanings were intended." *Sosa v. Alvarez–Machain,* 542 U.S. 692, 711 n.9 (2004) (quoting 2A N. Singer, Statutes and Statutory Construction, sec. 46:06, at 194 (6th rev. ed.2000)). We have no occasion in this case to decide ***98** whether "collected proceeds" as used in section 7623(b)(1) is broad enough to include civil penalties paid for violation of Title 31. *See supra* note 6. Even if that question were answered in the affirmative, petitioner could not qualify for a nondiscretionary award computed on that broader base unless he first satisfied the section 7623(b)(5)(B) monetary threshold. He cannot do this because FBAR civil penalties do not constitute "additional amounts" within the meaning of that section.

[9] As petitioner notes, courts may rely on a statute's structure as an aid to interpreting its specific terms. *See generally Abramski v. United States,* 573 U.S. ——, ——, 134 S.Ct. 2259, 2267 (2014). But reliance on context and structure in statutory interpretation is a "subtle business, calling for great wariness lest what professes to be mere rendering becomes creation and attempted interpretation of legislation becomes legislation itself." *Palmer v. Massachusetts,* 308 U.S. 79, 83 (1939); *Yari v. Commissioner,* 143 T.C. 157, 165 n.5 (2014) ("[T]he process of divining the legislative intent underlying a statute's * * * structure, while subject to canons of construction and well-established methodologies, is hardly an exact science."). In the absence of specific statutory language linking the potentially broader terms of subsections (a) and (b)(1) to the affirmative defense of subsection (b)(5)(B), we are not at liberty to give "additional amounts"—a term of art with a long-established meaning—a meaning that it has nowhere else in the Internal Revenue Code. [9]

2. *Policy Arguments*

Because FBAR civil penalties are "administered by the IRS, are reported alongside income tax returns, and have a tax-related purpose," petitioner contends that "they are, in effect, 'internal revenue laws,' and should be treated as such when construing Section 7623's scope." Given the IRS' important role in FBAR administration, at least one court has ***99** found that the Internal Revenue Code and the FBAR provisions of Title 31 are "related statutes." *Hom v. United States,* 2013 WL 5442960 (N.D.Cal. Sept. 30, 2013). According to petitioner, IRS closing agreements settling offshore voluntary disclosure cases have provided that, "in lieu of" an FBAR penalty, the IRS "may assess under Title 26 of the United States Code a miscellaneous penalty" in an agreed-upon amount. Given the close connections between the FBAR regime and tax enforcement, petitioner and NWC urge that treating FBAR penalties the same as taxes is a sensible policy.

The failure to treat FBAR penalties as taxes, petitioner continues, could undercut the effectiveness of the whistleblower law. At a time when undisclosed offshore accounts constitute a major form of tax evasion, FBAR penalties, which can range as high as 50% of the offshore account balance annually, may often dwarf the income tax liabilities generated by the earnings from that account. If FBAR penalties do not count toward the $2,000,000 monetary threshold, whistleblowers will allegedly have little incentive to blow the whistle on these schemes, frustrating Congress' intent in enacting this law.

Petitioner notes that the IRS and the Department of Justice have great discretion in negotiating settlements and plea agreements. If a case involving undisclosed offshore accounts also involves large potential income tax liabilities, the Government may elect to compromise the latter, effectively directing most of the proceeds into the FBAR penalty bucket. If FBAR proceeds do not count toward the $2,000,000 monetary threshold, petitioner fears that the Government could unilaterally make deserving whistleblowers ineligible for section 7623(b) awards by the manner in which it settles cases. [10]

[10] ***100** To the extent these concerns have force, they are directed to the wrong forum. There are indisputably strong practical connections between the FBAR regime and tax enforcement; that is presumably what persuaded the Secretary to redelegate FBAR administrative authority to the IRS. But our task is to decide whether FBAR penalties constitute "tax, penalties, interest, additions to tax, * * * [or] additional amounts" within the meaning of section 7623(b)(5)(B). Departmental delegation orders and the practical issues petitioner raises shed no meaningful light on the proper interpretation of this text. The IRS has broad discretion in deciding whether to pursue a taxpayer identified by a whistleblower and in determining how such cases shall be resolved. We lack jurisdiction to address these matters. *Cohen v. Commissioner,* 139 T.C. 299, 302 (2012), *aff'd,* 550 Fed.Appx. 10 (D.C.Cir.2014); *see Lichtman v. United States,* 316 Fed.Appx. 116, 119 (3d Cir.2008) ("[T]he IRS's decision to investigate or not investigate a particular taxpayer's case is within its discretion.").

Petitioner and NWC may well be right that the statute would offer stronger incentives to whistleblowers if FBAR civil penalties were treated like tax liabilities for purposes of determining eligibility for nondiscretionary awards under section 7623(b)(5)(B). And in that event the whistleblower law might more effectively advance the objectives that Congress envisioned for it. But if this is a gap in the statute, it is a gap that only Congress, and not this Court, can fill.

To reflect the foregoing,

An appropriate order and decision will be entered for respondent.

All Citations

146 T.C. No. 6, 146 T.C. 84, Tax Ct. Rep. (CCH) 60,552, Tax Ct. Rep. Dec. (RIA) 146.6

Footnotes

* Brief amicus curiae was filed by *Dean Zerbe* and *Stephen M. Kohn* as attorneys for the National Whistleblowers Center.

[1] All statutory references are to the Internal Revenue Code (Code or Title 26) in effect at the relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure. All dollar amounts are rounded to the nearest dollar.

[2] The Court granted petitioner's motion to proceed anonymously. In an effort to preserve petitioner's anonymity, the parties in their briefs and other filings refer to the U.S. taxpayer who is the subject of the relevant whistleblower claim as "Taxpayer 1." We will employ the same convention in this Opinion. When referring to Taxpayer 1 and to petitioner, we will employ the masculine pronoun and possessive adjective without intending to create any implication concerning the gender of either person.

[3] Respondent initially moved to dismiss this case for lack of jurisdiction, contending that the section 7623(b)(5)(B) "amount in dispute" requirement was jurisdictional. This Court subsequently rejected that argument in *Lippolis v. Commissioner,* 143 T.C. 393, 397 (2014), holding that section 7623(b)(5)(B) affords the IRS only an affirmative defense. On April 6, 2015, respondent moved to withdraw his motion to dismiss for lack of jurisdiction, citing this Court's holding in *Lippolis,* and we granted that motion. Respondent filed his answer on April 6, 2015, raising as an affirmative defense that petitioner's claim does not satisfy the $2,000,000 requirement.

[4] Respondent has not sought summary judgment on his alternative basis for denying petitioner's claim, namely, that petitioner's information did not "substantially contribute to" the recovery from Taxpayer 1. *See* sec. 7623(b)(1); *Whistleblower One 10683–13W,* 145 T.C. ——, —— (slip op. at 5) (Sept. 16, 2015) (noting that whistleblowers are entitled to an award only if there was a collection of proceeds "attributable in some way to the information that * * * [they] provided"). Because we rule for respondent under section 7623(b)(5)(B), we need not address his alternative basis for denial, which appears to raise at least one dispute of material fact.

[5] During the period relevant to this case, individuals were required to make FBAR reports on TD F 90–22.1, a Department of the Treasury form. On September 30, 2013, the Department's Financial Crimes Enforcement Network (FinCEN) announced that FBAR reports would thenceforth be made on FinCEN Report 114. Form 1040, Schedule B, now refers taxpayers to the latter form.

[6] Respondent also advances the broader contention that whistleblower awards are payable only for recoveries under "the internal revenue laws." *See* sec. 7623(a)(2). Because FBAR penalties are paid under Title 31, respondent argues that

they are not “collected proceeds” under section 7623(b)(1). Since we rule for respondent under the affirmative defense in section 7623(b)(5)(B), we need not address this alternative contention. We note that the IRS Chief Counsel opinion issued during the consideration of petitioner's case acknowledges one type of payment made outside of Title 26 that does constitute “collected proceeds.” That opinion notes that “[t]he IRS assesses and collects in the same manner as tax any criminal restitution ordered” in a criminal case, and that “any such restitution should be included as ‘collected proceeds' for purposes of section 7623, even though ordered pursuant to Title 18.” *See supra* p. 4.

[7] Such appearances include sections, 692(a)(2), 860, 3121(l)(1)(A), 4961(a), 6155(a), 6159(c)(1), 6201(a), 6202, 6214, 6221, 6226, 6229, 6230, 6242, 6247(c), 6321, 6324A(a), 6404, 6423(d)(2), 6503(f)(2)(B), 6601(e)(2), 6602, 6665, 6751, 6851(a)(1), 6852(a)(1)(B), 6861(a), 6862, 6871, 6902(b), 7122, 7463(e), 7485, 7491, 7508, 7508A, and 7522(a).

[8] Section 7623(b)(1) provides for nondiscretionary awards if the Secretary proceeds with an “action described in subsection (a),” and subsection (a) authorizes payment only “where such expenses are not otherwise provided for by law.” Noting that 31 U.S.C. sec. 5323(a) authorizes the Secretary to pay rewards to persons who provide information leading to recovery of FBAR penalties, respondent urges that FBAR informant awards are “otherwise provided for by law.” Petitioner disagrees, noting that rewards under 31 U.S.C. sec. 5323(a) are discretionary whereas rewards under section 7623(b)(1) would be mandatory. Because we rule for respondent under section 7623(b)(5), we need not address this alternative theory. Respondent also contends that FBAR recoveries, because deposited into the Department of the Treasury's General Fund, are not “available for” whistleblower awards. *See* sec. 7623(a). We need not address this argument either.

[9] Congress did create links between other parts of section 7623. For example, Congress explicitly linked subsection (b)(1) to subsection (a), mandating an award “[i]f the Secretary proceeds with any administrative or judicial action described in subsection (a).” Congress clearly knows how to create such links when it intends to do so. For whatever reason, it did not create links of the sort petitioner desires between subsection (b)(5) and the rest of the statute.

[10] As noted earlier, petitioner contends that the IRS often settles offshore voluntary disclosure cases by requiring the taxpayer, in lieu of paying an FBAR penalty, to pay “under Title 26 of the United States Code a miscellaneous penalty” in an agreed-upon amount. *See supra* p. 24; *see also* Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014, Q & A 7. If the penalties thus paid constitute “penalties” within the meaning of section 7623(b)(5)(B)—a point the parties have not addressed because Taxpayer 1 did not settle his case under those procedures—this manner of settling cases, far from hurting whistleblowers, would seem to help them.

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908 F.Supp.2d 1186
United States District Court, D. Utah, Central Division.

UNITED STATES of America, Plaintiff,
v.
Jon McBRIDE, Defendant.

Case No. 2:09–cv–378 DN.
|
Nov. 8, 2012.

Synopsis

Background: Government brought action to enforce civil penalty assessed against taxpayer based on his failure to report his interest in four foreign bank accounts during two tax years.

Holdings: Following a bench trial, the District Court, David Nuffer, J., held that:

[1] taxpayer had financial interests in four foreign financial accounts in foreign countries;

[2] taxpayer's failure to comply with FBAR (Report of Foreign Bank and Financial Accounts) reporting requirements was willful; and

[3] amounts of civil penalties assessed were proper.

Judgment for United States.

Attorneys and Law Firms

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Philip J. Hardy, Hardy & Hardy PC, Salt Lake City, UT, for Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER

DAVID NUFFER, District Judge.

Plaintiff United States of America brought this case to collect a civil penalty assessed to Defendant Jon McBride for his alleged willful failure to report his interest in four foreign bank accounts during tax years 2000 and 2001 as required under 31 U.S.C. § 5314 and related regulations. The matter was tried to the bench on May 21–22, 2012, and the court took the matter under advisement. The parties have submitted competing proposals as to the facts and legal conclusions that should be reached.[1] Having carefully considered the parties' proposals, along with the record of the hearing and applicable law, the court enters the following findings of fact and conclusions of law.

FINDINGS OF FACT

A. McBride Was the Co–Owner of The Clip Company.

1. Jon McBride is a citizen of the United States, was a citizen of the United States in 2000 and 2001, and has been since at least 1999. (Tr. 310:12–15, May 22, 2012).

2. McBride and Scott Newell ("Newell") were equal partners in The Clip Company, LLC (the "Clip Company"), a company which sold belt clip accessories for cellular telephones. (Tr. 315:12–317:7, May 22, 2012).

***1189** 3. The Clip Company was in continuous operation from 1994 to 2008. (Tr. 268:10–12, May 22, 2012).

4. McBride was responsible for the financial operations of the Clip Company, including keeping accounting records, and preparing quarterly and yearly reports for the Clip Company. (Tr. 268:13–269:7, May 22, 2012).

5. The only individual other than McBride involved in the financial operations of the Clip Company was the Clip Company's accountant, Craig Stayner. (Tr: 268:25–269:7, May 22, 2012).

6. The Clip Company utilized a manufacturer located in Taiwan, Piao Shang, Ltd., ("Piao Shang"), for the production of its inventory. (Tr. 118:17–119:22); (Tr. 318:15–22, May 22, 2012).

7. Beginning in approximately 1999, the Clip Company entered into several lucrative contracts for the sale of its

products to retailers including Ericsson, AT & T, Best Buy and Motorola. (Tr. 269:8–11, May 22, 2012).

8. As a result of the Clip Company's new contracts, McBride knew that the Clip Company was about to obtain a large increase in revenue. (Tr. 269:12–15, May 22, 2012).

9. In anticipation of this increase in revenue, McBride sought a way to reduce or defer the income taxes that would normally be paid on this revenue. (Tr. 269:16–20, May 22, 2012).

B. Merrill Scott and Associates Was a Financial Management Firm that Employed Strategies Designed to Disguise the Ownership of Its Clients' Assets.

10. Merrill Scott and Associates ("Merrill Scott") held itself out as a financial management firm that employed strategies that would allow its clients to avoid or defer the recognition of income for tax purposes and to shield their assets from the reach of creditors by utilizing, amongst other financial strategies and instruments, foreign variable annuities and foreign financial accounts. *See* (Pl. Exs. 10, 11, 12, 13, 81); (Pl. Ex. 118, Ackerson Dep. Tr. 15:7–14; 15:21–16:13; 25:24–26:10; 69:24–70:13).

11. In reality, Merrill Scott's strategies were designed to allow its clients to avoid reporting income and their ownership of assets by having the clients' assets held by nominees holding the legal title of shell corporations and foreign bank accounts. *See* (Pl. Exs. 10, 11, 12, 13, 81); (Pl. Ex. 118, Ackerson Dep. Tr. 15:7–14; 15:21–16:13; 25:24–26:10; 69:24–70:13); (Tr. 36:24–37:21, May 21, 2012).

12. Among other strategies, Merrill Scott and its clients purchased foreign variable annuities, set up International Business Corporations ("IBCs") that were incorporated in foreign countries for the benefit of individual clients, established bank and securities accounts in foreign countries, and created foreign trusts and other vehicles that would hold assets for the benefit of Merrill Scott's clients. *See* (Pl. Exs. 10, 11, 12, 13, 81); (Pl. Ex. 118, Ackerson Dep. Tr. 15:7–14; 15:21–16:13; 25:24–26:10; 69:24–70:13).

13. In 2002, a complaint was filed against Merrill Scott and its principals by the Securities and Exchange Commission for various securities violations, including various Securities Act violations and fraud. *See* (Ex. 81); (Tr. 69:20–70:23, May 21, 2012); (Tr. 347:7–14, May 22, 2012).

C. McBride Retained the Services of Merrill Scott in Order to Avoid or Defer Taxation.

14. In 1999, after seeing an advertisement for Merrill Scott, McBride contacted Merrill Scott in order to see if Merrill Scott could provide financial services that ***1190** would result in avoiding or deferring the recognition of $2 million in income that McBride expected to receive. (Tr. 39:21–41:1, May 21, 2012); (Tr. 320:12–321:11, May 22, 2012).

15. On or around July 20, 1999, McBride went to Merrill Scott's offices where he was given a presentation by several employees of Merrill Scott that described the various strategies that might be utilized by McBride, Newell, and the Clip Company. *See* (Pl. Ex. 12).

16. Merrill Scott's employees described that the various strategies available would be implemented in a "Master Financial Plan," which would utilize various IBCs, foreign financial accounts, foreign variable annuities, all for the benefit of McBride, Newell, and the Clip Company. *See* (Pl. Ex. 12).

17. After McBride was given an explanation of Merrill Scott's program, he responded, "This is tax evasion." (Tr. 321:22–23, May 22, 2012).

18. Merrill Scott employees responded that their programs were legal. (Tr. 321:24, May 22, 2012).

19. Merrill Scott employees told McBride that "your plan will be one of the cleanest we have." (Tr. 323:6–7, May 22, 2012).

20. McBride expressed his intention that Merrill Scott set up a structure that would move profits of the Clip Company offshore. (Tr. 40:17–22, May 21, 2012); (Tr. 108:8–13, May 21, 2012); (Tr. 393:12–14, May 22, 2012).

D. McBride Purchased Merrill Scott's Master Financial Plan Without First Obtaining an Outside Legal Opinion.

21. Merrill Scott provided McBride with several pamphlets and materials containing questions and answers regarding how the strategies employed by Merrill Scott interacted with extant income tax and reporting

regulations. *See* (Pl. Exs. 10, 11); (Tr. 322:4–10, May 22, 2012).

22. One of these pamphlets, entitled "Going Offshore: What is it and is it safe," included the following language under the heading "Tax Savings": "US citizens are subject to specific U.S. reporting requirements for interests in foreign corporations, trusts and bank accounts. US citizens and others filing Internal Revenue Service returns are not immune from requisite declaration of ownership interests in foreign entities." *See* (Pl. Ex. 10).

23. In that meeting, McBride was provided a legal opinion prepared by the Estate Planning Institute, P.C. (Tr. 322:4–8, May 22, 2012).

24. No later than July 29, 1999, McBride was informed that the Estate Planning Institute, P.C. was an entity controlled by or related to Merrill Scott. *See* (Pl. Ex. 13).

25. McBride did not understand the process by which Merrill Scott proposed to somehow legally move the Clip Company's U.S. revenue offshore. (Tr. 323:9–15, May 22, 2012).

26. On December 10, 2009, McBride stated, under penalty of perjury, that he "reviewed and considered all [Merrill Scott]-based literature and marketing information, including its 'due diligence' information on each of its officers and its track record pertaining to being in 'good standing' with Utah. This information includes (but is not all-inclusive) ... the legal opinion included as part of McBride's initial disclosures, and the packet of [Merrill Scott] literature ..." (Pl. Ex. 3, Response 6).

27. McBride testified at trial that he did not read the legal opinion provided to him by the Estate Planning Institute. (Tr. 402:6–16, May 22, 2012).

***1191** 28. On November 17, 2010, under penalty of perjury, McBride stated that he specifically read and asked questions from the pamphlet entitled "Questions and Answers." (Pl. Ex. 71, ¶ 4).

29. The pamphlet entitled "Questions and Answers," contains the following language under a heading entitled, "Why not just hide all my assets in a Swiss Account?": "As a U.S. taxpayer, the law requires you to report your financial interest in, or signature authority over, any foreign bank account, securities account, or other financial account.... Intentional failure to comply with the foreign account reporting rule is a crime and the IRS has means to discover such unreported assets." *See* (Pl. Ex. 11, pp. MB0130–MB0131).

30. McBride never obtained an outside legal opinion from an attorney about the legality of Merrill Scott's financial strategies. (Tr. 271:11, May 22, 2012).

31. McBride never sought advice from his accountant at the time, Craig Stayner, on whether or not to purchase a Master Financial Plan from Merrill Scott. (Tr. 270:18–25, May 22, 2012).

32. McBride was "gung ho" on Merrill Scott and the Master Financial Plan. *See* (Pl. Ex. 117, Newell Dep. Tr. 37:1–3).

33. Even though Craig Taylor, Scott Newell's accountant at the time, expressed concerns, McBride would not change his decision to enter into an agreement with Merrill Scott. Taylor did not raise any concerns about the FBAR reporting requirement. *See* (Pl. Ex. 9) (Pl. Ex. 117, Newell Dep. Tr. 36:22–37:7) (Tr. 161:9–162:14, May 21, 2012).

34. Even though he had not obtained an outside opinion regarding the legal consequences of entering into the Master Financial Plan, McBride entered into an Implementation Agreement wherein he agreed to purchase a Master Financial Plan from Merrill Scott for $75,000, in addition to retaining their services for regular monthly fees. *See* (Pl. Ex. 13).

35. Merrill Scott's proposed Master Financial Plan for McBride included the preparation of the income tax returns for McBride and Newell as part of the services that Merrill Scott would render. *See* (Pl. Ex. 13); *see also* (Pl. Ex. 118, Ackerson Dep. 141:12–147:8).

36. McBride declined to retain Merrill Scott's tax return preparation services for his personal income tax returns. *See* (Tr. 268:25–26:7, May 2, 2012); (Tr. 270:18–25, May 22, 2012); (Tr. 306:19–21, May 22, 2012).

37. McBride sent the payments for the Master Financial Plan to Merrill Scott with checks dated July 1, 1999, August 9, 1999 and December 20, 1999. *See* (Pl. Ex. 15).

38. In the memo field for the check dated August 9, 1999, McBride indicated that the check was for “Bank account offshore.” *See* (Pl. Ex. 15); (Tr. 272:9–19, May 22, 2012).

39. On or around August 22, 1999, Craig Taylor sent McBride and Newell a memorandum that advised McBride of Taylor's concerns and questions he had regarding the Merrill Scott proposal as he understood it at the time. (Tr. 269:24–270:14, May 22, 2012); *see* (Pl. Exs. 8, 9).

40. Attached to Taylor's letter of August 22, 1999, was a newspaper article that described that holding bank accounts in foreign countries was associated with tax evasion and fraudulent activity. *See* (Pl. Ex. 9).

41. The newspaper article further described the illegality of a process whereby individuals would create fictitious loans that in reality consisted of their own money, while treating the loans as real in order to take deductions on the interest paid and ***1192** avoid federal income taxation. *See* (Pl. Ex. 9).

42. McBride read the letter and attached article. (Tr. 270:3–14, May 22, 2012).

43. Taylor also composed a letter for McBride to send to Merrill Scott, asking Merrill Scott to clarify certain of its strategies with respect to the Master Financial Plan, based on Taylor's understanding of the Master Financial Plan as of August 22, 1999. The letter did not contain any reference or question regarding the reporting requirements that might be incurred by McBride. *See* (Pl. Exs. 8, 87).

E. McBride Executed the Merrill Scott–Designed Master Financial Plan.

44. Pursuant to the Master Financial Plan, McBride purchased a Foreign Variable Annuity. (Tr. 282:8–18, May 22, 2012); *see* (Pl. Exs. 12, 13).

45. Pursuant to the Master Financial Plan, Merrill Scott made three IBCs available to McBride and Newell: Drehpunkt, Ltd. (“Drehpunkt”); Lombard & Associates, Ltd. (“Lombard”); and Palisades & Associates, Ltd. (“Palisades”). (Tr. 114:7–25, May 21, 2012); *see* (Pl. Exs. 12, 13, 64, 69, 87).

46. Pursuant to the Master Financial Plan, Drehpunkt, Lombard, and Palisades were each nominally controlled by officers/directors employed by or otherwise associated with Merrill Scott on behalf of McBride and Newell. (Tr. 283:8–284:18, May 22, 2012); (Pl. Exs. 12, 13, 59, 87).

47. In order to implement the Master Financial Plan, McBride entered into an agreement or multiple agreements with Piao Shang on behalf of the Clip Company. (Tr. 118:8–119:22, May 21, 2012).

48. Pursuant to these agreements, Piao Shang and the Clip Company agreed that the Clip Company would pay Piao Shang a higher per-unit price that included the amortized fixed cost of the molds, even though the cost of the molds had already been paid by the Clip Company. Such higher payments would result in excess funds (the “excess funds”) that would have otherwise represented the profits of the Clip Company. (Tr. 276:23–277:20, May 22, 2012); (Pl. Exs. 59, 60).

49. Instead of retaining the excess funds and reporting the difference in cost of goods sold as profit on its federal income tax returns, the Clip Company paid the excess funds to Piao Shang during the tax years 2000 and 2001. (Tr. 118:8–119:22, May 21, 2012); (Tr. 128:10–129:24, May 21, 2012).

50. Pursuant to the agreement between Piao Shang and the Clip Company, Piao Shang remitted the excess funds to Drehpunkt, even though Drehpunkt had provided no consideration to Piao Shang for such excess funds. (Tr. 118:8–119:22, May 21, 2012); (Tr. 128:10–129:24, May 21, 2012).

51. Drehpunkt received these excess funds via wire transfer in a bank account with the Royal Bank of Scotland, located in the Bahamas, account number XXXXXX–XX3579 (the “Drehpunkt account”). (Tr. 128:16–129:24, May 21, 2012); (Pl. Ex. 88).

52. McBride set up the wire transfer arrangement between Piao Shang and the Drehpunkt account. (Tr. 276:23–277:20, May 22, 2012); (Pl. Ex. 60).

53. McBride also set up a wire transfer arrangement between Vanli International (another supplier) and the Drehpunkt account. (Tr. 278:3–11, May 22, 2012).

54. Lombard also held a bank account with the Royal Bank of Scotland, located in the Bahamas, account number XXXXXX–XX5776 (the "Lombard account"). (Tr. 186:3–15, May 21, 2012); (Tr. 283:20–284:11, May 22, 2012); (Pl. Ex. 89).

***1193** 55. Pursuant to the Master Financial Plan, Drehpunkt received and disbursed funds from Piao Shang to the Clip Company and to other entities on behalf of the Clip Company as well as McBride, individually. (Tr. 130:19–133:7, May 21, 2012).

56. Lombard received the vast majority, if not all, of its funds from Drehpunkt via wire transfers between the Drehpunkt account and the Lombard account. (Tr. 280:7–12, May 22, 2012).

57. The Drehpunkt account carried a balance of $310,002 in 2000. (Uncontroverted Fact No. 4); (Pl. Ex. 88, p. US02105); *see* (Tr. 109:24–110:6, May 21, 2012).

58. The Drehpunkt account carried a balance of $736,902 in 2001. (Uncontroverted Fact No. 4); (Pl. Ex. 88, p. US02113); *see* (Tr. 110:9–24, May 21, 2012).

59. The Lombard account carried a balance of $140,250 in 2000. (Uncontroverted Fact No. 4); (Pl. Ex. 89, p. US02088); *see* (Tr. 109:24–110:6, May 21, 2012).

60. The Lombard account carried a balance of $150,132 in 2001. (Uncontroverted Fact No. 4); (Pl. Ex. 89, p. US02117); *see* (Tr. 110:9–24, May 21, 2012).

61. Pursuant to the Master Financial Plan, Lombard received and disbursed funds exclusively on behalf of McBride. (Tr. 132:17–21, May 21, 2012); (Tr. 280:7–9, May 22, 2012).

62. McBride believed and understood Drehpunkt and Lombard to be "bank accounts." (Tr. 46:8–12, May 21, 2012).

63. During 2000 and 2001, Drehpunkt, Lombard, and Palisades were each utilized for the benefit of the Clip Company, McBride, and Newell, and no other individuals. (Tr. 281:24–282:2, May 22, 2012).

F. McBride Dictated the Activity and Disposition of Funds Held by Drehpunkt and Lombard.

64. McBride understood that persons employed by or otherwise associated with Merrill Scott were the nominee directors of Drehpunkt and Lombard. *See* (Pl. Exs. 13, 87); (Tr. 46:8–19, May 21, 2012).

65. McBride understood that he would be able to exercise control over the funds held by Drehpunkt and Lombard. (Tr. 46:8–19, May 21, 2012); (Tr. 53:7–12, May 21, 2012); (Tr. 280:7–12, May 22, 2012).

66. In various materials, McBride was listed as the "beneficial owner" of Drehpunkt, Lombard, and the other accounts created in connection with his Master Financial Plan. (Tr. 186:8–15, May 21, 2012); (Tr. 210:8–17, May 21, 2012); (Tr. 251:3–16, May 22, 2012).

67. McBride considered the money in the Lombard account to be his. (Tr. 285:5–7, May 22, 2012).

68. McBride considered the funds in the Lombard account to be used for his benefit. (Tr. 285:16–19, May 22, 2012).

69. Pursuant to McBride's requests, employees of Merrill Scott executed wire transfers to move money to or from the Drehpunkt account and the Lombard account. (Tr. 285:20–25, May 22, 2012); (Pl. Ex. 4).

70. McBride communicated to employees of Merrill Scott with instructions on when, how, where, and in what amounts to transfer funds to and from the Drehpunkt and Lombard accounts. (Tr. 279:3–10, May 22, 2012).

71. Merrill Scott generated documents that memorialized some, but not all, of the wire transfer requests made by McBride. These documents contained instructions regarding the sending bank, receiving bank, intermediary bank, account numbers, ***1194** routing numbers, amounts, and often the purpose for each transfer. (Pl. Ex. 118, Ackerson Dep. Tr. 29:13–18; 49:13–50:4).

72. McBride received an accounting of the activity that was conducted with respect to the Drehpunkt account and the Lombard account approximately every two weeks from David Fraidenburg, an employee of Merrill Scott. (Tr. 49:23–50:4, May 21, 2012).

73. Every direction to transfer funds to or from the Drehpunkt account or the Lombard account made by McBride was either honored by the employees of Merrill

Scott or McBride withdrew the request before Merrill Scott could fail to honor the request. (Tr. 87:2–6, May 21, 2012); (Tr. 114:5–116:7, May 21, 2012).

74. On several occasions, employees of Merrill Scott asked for McBride's authorization or explicit instructions before transferring funds to and from the Drehpunkt account and the Lombard account. *See, e.g.,* (Pl. Exs. 19, 64, 68).

75. Whether by telephone, facsimile, or email message, McBride directed employees of Merrill Scott to make several wire transfers to or from the Drehpunkt account and the Lombard account on his behalf or on the behalf of the Clip Company. *See* (Pl. Ex. 19–55, 63–69, 95–115).

G. McBride Funneled Profits of the Clip Company Through Its Taiwanese Manufacturer to his IBCs and Back to Himself Through a Sham Line of Credit.

76. Approximately $2.7 million in excess funds, which would have otherwise represented the profits of the Clip Company, were circuitously funneled through various foreign entities, including Drehpunkt and Lombard. (Tr. 109:19–23, May 21, 2012); (Tr. 118:23–119:22, May 21, 2012); (Tr. 128:10–132:12, May 21, 2012); (Tr. 274:25–275:12, May 22, 2012); (Tr. 276:12–278:25, May 22, 2012); (Tr. 277:5–278:18, May 22, 2012); (Pl. Exs. 82, 83, 84, 86).

77. Commencing on or around November 16, 1999, and continuing through December 6, 2001, at least $1.8 million was transferred from the Drehpunkt account to Fidelity Funding, Ltd., an entity controlled by Merrill Scott, and subsequently to Legacy Capital, another entity controlled by Merrill Scott. That money funded a "loan" from the Merrill Scott-controlled entities to the Clip Company in the form of a line of credit. (Tr. 53:3–6, May 21, 2012); (Tr. 118:23–119:22, May 21, 2012); (Tr. 128:10–132:12, May 21, 2012); (Pl. Exs. 66, 67, 82, 83, 84, 86).

78. During 2000 and 2001, the Clip Company "borrowed" more than $1.2 million dollars against this line of credit and only repaid a fraction of the principal and interest. (Pl. Ex. 118, Ackerson Dep. Tr. 156:1–158:23); (Pl. Ex. 16).

79. The Clip Company borrowed its own money from the line of credit. (Tr. 279:14–16, May 22, 2012).

80. The Clip Company treated the line of credit as a loan for tax purposes. (Tr. 128:20–129:9, May 21, 2012); (Tr. 152:13–154:1, May 21, 2012); (Tr. 282:22–283:7); (Tr. 309:14–20, May 22, 2012).

81. The Clip Company used the proceeds of the line of credit to pay regular business expenses. (Tr. 279:18–21, May 22, 2012).

82. McBride made several draws on the line of credit on behalf of the Clip Company. (Tr. 278:19–279:21, May 22, 2012).

83. Whenever the Clip Company reached the maximum amount allotted to the line of credit, Merrill Scott employees would raise the limit and again honor the requested draw on the line of credit. (Tr. 278:19–279:21, May 22, 2012).

***1195** 84. Hundreds of thousands of dollars of this "borrowed" money was distributed to McBride and Newell in the form of "partner draws" which were accounted for as "royalty payments." (Tr. 279:22–280:2, May 22, 2012).

85. Neither Piao Shang nor Vanli International ever received any payments on the line of credit. (Tr. 152:8–14, May 21, 2012); (Tr. 281:24–282:2).

H. McBride Used the Profits of the Clip Company Captured by Drehpunkt and Lombard for His Own Benefit.

86. McBride gave instructions to Merrill Scott employees to wire funds from the Drehpunkt account or the Lombard account to his designated recipient on multiple occasions during 2000 and 2001. *See* (Pl. Exs. 19–55, 63–69, 95–115).

87. On or around January 19, 2000, McBride directed Merrill Scott employees to transfer $141,900 to fund a mortgage for McBride's former wife. (Tr. 49:6–12, May 21, 2012); (Tr. 294:25–295:12, May 22, 2012); *see* (Pl. Ex. 22).

88. On or around December 20, 2000, McBride directed Merrill Scott employees to transfer $5,000 from the Lombard account to Brandon Carver, a neighbor of McBride's parents. That money was used by Carver to purchase Christmas presents for McBride's parents. (Tr. 124:20–125:10, May 21, 2012); (Pl. Ex. 27).

89. On or around September 1, 2000, McBride directed Merrill Scott employees to transfer $35,000 from the Lombard account to Court L. Armstrong. McBride directed that these funds be paid to Mr. Armstrong in consideration of airline travel provided by Mr. Armstrong for McBride's benefit. (Pl. Ex. 25); (Tr. 290:18–291:10, May 22, 2012).

90. McBride entered into two automobile leases with Merrill Scott Leasing, an entity controlled by Merrill Scott, using funds held in the Lombard account. (Tr. 49:6–12, May 21, 2012); (Tr. 293:23–294:21, May 22, 2012); (Pl. Exs. 4, 31, 32).

91. McBride directed employees of Merrill Scott to make a direct investment in GEET, International using funds from the Lombard account in the amount of $50,000. (Tr. 49:6–12, May 21, 2012); (Tr. 293:5–13, May 22, 2012); (Pl. Exs. 4, 29).

92. Employees of Merrill Scott transferred $50,000 from the Lombard account to GEET, International on McBride's behalf and as an investment for McBride. (Pl. Ex. 29)

93. McBride personally entered into a retainer agreement with attorney William Gregory Burdett to sue the principals of GEET International. (Tr. 293:2–22, May 22, 2012); (Pl. Exs. 4, 29).

94. McBride directed that Mr. Burdett's fees be paid from the Lombard account. (Tr. 293:2–22, May 22, 2012); (Pl. Exs. 4, 29).

95. McBride also directed employees of Merrill Scott to make a direct investment in Choice Sports Network in the amount of $50,000. (Pl. Exs. 23, 63).

96. Employees of Merrill Scott transferred $50,000 from the Lombard account to Choice Sports Network on McBride's behalf and as an investment for McBride. (Pl. Ex. 26).

97. McBride also directed employees of Merrill Scott to make a direct investment in ICUNET, Inc. in the amount of $50,000. (Tr. 292:4–9, May 22, 2012); (Pl. Exs. 4, 26).

98. Employees of Merrill Scott transferred $50,000 from the Lombard account to ICUNET, Inc. on McBride's behalf and as an investment for McBride. (Pl. Ex. 26).

99. McBride directed Merrill Scott employees to transfer $51,000 from the Drehpunkt ***1196** account, $7,000 from the Lombard account, and $59,000 from Palisades for a total of $117,000 to the Clip Company. (Pl. Exs. 19, 33).

I. McBride Directed Employees of Merrill Scott to Create Other Accounts to Hold His Assets.

100. Among McBride's several requests were that Merrill Scott establish brokerage accounts so that he could purchase securities and make other investments with the funds that were held by Lombard. (Tr. 303:13–20, May 22, 2012); (Tr. 304:8–306:5, May 22, 2012); (Pl. Exs. 17, 24, 30, 61, 62).

101. Pursuant to McBride's request, a TD Evergreen Wealth Management/Toronto Dominion Bank (Canada) brokerage account number XX1350 (the “TD Evergreen account”) was established and held in the name of Phoenix Overseas Advisors, Ltd. (“POA”). (Tr. 50:5–12, May 21, 2012); (Tr. 51:8–18, May 21, 2012); (Tr. 112:18–113:16, May 21, 2012); *see* (Pl. Exs. 20, 61, 91).

102. The TD Evergreen account was located in Canada. *See* (Pl. Ex. 91).

103. POA was an entity controlled by Merrill Scott, used to invest its clients' funds in brokerage accounts, such as TD Evergreen Wealth Management/Toronto Dominion Bank. (Tr. 133:11–21, May 21, 2012); (Tr. 181:4–20, May 21, 2012); (Tr. 296:2–15, May 22, 2012); (Pl. Ex. 118, Ackerson Dep. Tr. 49:13–50:4); *see* (Pl. Exs. 20, 61, 68).

104. McBride directed employees of Merrill Scott as to which securities should be purchased by POA and held in the TD Evergreen account. (Tr. 49:19–50:23, May 21, 2012); (Tr. 86:21–87:1, May 21, 2012); *see* (Pl. Ex. 68).

105. The amounts that were transferred into the TD Evergreen account from POA were consistent with amounts transferred from the Lombard account to POA. (Tr. 249:6–18, May 22, 2012); (Tr. 254:14–255:8, May 22, 2012); (Tr. 254:14–255:8, May 22, 2012); (Pl. Ex. 118, Ackerson Dep. 169:25–170:12).

106. Whenever McBride directed that an investment be made in blue chip stocks, these stocks were purchased and held in the TD Evergreen account. (Tr. 255:9–256:6, May 22, 2012).

107. McBride also had an E*Trade account with a portfolio of stocks and securities he managed himself. (Tr. 255:9–15, May 22, 2012).

108. The stock purchases in the TD Evergreen account and in McBride's E*Trade portfolio were consistent with respect to which securities were purchased and when the securities were purchased. (Tr. 255:9–256:6, May 22, 2012).

109. The TD Evergreen account carried a balance of $39,507.22 in 2000. (Tr. 112:17–113:16, May 21, 2012); (Pl. Ex. 91, p. H & H02282); (Def. Exs. 27, 28).

110. The TD Evergreen account carried a balance of $10,899.63 in 2001. (Tr. 252:19–253:23, May 22, 2012); (Def. Ex. 28, p. H & H02289).

111. Pursuant to McBride's request, a Global Securities Corporation (Canada) brokerage account was established and held in the name of Lombard & Associates, Ltd., c/o Merrill Scott & Associates, account number XXX–308U–0 (the "Global Securities account"). (Tr. 111:20–112:18, May 21, 2012); (Tr. 134:8–23, May 21, 2012); (Tr. 183:8–15, May 21, 2012); *see* (Pl. Exs. 17, 18, 90, 116).

112. The Global Securities account was located in Canada. *See* (Pl. Exs. 17, 18).

113. The Global Securities account carried a balance of $299,977 in 2000. *See* (Pl. Ex. 90, p. H & H01063).

***1197** 114. The Global Securities account carried a balance of $308,377 in 2001. *See* (Pl. Ex. 90., p. H & H01060).

115. McBride was aware that his assets were being handled by Mark Stern, who worked for Global Securities. (Tr. 134:8–23, May 21, 2012); (Tr. 246:10–21, May 22, 2012); (Pl. Ex. 17); *see* (Pl. Ex. 71 at ¶ 13).

J. McBride Pulled His Assets Out of Merrill Scott in Mid–2001.

116. McBride stopped receiving biweekly spreadsheets reflecting the status of his assets in the foreign accounts sometime in early 2001. (Tr. 336:3–6, May 22, 2012).

117. McBride also stopped receiving billing statements for interest payments on the line of credit sometime around early 2001. (Tr. 336:7–12, May 22, 2012).

118. McBride was concerned about the legitimacy of Merrill Scott no later than March of 2001. (Tr. 339:11–14, May 22, 2012).

119. McBride convinced Merrill Scott employees to increase the amount of the line of credit by $665,000. He then immediately withdrew all those funds from the line of credit on March 2, 2001. (Tr. 339:1–10, May 22, 2012); (Pl. Ex. 86).

120. McBride filed a claim with a receiver appointed to administer Merrill Scott, stating that he had an interest in both Drehpunkt and Lombard. (Pl. Ex. 81); *see* (Tr. 152:15–153:16, May 21, 2012).

K. McBride Did Not File an FBAR Report for the Tax Years 2000 and 2001.

121. In 2000 and 2001, McBride knew that the Drehpunkt account, the Lombard account, the TD Evergreen account, and the Global Securities account, (collectively, the "foreign accounts"), were located in countries outside of the United States. (Tr. 274:1–6, May 22, 2012); (Tr. 276:16–22, May 22, 2012); (Tr. 283:20–25, May 22, 2012); (Pl. Exs. 17, 18, 91).

122. For all relevant periods prior to the filing of his 2001 federal income tax return, McBride's personal accountant was Craig Stayner ("Stayner"). (Tr. 204:12–15, May 21, 2012); (Tr. 268:25–269:7, May 2, 2012); (Tr. 270:18–25, May 22, 2012); (Tr. 310:16–22, May 22, 2012).

123. Stayner was also the accountant who prepared the federal tax returns for the Clip Company. (Tr. 270:18–25, May 22, 2012); (Tr. 306:11–13, May 22, 2012).

124. McBride never discussed his involvement with Merrill Scott with Stayner. (Tr. 270:18–25, May 22, 2012).

125. McBride never informed Stayner of either the TD Evergreen account or the Global Securities account. (Tr. 306:11–18, May 22, 2012).

126. No other person assisted McBride in the preparation of his federal tax returns for the tax year 2000. (Tr. 268:25–269:7, May 22, 2012).

127. McBride was the sole source of information used by Stayner in preparing McBride's personal federal tax return for the year 2000. (Tr. 360:6–21, May 22, 2012).

128. McBride prepared and sent Stayner statements of his financial affairs for the year, and informed him what deductions McBride sought to take. (Tr. 360:14–17, May 22, 2012).

129. McBride checked to see that Stayner accurately included at least some of the information he transmitted to Stayner on the schedules to the Form 1040. (Tr. 360:17–21, May 22, 2012).

130. For the tax year 2001, Taylor prepared McBride's personal federal income tax return. (Tr. 306:19–21, May 22, 2012).

131. On McBride's U.S. Individual Income Tax Return (Form 1040) for the tax ***1198** year 2000, Schedule B, Line 7a contained the following question/instruction: "At any time during 2000, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions for exceptions and filing requirements for Form TD F 90–22.1" (Pl. Ex. 56).

132. On McBride's Form 1040 Schedule B for the tax year 2000, on Line 7a, the "No" box is filled. (Pl. Ex. 56).

133. On his federal income tax return (Form 1040) for the tax year 2000, McBride did not report that he had an interest in any foreign bank or financial account. (Tr. 310:23–311:3, May 22, 2012); *see* (Pl. Ex. 56).

134. McBride did not complete or file a Form TD F 90–22.1 for the tax year 2000. (Tr. 311:4–7, May 22, 2012).

135. The Form 1040 U.S. Individual Income Tax Return for the tax year 2000 signed by McBride contains the following declaration immediately above the signature line: "Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge." (Pl. Ex. 56, p. 2).

136. On McBride's U.S. Individual Income Tax Return (Form 1040) for the tax year 2001, Schedule B, Line 7a contained the following question/instruction: "At any time during 2001, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions for exceptions and filing requirements for Form TD F 90–22.1" (Pl. Ex. 57).

137. On McBride's Form 1040 Schedule B for the tax year 2001, on Line 7a, the "No" box is filled. (Pl. Ex. 57).

138. On his federal income tax return (Form 1040) for the tax year 2001, McBride did not report that he had an interest in any foreign bank or financial account. (Tr. 312:1–7, May 22, 2012); *see* (Pl. Ex. 57).

139. McBride did not complete or file a Form TD F 90–22.1 for the tax year 2001. (Tr. 312:4–7, May 22, 2012).

140. The Form 1040 U.S. Individual Income Tax Return for the tax year 2001 signed by McBride contains the following declaration immediately above the signature line: "Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge." (Pl. Ex. 57, p. 2).

141. McBride signed his Form 1040 U.S. Individual Income Tax Returns for the tax years 2000 and 2001. (Pl. Exs. 56, 57).

L. McBride Never Obtained a Legal Opinion Regarding the Consequences of Engaging in Merrill Scott's Master Financial Plan.

142. On December 10, 2009, McBride stated, under penalty of perjury, that he "reviewed and considered all [Merrill Scott]-based literature and marketing information, including its 'due diligence' information on each of its officers and its track record pertaining to being in 'good standing' with Utah. This information includes

(but is not all-inclusive) ... the legal opinion included as part of McBride's initial disclosures, and the packet of [Merrill ***1199** Scott] literature ...” (Pl. Ex. 3, Response 6).

143. At trial, McBride contradicted that statement and testified that he did not read the legal opinion that was provided to him by the Estate Planning Institute, a Merrill Scott-controlled entity. (Tr. 402:9–16, May 22, 2012).

144. McBride never obtained an outside legal opinion from an attorney about his reporting or tax obligations under the Master Financial Plan. (Tr. 271:11, May 22, 2012).

145. Even though McBride was “concerned” about Merrill Scott no later than March, 2001, McBride did not discuss his involvement with Merrill Scott with Stayner, his accountant, in connection with the preparation of his federal income tax return, which Stayner signed and dated April 6, 2001, and McBride signed and dated April 14, 2001. (Tr. 270:18–22, May 22, 2012); (Tr. 392:10–20, May 22, 2012); (Pl. Ex. 56).

146. McBride never sought advice from Stayner on the legality of the strategies contemplated by the Master Financial Plan or otherwise employed by Merrill Scott. (Tr. 392:10–20, May 22, 2012).

147. McBride never provided Stayner any of the promotional or informational materials provided to him by Merrill Scott. (Tr. 270:18–25, May 22, 2012); (Tr. 392:10–20, May 22, 2012).

148. McBride never informed his accountant, Craig Stayner, of his involvement with Merrill Scott in connection with the preparation of the Clip Company's tax returns for 2000. (Tr. 270:23–25, May 22, 2012); (Pl. Ex. 3, Response 4).

149. McBride did not discuss his involvement with Merrill Scott with Stayner because he “thought that was the purpose of Merrill Scott because ... if you disclose the accounts on the form, then you pay tax on them, so it went against what [he] set up Merrill Scott for in the first place.” (Tr. 392:13–29, May 22, 2012).

150. McBride did not tell or otherwise inform Craig Stayner that Craig Taylor may have relevant information or expertise regarding McBride's tax and reporting obligations as a result of entering into a Master Financial Plan with Merrill Scott. (Tr. 270:18–22, May 22, 2012); (Tr. 392:10–20, May 22, 2012).

151. McBride sent the materials provided to him by Merrill Scott to Newell's accountant, Craig Taylor (“Taylor”), in or around July, 1999. (Tr. 322:18–323:2, May 22, 2012).

152. Taylor declared, under penalty of perjury, that he only used the information provided to him by McBride in order to prepare McBride's federal income tax returns. (Pl. Ex. 8, ¶ 2). Taylor also stated that McBride never informed him that he had any foreign bank accounts. (Pl. Ex. 8, ¶ 6).

M. McBride Lied to the IRS and the United States in Order to Hide his Ownership and Financial Interest in the Foreign Accounts.

153. Beginning in 2004, the IRS began to investigate McBride for potential issues related to his federal income tax returns as a result of his participation in Merrill Scott programs. (Tr. 92:22–93:2, May 21, 2012).

154. The IRS determined that McBride worked with Merrill Scott to set up an offshore business structure to move domestic profits of the Clip Company offshore by inflating the costs of inventory paid to Piao Shang and retaining the excess funds in foreign financial accounts. (Tr. 95:19–96:7, May 21, 2012); (Pl. Ex. 13).

155. Over the course of the examination, the IRS repeatedly requested that McBride produce various documents related ***1200** to his participation in Merrill Scott programs. (Tr. 103:21–25, May 21, 2012).

156. Initially, McBride did not produce any emails, letters, or handwritten notes in response to the IRS's document requests. (Tr. 148:4–21, May 21, 2012).

157. In interviews with the IRS, McBride denied that he had utilized the programs described in the Master Financial Plan with offshore components. (Tr. 106:23–107:5, May 21, 2012).

158. In interviews with the IRS, McBride lied to the IRS, and denied knowledge of any wire transfer from the Drehpunkt account or the Lombard account. (Tr. 107:9–17, May 21, 2012); (Tr. 309:21–310:1, May 22, 2012).

159. In interviews with the IRS, McBride lied to the IRS, and claimed that the money funneled from Piao Shang through Fidelity Funding and Legacy Capital to the Clip Company constituted a valid loan from Piao Shang, as opposed to the profits of the Clip Company. (Tr. 309:14–20, May 22, 2012).

160. In interviews with the IRS, McBride lied to the IRS, and denied knowing Brandon Carver. (Tr. 124:20–125:24, May 21, 2012); (Tr. 310:2–6, May 22, 2012).

161. In interviews with the IRS, McBride lied to the IRS, and denied knowing Court Armstrong. (Tr. 310:7–11, May 22, 2012).

162. In the course of its examination, the IRS requested the McBride file an FBAR report, Form TD F 90–22.1 for the tax years 2000 and 2001, but McBride did not do so. (Tr. 158:5–14, May 21, 2012).

163. As a result of McBride's failure to comply with the FBAR requirements for the tax year 2000, the IRS assessed McBride with a civil penalty assessment in the amount of $100,000 ($25,000 per account) for his willful failure to report his interest in the foreign accounts as required by 31 U.S.C. § 5314. (Pl. Ex. 1).

164. As a result of McBride's failure to comply with the FBAR requirements for the tax year 2001, the IRS assessed McBride with a civil penalty assessment in the amount of $100,000 ($25,000 per account) for his willful failure to report his interest in the foreign accounts as required by 31 U.S.C. § 5314. (Pl. Ex. 2).

CONCLUSIONS OF LAW

I. STATUTORY FRAMEWORK

Section 5314(a) authorizes the Secretary of the Treasury to require that U.S. citizens report when they "make[ ] a transaction or maintain[ ] a relation for any person with a foreign financial agency." 31 U.S.C. § 5314(a) (2001). The Secretary has exercised that authority, and requires that individuals "having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship ... for each year in which such relationship exists," 31 C.F.R. § 103.24(a) (2001), but only "with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year." 31 C.F.R. § 103.27(c) (2001).[2] The Secretary may impose penalties upon taxpayers that violate this requirement. 31 U.S.C. § 5321(a)(5) (2001). As it existed during ***1201** the years at issue, prior to an amendment that took effect in 2004, Section 5321(a)(5) authorized penalties against taxpayers who "willfully" violated Section 5314, in the amount of $25,000, or the value of the unreported account (not to exceed $100,000). *See also* 31 C.F.R. § 103.57(g)(2) (2001).

Thus, in order to prevail, the United States must satisfy the following elements: (a) McBride was a citizen of the United States, or a resident or a person doing business in the United States during 2000 and 2001; (b) McBride had a financial interest in, or signatory or other authority over, a bank, securities or other financial account during 2000 and 2001; (c) the bank, securities or other financial account had a balance that exceeded $10,000 during 2000 and 2001; (d) the bank, securities or other financial account was in a foreign country; (e) McBride failed to disclose the bank, securities or other financial account; (f) the failure to report was willful; and (g) the amounts of the penalties were proper.

II. BURDEN OF PROOF

[1] The statute at issue, 31 U.S.C. § 5321(b)(2), permits the Secretary of Treasury to "commence a civil action to recover a civil penalty assessed under subsection (a)...." The statute does not specify the legal standard to be applied by courts in such an action. The one district court that has directly addressed the question of the burden of proof in a civil FBAR penalty case, *United States v. Williams,* concluded that the United States' burden of proof was "the preponderance of the evidence" on all questions before the court, including the question of whether the taxpayer's failure to report in that case was "willful." *United States v. Williams,* No. 1:09–cv–437, 2010 WL 3473311 (E.D.Va. Sep. 1, 2010), *rev'd on other grounds, United States v. Williams,* 489 Fed.Appx. 655 (4th Cir.2012). "In enforcement actions brought by the Government in other contexts, ... the Government is required to prove its case by a preponderance of the evidence on the record established at trial." *Id.* at *1 (internal citations omitted). In addition, the district court in *Williams* held that "[t]he Court's review is '*de novo,* and the general rule is that it is a decision based on the merits of the case and not on any record developed at the administrative level.' " *Id.* (quoting *Eren v. Comm'r,* 180 F.3d 594 (4th Cir.1999)).

The preponderance of the evidence standard applied by the district court in *Williams* is the correct standard. As with Government penalty enforcement and collection cases generally, absent a statute that prescribes the burden of proof, imposition of a higher burden of proof is warranted only where "particularly important individual interests or rights," are at stake. *See Herman & MacLean v. Huddleston,* 459 U.S. 375, 389, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983); *Grogan v. Garner,* 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Because the FBAR penalties at issue in this case only involve money, it does not involve "particularly important individual interests or rights" as that phrase is used in *Huddleston* and *Grogan.* In *Huddleston,* the court of appeals had reversed the district court, stating that the district court's application of the preponderance-of-the-evidence standard in connection with a fraudulent misrepresentation case was incorrect and that a "clear and convincing evidence" standard should have applied in connection with allegations of fraud. 459 U.S. at 379, 103 S.Ct. 683. The Supreme Court reversed, stating that the applicable burden was merely a preponderance of the evidence in cases, even where allegations of fraud were involved, unless "particularly important individual interests or rights are at stake." *Id.* at 390, 103 S.Ct. 683.

> By contrast, imposition of even severe civil sanctions that do not implicate such ***1202** interests has been permitted after proof by a preponderance of the evidence. *See, e.g., United States v. Regan,* 232 U.S. 37, 48–49, 34 S.Ct. 213, 58 L.Ed. 494 (1914) (proof by a preponderance of the evidence suffices in civil suits involving proof of acts that expose a party to a criminal prosecution).

Id. at 389–90, 103 S.Ct. 683. *United States v. Regan* held that, at least where the Government is suing to recover a monetary penalty (as is the case here), its suit is a "civil action" to be "conducted and determined according to the same rules and with the same incidents as are other civil actions." 232 U.S. at 46–47, 34 S.Ct. 213. The logic of *Huddleston* has been applied in the civil tax-penalty area. *See, e.g., Mattingly v. United States,* 924 F.2d 785, 787 (8th Cir.1991) ("The standard of proof in these [civil tax violation] cases is usually a preponderance of the evidence, and by statute the burden of proof is often placed on the government.").

Moreover, the Supreme Court has been unwilling to require that litigants meet a higher burden of proof than the preponderance of the evidence standard where the statute does not specify a higher burden of proof. *See Grogan,* 498 U.S. at 286, 111 S.Ct. 654 ("The language of [the statute] does not prescribe the standard of proof.... This silence is inconsistent with the view that Congress intended to require a special, heightened standard of proof."). With respect to 31 U.S.C. §§ 5314 and 5321, Congress did not specify any special, heightened standard of proof. As a result, there is no reason to deviate from the default burden of proof applicable in civil cases.

Therefore, the United States bears the burden of proving that McBride willfully failed to file FBARs with respect to the accounts at issue by the preponderance of the evidence.

III. THE UNITED STATES HAS PROVEN, BY A PREPONDERANCE OF THE EVIDENCE, EACH OF THE ELEMENTS OF THE ASSESSED CIVIL FBAR PENALTIES.

a. Jon McBride is a citizen of the United States.

There is no dispute that Jon McBride is a citizen of the United States. Findings of Fact, *supra,* ("FOF"), ¶ 1.

b. Jon McBride had a financial interest in the accounts at issue.

[2] McBride had a "financial interest" in the Drehpunkt, Lombard, TD Evergreen, and Global Securities accounts. Pursuant to 31 C.F.R. § 103.24(a) (2001), individuals must disclose "a financial interest in, or signature or other authority over, a bank, securities or other financial account." The Drehpunkt and Lombard accounts were bank accounts, and the TD Evergreen and Global Securities accounts were securities accounts. FOF, ¶ 51, 54, 101, 111. Unfortunately, Section 103.24(a) does not clarify what constitutes a "financial interest."

IRS Form TD F 90–22.1 (the form used for reporting interests in foreign financial accounts) states that an individual has a reportable "financial interest" in foreign accounts for which he "is the owner of record" or for which "the owner of record or holder of legal title is: (a) a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the [individual]; (b) a corporation in which the United States person owns directly or indirectly more than 50 percent of the total value of shares of stock; [...] or (d) a trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income." *See* Form ***1203** TDF 90–22.1, (Plaintiff's Ex. No. 1; Uncontroverted Fact No. 9). This language captures a broad range of relationships through which a party may maintain an interest in a foreign financial account and is consistent with more recent regulation. [3]

Under this definition, McBride had a financial interest in each of the four foreign accounts at issue. The accounts were treated by Merrill Scott as "McBride's" accounts—as reflected on the documentation and communications related to those accounts and McBride's understanding and expectation as well as the course of dealing with Merrill Scott—and McBride had the expectation of enjoying the benefit of the assets in the accounts. FOF, ¶¶ 62, 64, 65. The documentation related to the foreign accounts shows that persons or entities employed by or otherwise associated with Merrill Scott would act on behalf of McBride as nominee officers/directors of IBCs or as the nominee holders of the accounts. FOF, ¶¶ 11, 45, 46, 64, 101, 103, 104, 111.

Through this deliberately disguised ownership structure, McBride was able to direct Merrill Scott to use the overpayments and profits—that would have otherwise flowed to the Clip Company but were instead captured overseas in the Drehpunkt and Lombard accounts—in whatever way he saw fit. FOF, ¶¶ 64–75, 86–115. Given McBride's tacit ownership of the value held in these accounts, Drehpunkt and Lombard were each a "corporation in which [McBride] own[ed] directly or indirectly more than 50 percent of the total value of shares of stock." McBride was then able to direct Merrill Scott to repatriate the Clip Company's overpayments by funneling them through Drehpunkt back to the Clip Company disguised as a "line of credit" from Legacy Capital, an entity controlled by Merrill Scott. *See* FOF, ¶¶ 76–85; (*See* Uncontroverted Fact No. 5). During 2000 and 2001, the Clip Company "borrowed" more than $1.2 million dollars of its own money and only repaid a fraction of the principal and interest. FOF, ¶¶ 78–81. Hundreds of thousands of dollars of this "borrowed" money was then distributed directly to McBride in the form of "partner draws" which were accounted for as "royalty payments." FOF, ¶ 84. McBride acted as though the assets contained in each of the foreign accounts, as well as the line of credit, were his and were maintained for his benefit. FOF, ¶¶ 45, 46, 62–75, 84, 86–115.

McBride was able to exercise substantial control over the Drehpunkt and Lombard accounts by communicating with Merrill Scott employees and instructing them on how to dispose of the assets, whether that disposition was to fund an investment or transfer the funds. FOF, ¶¶ 63–75, 86–115. These transfers were initiated at the request of McBride, and normally made exclusively for his own benefit without any possible business purpose for either Drehpunkt or Lombard (or Merrill Scott for that matter). FOF, ¶¶ 86–99. Not one of McBride's requests to transfer funds was ever denied by the employees of Merrill Scott. FOF, ¶ 73. In many instances, employees of Merrill Scott requested explicit authorization and instructions from McBride in order to dispose of the funds in the foreign accounts. FOF, ¶ 74. Through Merrill Scott and its affiliate, McBride was also able to establish the TD Evergreen account and the Global Securities account (held in the name of Lombard & Associates, Ltd.) and to direct the securities purchased and held in those accounts ***1204** for McBride's benefit. FOF, ¶¶ 100–115. Although the money used to fund the TD Evergreen securities account was apparently routed through POA (which held money on behalf of many other Merrill Scott clients), the securities in both the TD Evergreen and Global Securities accounts were purchased at McBride's direction and were held on his behalf. FOR, ¶¶ 100, 105–108, 111.

The evidence thus demonstrates that there was an agency relationship between McBride and Merrill Scott through which McBride owned and controlled the Drehpunkt, Lombard, TD Evergreen, and Global Securities accounts. Accordingly, Mr. McBride's interest in the Drehpunkt, Lombard, TD Evergreen, and Global Securities accounts rises to the level of a financial interest that triggered the FBAR reporting requirements.

c. The foreign accounts were located outside of the United States.

The four foreign accounts at issue in this case were located in countries outside the United States. FOF ¶¶ 51, 54, 101, 111, Uncontroverted Fact No. 6.

d. The foreign accounts each had a balance that exceeded $10,000 in both 2000 and 2001.

The foreign bank accounts at issue had balances of at least $10,000 in 2000 and 2001 as demonstrated by statements issued for those accounts as well as the investigation by the IRS that traced the flow of funds from Piao Shang through the Drehpunkt account, the Lombard account, the TD Evergreen account, and the Global Securities account. FOF, ¶¶ 57–60, 109, 110, 113, 114.

e. McBride failed to disclose the foreign accounts in accordance with the FBAR requirements.

McBride filed U.S. Individual Income Tax Returns for both the tax years 2000 and 2001, which did not disclose any interest in any of the foreign accounts. FOF, ¶¶ 132, 137. McBride did not file a Form TD F 90–22.1 for either of the tax years 2000 or 2001. FOF, ¶¶ 134, 139.

f. McBride's Failure to Report His Interest in the Foreign Accounts was Willful.

[3] Section 5321(a)(5) does not define how to assess whether an individual acted willfully in his failure to comply with the reporting requirements imposed by § 5314. " '[W]illfully' is a 'word of many meanings whose construction is often dependent on the context in which it appears.' " *Safeco Ins. Co. of Am. v. Burr,* 551 U.S. 47, 57, 127 S.Ct. 2201, 167 L.Ed.2d 1045 (2007) (quoting *Bryan v. United States,* 524 U.S. 184, 191, 118 S.Ct. 1939, 141 L.Ed.2d 197 (1998)).

[4] Because § 5321(a)(5) involves civil penalties, the applicable definition of willfulness is that which has been used in other civil contexts, including civil tax collection matters and compliance with reporting requirements. Where willfulness is a condition of civil liability, it covers "not only knowing violations of a standard, but reckless ones as well." *Safeco Ins. Co.,* 551 U.S. at 57, 127 S.Ct. 2201; *cf. United States v. Illinois Central R. Co.,* 303 U.S. 239, 242–43, 58 S.Ct. 533, 82 L.Ed. 773 (1938) ("willfully" includes "conduct marked by careless disregard whether or not one has the right to so act") (citation omitted). Therefore, "willfulness" may be satisfied by establishing the individual's reckless disregard of a statutory duty, as opposed to acts that are known to violate the statutory duty at issue. *See Safeco Ins. Co.,* 551 U.S. at 57, 127 S.Ct. 2201. An improper motive or bad purpose is not necessary to establish willfulness in the civil context. *Am. Arms Int'l v. Herbert,* 563 F.3d 78, 83 (4th Cir.2009); *Prino v. Simon,* 606 F.2d 449, 451 (4th Cir.1979).

***1205** **[5]** The Supreme Court recently confirmed that acting with "willful blindness" to the obvious or known consequences of one's action also satisfies a willfulness requirement in both civil and criminal contexts. *See Global–Tech Appliances, Inc. v. SEB S.A.,* ––– U.S. ––––, 131 S.Ct. 2060, 2068–69, 179 L.Ed.2d 1167 (2011) ("persons who know enough to blind themselves to direct proof of critical facts in effect have actual knowledge of those facts") (citing *United States v. Jewell,* 532 F.2d 697, 700 (9th Cir.1976) (*en banc*)). Under the "willful blindness" standard, "a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts." *Id.* at 2070–71. Where a taxpayer makes a "conscious effort to avoid learning about reporting requirements," evidence of such willful blindness is a sufficient basis to establish willfulness. *United States v. Williams,* 489 Fed.Appx. 655, 659–60 (4th Cir.2012) (internal quotations omitted).

[6] In civil contexts involving a requirement to report or disclose certain information to the IRS, willfulness has been defined as conduct which is voluntary, rather than accidental or unconscious. *Lefcourt v. United States,* 125 F.3d 79, 83 (2d Cir.1997) (defining "willfulness" in the context of a civil penalty for willfully failing to disclose required information to the IRS as conduct that "requires only that a party act voluntarily in withholding requested information, rather than accidentally or unconsciously."); *accord Denbo v. United States,* 988 F.2d 1029, 1034–35 (10th Cir.1993) (defining "willful" conduct as a "voluntary, conscious and intentional decision") (quoting *Burden v. United States,* 486 F.2d 302, 304 (10th Cir.1973), *cert. denied,* 416 U.S. 904, 94 S.Ct. 1608, 40 L.Ed.2d 109

(1974)). Conduct that evidences "reckless disregard of a known or obvious risk" or a "failure to investigate ... after being notified [of the violation]" also satisfies the civil standard for willfulness in such contexts. *Denbo,* 988 F.2d at 1033.

[7] Willfulness may also "be proven through inference from conduct meant to conceal or mislead sources of income or other financial information." *United States v. Sturman,* 951 F.2d 1466, 1476–77 (6th Cir.1991). Moreover, willful intent may be proved by circumstantial evidence and reasonable inferences drawn from the facts because direct proof of the taxpayer's intent is rarely available. *See id.* (citing *Spies v. United States,* 317 U.S. 492, 499, 63 S.Ct. 364, 87 L.Ed. 418 (1943)).

1. McBride Had Knowledge of the Duty to Comply with the FBAR Requirements.

McBride was aware that he was engaged in a plan to avoid income taxes by hiding his interest in assets in overseas shell corporations. FOF, ¶¶ 16–20, 44–63. Concomitant with this intention is his willfulness with respect to whether or not he complied with the FBAR filing requirements. McBride was "gung ho" about retaining Merrill Scott to assist in avoiding the payment of his income taxes, FOF, ¶ 32, and he was similarly willful with respect to the FBAR filing requirement. After all, McBride reasoned, "that was the purpose of Merrill Scott because ... if you disclose the accounts on the form, then you pay tax on them, so it went against what [he] set up Merrill Scott for in the first place." FOF, ¶ 149.

A. Constructive Knowledge of the Reporting Requirement Is Imputed to Taxpayers Who Sign Their Federal Tax Returns.

[8] **[9]** All persons in the United States are charged with knowledge of the Statutes–at–Large. *Jones v. United States,* 121 F.3d 1327 (9th Cir.1997) (citing *Bollow* ***1206** *v. Federal Reserve Bank,* 650 F.2d 1093, 1100 (9th Cir.1981)). It is well established that taxpayers are charged with the knowledge, awareness, and responsibility for their tax returns, signed under penalties of perjury, and submitted to the IRS. *Magill v. Comm'r,* 70 T.C. 465, 479–80 (1978), *aff'd,* 651 F.2d 1233 (6th Cir.1981); *Teschner v. Comm'r,* T.C. Memo. 1997–498, *17 (1997); *accord United States v. Overholt,* 307 F.3d 1231, 1245–46 (10th Cir.2002) (observing that in *Bryan v. United States,* 524 U.S. 184, 194–95, 118 S.Ct. 1939, 141 L.Ed.2d 197 (1998), the Supreme Court distinguished cases like *Cheek v. United States,* 498 U.S. 192, 111 S.Ct. 604, 112 L.Ed.2d 617 (1991) and *Ratzlaf v. United States,* 510 U.S. 135, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994) from another context of willfulness on the grounds that the "highly technical statutes" involved in criminal tax prosecutions "carve out an exception to the traditional rule that ignorance of the law is no excuse and require that the defendant have knowledge of the law.") (internal quotation marks and citations omitted); *see also Am. Vending Group, Inc. v. United States,* 102 A.F.T.R.2d 2008–6305, 2008 WL 4605934, *6 (D.Md.2008) ("Failing to read does not absolve a filer of his or his corporation's legal obligations. Of course if one does not read the instructions, one does not know of the obligation to file the informational returns.").

In *United States v. Williams,* the only case to examine willfulness in the context of a civil FBAR penalty, the Fourth Circuit recently held that a taxpayer was willful in failing to comply with FBAR requirements when he signed a federal tax return that failed to disclose the existence of foreign accounts, "thereby declaring under penalty of perjury that he had 'examined this return and accompanying schedules and statements' and that, to the best of his knowledge the return was 'true, accurate, and complete.' " *See United States v. Williams,* 489 Fed.Appx. 655, 659 (4th Cir.2012). The Fourth Circuit reversed the district court's findings of fact as "clearly erroneous," on the grounds that the district court failed to consider the taxpayer's signature on his returns sufficient evidence of his knowledge of his failure to comply with the FBAR requirement. "A taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents." *Id.* (quoting *Greer v. Comm'r,* 595 F.3d 338, 347 n. 4 (6th Cir.2010)). At a minimum, "line 7a's directions to '[s]ee instructions for exceptions and filing requirements for Form TD F 90–22.1' " puts a taxpayer "on inquiry notice of the FBAR requirement." *Id.* As a result, the Fourth Circuit held that Williams's explicit statement that he never consulted Form TD F 90–22.1 or its instructions, never read line 7a, and "never paid any attention to any of the written words on his federal tax return" constituted a " 'conscious effort to avoid learning about reporting requirements,' " and his false answers on his federal tax return "evidence conduct that was 'meant to conceal or mislead sources of income or other financial information.' " *Id.* (quoting *Sturman,* 951 F.2d at 1476).

[10] **[11]** A taxpayer's signature on a return is sufficient proof of a taxpayer's knowledge of the instructions contained in the tax return form and in other contexts. "In general, individuals are charged with knowledge of the contents of documents they sign—that is, they have 'constructive knowledge' of those contents." *Consol. Edison Co. of N.Y., Inc. v. United States,* 221 F.3d 364, 371 (2d Cir.2000). In *In re Crawley,* 244 B.R. 121, 130 (Bankr.N.D.Ill.2000), the debtors contended that they did not read and review the information in their tax returns, which were prepared for ***1207** them by their accountant, so they could not have failed to pay their taxes willfully. Despite not reviewing the returns, the court charged the debtors with knowledge of the contents of their returns, stating:

> [P]eople who sign tax returns omitting income or overstating deductions often blame their accountant or tax preparer. But these arguments never go anywhere. People are free to sign legal documents without reading them, but the documents are binding whether read or not.

Id. at 130 (quoting *Novitsky v. Am. Consulting Engr's, L.L.C.,* 196 F.3d 699, 702 (7th Cir.1999)).

Many cases have cited the proposition that "[a] taxpayer's signature on a return does not in itself prove his knowledge of the contents, but knowledge may be inferred from the signature along with the surrounding facts and circumstances, and the signature is *prima facie* evidence that the signer knows the contents of the return." *See, e.g., United States v. Mohney,* 949 F.2d 1397, 1407 (6th Cir.1991); *accord Hayman v. Comm'r,* 992 F.2d 1256, 1262 (2d Cir.1993) (holding that where a taxpayer "claims to have signed the returns without reading them, [he or] she nevertheless is charged with constructive knowledge of their contents"). However, the "knowledge of the contents" discussed therein refers to the knowledge of what entries and submissions are made by the taxpayer or the taxpayer's preparer. *Mohney,* 949 F.2d at 1407 ("Such surrounding facts and circumstances include the defendant's knowledge of the business' revenues, his active role in the operations, his hiring of the accounting firm, and his payment of the taxes."); *accord United States v. Drape,* 668 F.2d 22, 26 (1st Cir.1982) ("Appellant's signature on his return was sufficient to establish knowledge once it had been shown that the return was false." (citing *United States v. Romanow,* 509 F.2d 26, 27 (1st Cir.1975))). On the other hand, knowledge of what instructions are contained within the form is directly inferable from the contents of the form itself, even if it were a blank. FOF, ¶¶ 132, 137. If this court were to read *Mohney* otherwise, that result would conflict with the well-established legal principle that citizens are charged with knowledge of the law.

By the same token, in *Burack v. United States,* 461 F.2d 1282 (Ct.Cl.1972), the court held that disregard of one's duties should not "be able to defeat the statutory liability fixed upon responsible persons by pleading that he did not know what he was signing and that his action was therefore not 'willful.' " *Id.* at 1292–93. That is precisely what McBride asks this court to do—to excuse his liability and knowledge of a plainly evident duty because he failed to read what he was signing. *Accord Katz v. United States,* 321 F.2d 7, 10 (1st Cir.1963) ("A return is not short of wilful [sic] falsity because the taxpayer chooses to keep himself uninformed as to the full extent that it is insufficient, or as to what exact figures should have been inserted. Innocence cannot outdistance ignorance.").

Inferring knowledge of the contents of a return signed by the taxpayer is consistent with the conclusion drawn by the Sixth Circuit in *United States v. Sturman,* which held that, "It is reasonable to assume that a person who has foreign bank accounts would read the information specified by the government in tax forms," including the reference on Schedule B to the FBAR. 951 F.2d at 1477. Moreover, the line of criminal cases dealing with whether or not a taxpayer's signature on a return demonstrates knowledge of the contents has upheld convictions where the jury was permitted to infer knowledge of the contents of the return from the signature on the return alone. *See, e.g., United States v. Olbres,* 61 F.3d 967, 971 (1st Cir.1995) (in ***1208** prosecution for tax fraud, "jury may permissibly infer that a taxpayer read his return and knew its contents from the bare fact that he signed it"); *United States v. Romanow,* 509 F.2d 26, 27 (1st Cir.1975) (jury could believe from the uncontested signature of the defendant on return that he had read the form, despite his claim that he merely signed the return that was prepared by bookkeeper).

In another case where plaintiffs alleged that a bank had a duty to inform its depositors of the FBAR requirement, the district court held that the plaintiffs could not show justifiable or reasonable reliance on any advice given (or not given) by the bank in interpreting the instructions on the tax return. *See Thomas v. UBS AG,* No. 11C4798, 2012 WL 2396866, *5 n. 2 (N.D.Ill. Jun. 21, 2012). “The simple yes-or-no question of Schedule B makes it inconceivable that [a taxpayer] could have misinterpreted this question.” *Id.* (holding that it was not possible to have reasonably or justifiably relied on any negligent or fraudulent representation concerning the applicability of the FBAR requirement).

B. McBride had knowledge of his obligation to file FBAR reports for the foreign accounts, and failed to do so.

Knowledge of the law, including knowledge of the FBAR requirements, is imputed to McBride. The knowledge of the law regarding the requirement to file an FBAR is sufficient to inform McBride that he had a duty to file a Form TD F 90–22.1 for any foreign account in which he had a financial interest.

McBride signed his federal tax returns for both the tax year 2000 and 2001. FOF. ¶¶ 135, 140, 141. Accordingly, McBride is charged with having reviewed his tax return and having understood that the federal income tax return asked if at any time during the tax year, he held any financial interest in any foreign bank or financial account. FOF, ¶¶ 131, 136. The federal income tax returns contained a plain instruction informing individuals that they have the duty to report their interest in any foreign financial or bank accounts held during the taxable year. *See Thomas,* 2012 WL 2396866, at *5 n. 2. McBride is therefore charged with having had knowledge of the FBAR requirement to disclose his interest in any foreign financial or bank accounts, as evidenced by his statement at the time he signed the returns, under penalty of perjury, that he read, reviewed, and signed his own federal income tax returns for the tax years 2000 and 2001, as indicated by his signature on the federal income tax returns for both 2000 and 2001. FOF, ¶¶ 131–141. *See Williams,* 489 Fed.Appx. at 659. As a result, McBride's willfulness is supported by evidence of his false statements on his tax returns for both the 2000 and the 2001 tax years, and his signature, under penalty of perjury, that those statements were complete and accurate. FOF, ¶¶ 131–141.

More importantly, McBride actually read the marketing and promotional materials provided to him by Merrill Scott. FOF, ¶ 142. The marketing and promotional materials informed McBride of the duty imposed by federal law that U.S. taxpayers are required to report their interest in foreign bank and financial accounts. FOF, ¶¶ 21–23 (“As a U.S. taxpayer, the law requires you to report your financial interest in, or signature authority over, any foreign bank account, securities account, or other financial account”). As a result, McBride had actual knowledge of his duty to file an FBAR for any account in which he had a financial interest prior to filing his 2000 and 2001 tax returns. McBride even testified that “the purpose of Merrill Scott” was to avoid disclosure and reporting the existence of interests “because ... if you disclose the accounts on the form, then you pay tax on them, so ***1209** it went against what [he] set up Merrill Scott for in the first place.” FOF, ¶ 149.

McBride's claim that he did not know he had a legal duty to file FBARs is not credible. During his interviews with the IRS, McBride admitted to misleading the IRS, lying about several pertinent factual details, withholding information, and failing to disclose documentary evidence. FOF, ¶¶ 155–161. McBride has not only lied to the IRS, but has also made contradictory statements in his sworn responses to interrogatories and his testimony on the stand. *Compare* FOF, ¶¶ 26, 28 with ¶ 27. Moreover, once it was apparent the IRS was considering imposing the FBAR penalty, McBride has had every incentive to continue to conceal his awareness of the FBAR requirement. As a result, McBride's evasive course of conduct in lying to the IRS and concealing information is circumstantial evidence of McBride's willfulness. *See Sturman,* 951 F.2d at 1476 (holding that where a taxpayer “concealed his signature authority, his interests in various transactions, and his interest in corporations transferring cash to foreign banks” was conduct adequate to infer willfulness); *see also United States v. Dashney,* 117 F.3d 1197, 1203 (10th Cir.1997) (“[I]n the structuring context, ‘proof of concealment tends to prove knowledge of illegality.’ ”) (quoting *United States v. Marder,* 48 F.3d 564, 574 (1st Cir.1995)).

2. McBride's Conduct was Reckless.

A. Recklessness Satisfies the Civil Willfulness Requirement.

Under the wilfulness analysis in the analogous § 6672 context, "A responsible person is reckless if he knew or should have known of a risk that the taxes were not being paid, had a reasonable opportunity to discover and remedy the problem, and yet failed to undertake reasonable efforts to ensure payment." *Jenkins v. U.S.,* 101 Fed. Cl. 122, 134 (Fed.Cl.2011). In the same context, willfulness has been found where "the facts and circumstances of a particular case, taken as a whole, demonstrate" that the taxpayer "knew or should have known that there was a risk [of noncompliance] and failed to take available corrective action," with the result being the violation of the law. *Id.* (citing *Ghandour v. United States,* 36 Fed. Cl. 53, 63 (Fed.Cl.1996)); *accord Monday v. United States,* 421 F.2d 1210 (7th Cir.1970).

In *Sorenson v. United States,* a case which involved a civil penalty for the willful failure to pay trust fund taxes to the United States, the taxpayer claimed he "mistakenly believed that withholding need not be made on salaries paid out of 'personal' funds." 521 F.2d 325 (9th Cir.1975). However, the Ninth Circuit specifically rejected the argument that this subjective lack of knowledge excused the defendant from having knowledge of the duty imputed to him, stating, "He also had an accountant and an attorney available when he sought advice. If he did not understand his responsibilities it is because he did not ask those who could have informed him; and if he did not ask we are inclined to believe that was because he preferred ignorance." *Id.* at 329 (concluding that "he acted with a reckless disregard for obvious risks," sufficient to satisfy the willfulness requirement).

[12] An individual's actions may be deemed willful if the individual recklessly ignores the risk that conduct is illegal by failing to investigate whether the conduct is legal. Taxpayers have long been cautioned that they have a responsibility to "investigate claims when they are likely 'too good to be true.' " *Pasternak v. Comm'r,* 990 F.2d 893, 903 (6th Cir.1993) (quoting *McCrary v. Comm'r,* 92 T.C. 827, 850 (1989)). "When, as here, a taxpayer is presented with what would appear to be a fabulous opportunity to avoid tax obligations, he should recognize that he proceeds ***1210** at his own peril." *Neonatology Associates, P.A. v. Comm'r,* 299 F.3d 221, 234 (3rd Cir.2002).

B. Willful Blindness Satisfies the Civil Willfulness Requirement.

[13] The same logic applies to those who deliberately avoid learning of their legal duty or the facts that would give rise to their wrongdoing. For an individual to have acted "wilfully," an individual need not have been subjectively aware of the FBAR reporting requirement or else an individual would be able to defeat liability by deliberately avoiding learning of his or her legal duties. "To allow the most clever, inventive, and sophisticated wrongdoers to hide behind a constant and conscious purpose of avoiding knowledge of criminal misconduct would be an injustice in its own right." *United States v. Jinwright,* 683 F.3d 471, 478 (4th Cir.2012). In order to demonstrate willful blindness, "a defendant must subjectively believe that there is a high probability that a fact exists and the defendant must take deliberate actions to avoid learning of that fact." *Global–Tech Appliances,* 131 S.Ct. at 2070–2071.

C. McBride's Conduct Was Reckless and Willfully Blind as to the Obvious Risk of Failing to Comply With the FBAR Requirements.

McBride was either in reckless disregard of a known or obvious risk or willfully blind to the possibility of the failure to make the proper disclosures to the IRS as a result of his involvement in the Master Financial Plan.

i. Known or obvious risk.

Because McBride acted in reckless disregard of the known or obvious risks created by his involvement with Merrill Scott actual, subjective knowledge is not required for him to have willfully failed to comply with the FBAR requirements. *See Sorenson,* 521 F.2d at 329.

As described above, McBride had notice of the potential risks of failing to report one's interest in foreign bank accounts as a result of the correspondence between Taylor and himself, as well as the article attached by

Taylor. FOF, ¶¶ 40–42. By the time McBride filed his income tax return for the tax year 2000, McBride was concerned about Merrill Scott, and it was, or should have been, obvious to McBride that Merrill Scott was employing illegal strategies. FOF, ¶¶ 145; *see* FOF, ¶ 13; *see also SEC v. Merrill Scott & Associates, Ltd. et al.,* Complaint for Temporary Restraining Order, Preliminary and Permanent Injunctions and Legal and Other Equitable Relief (Case No. 2:02–cv–0039, January 15, 2002).

The risk of failing to comply with all applicable reporting requirements with respect to assets hidden through the Master Financial Plan was also obvious. McBride understood that he was engaging Merrill Scott in order to take advantage of a scheme to avoid or defer taxes using means that initially appeared to him to be tax evasion. FOF, ¶¶ 17, 19, 20. McBride was aware that the strategies used by Merrill Scott involved using nominee directors and IBCs that would disguise the true ownership of his assets in the Master Financial Plan. FOF, ¶¶ 64, 66, 69, 70, 74. When Merrill Scott explained the Master Financial Plan, McBride's initial reaction was to say, “This is tax evasion,” demonstrating that the risk of potential noncompliance was obvious. FOF, ¶ 17. McBride even testified that “the purpose of Merrill Scott” was to avoid disclosure and reporting the existence of his financial interests “because ... if you disclose the accounts on the form, then you pay tax on them, so it went against what [he] set up Merrill Scott for in the first place.” FOF, ¶ 149. ***1211** And yet, McBride did not attempt to obtain a legal opinion that would identify whether or not the scheme had any consequences with respect to his filing obligations. FOF, ¶¶ 30, 31, 34. The risk of failing to comply with the FBAR requirements was therefore known to McBride and obvious.

In addition, because the federal tax returns contain a plain instruction regarding the disclosure of interests in foreign financial or bank accounts, the risk of failing to disclose an interest in such a foreign account is obvious. The risk of failing to disclose a financial interest in a foreign account is an obvious risk, given that the question on line 7a of Schedule B is available to anyone who looks at a blank Form 1040 individual income tax return. *See Williams,* 489 Fed.Appx. at 659–60. Moreover, the question is simple and appraises anyone who reads it of an obvious risk of failure to disclose one's interest in foreign financial accounts: “The simple yes-or-no question of Schedule B makes it inconceivable that [a taxpayer] could have misinterpreted this question.” *See Thomas,* 2012 WL 2396866, at *5 n. 2. As a result, the risk of failing to comply with the FBAR requirements is an obvious risk.

Therefore, even if McBride did not have actual, subjective knowledge of the FBAR requirements when he signed and filed his federal income tax returns for the tax years 2000 and 2001, the risk of failing to comply with the FBAR requirements was known or obvious.

ii. Reckless disregard.

In this case, McBride deliberately engineered a financial scheme, with the help of Merrill Scott, that he believed allowed him to remain unaware of his filing duties. His stated purpose of entering the Master Financial Plan was to make it appear that, for tax purposes, he did not have a financial interest in the foreign accounts that could be subject to any reporting requirements, whether reporting income or FBAR. FOF, ¶ 149.

McBride was aware of the potential risks, which include criminal liability, of engaging in activities resembling the strategies taken pursuant to the Master Financial Plan: placing assets in foreign bank accounts without reporting income or the existence of those accounts. FOF, ¶¶ 40–42. However, McBride did not care about the potential legal ramifications of the Master Financial Plan; he was “gung ho” about the plan. FOF, ¶ 32. He did not attempt to obtain an outside legal opinion to assess the legality of Merrill Scott's strategies. FOF, ¶¶ 30, 144. He now claims he did not even attempt to read the legal opinion provided to him. FOF, ¶ 143. He did not discuss the legality or consequences of the Master Financial Plan with Stayner, his accountant at the time. FOF, ¶ 31. He did not obtain any kind of feedback from his partner's accountant before cutting two of the three checks paid to Merrill Scott in consideration of the Master Financial Plan. FOF, ¶¶ 34, 37, 38.

Moreover, McBride was already suspicious of whether or not Merrill Scott was a legitimate business before he signed or filed his federal income taxes for the tax years 2000 or 2001. FOF, ¶¶ 116–118, 145. However, he did not seek a legal opinion regarding the validity of the Master Financial Plan, or his reporting obligations under it at that time either.

iii. Tax year 2000.

McBride's failure to disclose all of the pertinent and relevant information that must be disclosed constitutes evidence of willfulness. *See, e.g., Korecky v. Comm'r,* 781 F.2d 1566 (11th Cir.1986) (holding that a taxpayer who failed to disclose all relevant financial statements and affairs to his accountant cannot rely on advice from that accountant as a defense to fraud, which ***1212** includes a requirement of showing willfulness).

By virtue of his deliberately engineered belief that he did not have a financial interest in the foreign accounts, McBride did not disclose the existence of those accounts to Stayner, his accountant who prepared his income tax returns for the tax year 2000. FOF, ¶¶ 146–149. McBride was the only source of information regarding his financial affairs from which Stayner based the preparation of his returns, but McBride did not include any of the information regarding the Master Financial Plan or his involvement with Merrill Scott to Stayner. FOF, ¶¶ 145–150. McBride's decision to not disclose his involvement with Merrill Scott to Stayner was deliberate and knowing. FOF, ¶ 149. The fact that McBride did not discuss these significant financial strategies, involving millions of dollars, with his accountant for the tax year 2000 is significant evidence of willfulness or at least recklessness and willful blindness. *See Drape,* 668 F.2d at 25 (considering it "significant" in determining whether the taxpayer had acted willfully that the taxpayer never discussed his participation in a tax shelter with his accountant for the previous year). Moreover, the fact that Stayner prepared McBride's return does not negate willfulness on McBride's part in failing to furnish Stayner with information concerning all of the relevant facts of his financial affairs. *See United States v. Samara,* 643 F.2d 701, 703 (10th Cir.1981) ("Defendant's reliance on the advice of his lawyer and accountant does not negate willfulness unless defendant made a complete disclosure of all pertinent facts.") (citing *United States v. Jett,* 352 F.2d 179, 182 (6th Cir.1965))

As such, McBride's failure to disclose all relevant information to Stayner is evidence of his willfulness, or at least his reckless disregard, of the potential consequences of failing to comply with the FBAR requirements. *See Korecky,* 781 F.2d at 1569. McBride subjectively believed that there was a high probability that a fact exists—namely, that there were reporting obligations that might be shirked by engaging in Merrill Scott and the Master Financial Plan. McBride further took steps to avoid learning of this fact by failing to disclose his participation in Merrill Scott to his accountant Stayner. As a result, McBride was willfully blind to the possibility that he had failed to comply with the FBAR requirements. In addition, McBride's failure to seek a legal opinion concerning his reporting requirements was in reckless disregard of the known or obvious risk of failure to disclose his interest in a foreign account. Therefore, McBride signed his returns with either full knowledge or reckless disregard of the high probability that they did not include all pertinent and required information.

Even if McBride did not already know of his legal duty to file an FBAR with respect to the foreign accounts, he did act deliberately in engineering a scheme that he believed would not require learning of this duty by reporting his financial affairs related to the Master Financial Plan. McBride's belief, that the purpose of entering into the arrangement with Merrill Scott was to "avoid reporting" the income one received, demonstrates that he had a sufficiently willful mental state as to the reporting of either income or his financial interests in overseas accounts. At the very least, McBride must have been reckless as to the consequences of failing to report or disclose income sources, and therefore reckless as to whether or not his failure to report income would also result in a failure to comply with the FBAR requirements.

Furthermore, even if McBride were not charged with knowledge of the contents of a tax return by virtue of having signed it, ***1213** the fact that McBride signed a federal income tax return without having an understanding as to its contents, while simultaneously engaging in transactions with foreign entities designed to avoid or defer tax, constitutes evidence of either willful blindness or recklessness.

iv. Tax Year 2001.

Though McBride asserted repeatedly that he relied on representations by Merrill Scott and its affiliated attorneys that the Master Financial Plan was legal, that reliance cannot negate willfulness. "Taxpayers may not rely on someone with an inherent conflict of interest, or someone with no knowledge concerning that matter upon which the advice is given." *Chamberlain v. Comm'r,* 66 F.3d 729, 732 (5th Cir.1995) (citations omitted). McBride accepted responsibility for completing his own federal income tax returns, despite offers by Merrill Scott to prepare them for him. FOF, ¶¶ 35, 36.

In 2001, McBride claims to have relied on Taylor to determine whether or not he was subject to any reporting requirements for his interest in the foreign accounts. However, McBride did not call Taylor as a witness, so the court was presented only with conflicting evidence as to Taylor's out of court statements.

[14] In a declaration signed by Taylor on March 3, 2010, Taylor stated that McBride "never informed [him] that [McBride] had any foreign bank accounts." Plaintiff's Ex. 8 at ¶ 6. There was no testimony that Taylor told McBride not to report his interests in the foreign bank accounts. Even if Taylor was fully aware of the Merrill Scott scheme, yet failed to properly advise McBride to report his interests in the foreign accounts, this would not excuse McBride. The taxpayer, not the preparer, has the ultimate responsibility to file his or her return and pay the tax due. *Kooyers v. Comm'r,* T.C. Memo. 2004–281 (2004). This duty cannot generally be avoided by relying on an agent. *Estate of Clause v. Comm'r,* 122 T.C. 115, 123–24 (2004); *Am. Props., Inc. v. Comm'r,* 28 T.C. 1100 (1957), *aff'd,* 262 F.2d 150 (9th Cir.1958). McBride knew, or at least made himself willfully blind, about the need to report his interests in the foreign accounts when he signed his 2000 return. That Mr. Taylor may have further facilitated McBride's willful blindness a year later by failing to dispense proper advice does not render McBride's failure to report his interest in foreign accounts any less willful.

Moreover, even if the decision not to disclose McBride's interest in the foreign accounts was based on McBride's belief that he did not hold sufficient interest in those accounts to warrant disclosure, that failure to disclose those interests would constitute willfulness. *Lefcourt,* 125 F.3d at 83 ("Once it is determined, as it was here, that the failure to disclose ... information was done purposefully, rather than inadvertently, it is irrelevant that the filer may have believed he was legally justified in withholding such information. The only question that remains is whether the law required its disclosure."). Because McBride signed his tax returns, he is charged with knowledge of the duty to comply with the FBAR requirements. *United States v. Williams,* 489 Fed.Appx. at 659. Whether McBride believed Taylor had determined that a disclosure was not required is irrelevant in light of *Lefcourt,* which states that the only question is whether the decision not to disclose was voluntary, as opposed to accidental. The government does not dispute that McBride's failure to comply with FBAR was the result of his belief that he did not have a reportable financial interest in the foreign accounts. However, because it is irrelevant that McBride "may have believed he was legally justified in withholding such information[,] [t]he only question that remains is whether the law required ***1214** its disclosure." *Lefcourt,* 125 F.3d at 83. Here, the FBAR requirements did require that McBride disclose his interests in the foreign accounts during both the 2000 and the 2001 tax years. As a result, McBride's failure to do so was willful.

g. The amounts of the assessed FBAR penalties are proper.

[15] As it existed prior to an amendment that took effect in 2004, Section 5321(a)(5)(B)(ii) authorized penalties of "(I) an amount (not to exceed $100,000) equal to the balance in the account at the time of the violation; or (II) $25,000." The penalties at issue were assessed against McBride in the amount of $200,000—$100,000 for 2000, and $100,000 for 2001. *See* FOF ¶¶ 163, 164. These penalties were justified under Section 5321(a)(5)(B)(ii)(I) because the foreign bank accounts each had balances of at least $10,000 in 2000 and 2001 as demonstrated by statements issued for those accounts. FOF, ¶¶ 57–60, 109, 110, 113, 114. Accordingly, the amounts of the penalties were proper. In addition to the amounts assessed, the United States is entitled to interest and penalties pursuant to 31 U.S.C. § 3717.

CONCLUSION AND ORDER

The United States has established, by a preponderance of the evidence, each of the requirements of 31 U.S.C. § 5321 with respect to the assessment against McBride for the tax years 2000 and 2001.

IT IS THEREFORE ORDERED that judgment is ENTERED in favor of the Plaintiff United States of America and against Defendant Jon McBride in the amount of $200,000, plus interest and penalties in the amount of $74,621.92 pursuant to 31 U.S.C. § 3717.

All Citations

908 F.Supp.2d 1186, 110 A.F.T.R.2d 2012-6600, 2012-2 USTC P 50,666

Footnotes

[1] Proposed Findings of Fact and Conclusions of Law [submitted by United States of America], docket no. 101, filed July 23, 2012; Defendant Jon McBride's Proposed Findings of Fact and Conclusions of Law, docket no. 104, filed August 22, 2012.

[2] The Secretary implemented the regulatory requirements with a two-step reporting process. Form 1040, Schedule B, Part III instructs taxpayers to indicate an interest in a financial account in a foreign county by checking “Yes” or “No” in the appropriate box. *See* Uncontroverted Fact No. 8. Form 1040 further refers taxpayers to Form TD F 90–22.1 which provides specific instructions for reporting a financial interest in or authority over bank accounts, securities accounts, or other financial accounts in a foreign country. *See* Uncontroverted Fact No. 9.

[3] 31 C.F.R. § 1010.350(e)(2)-(3) (2011) essentially adopts the definitions of “financial interest” used in Form TD F 90–22.1 and indicates that “financial interest” is intended to reach a situation where entities are used to disguise the taxpayer's interest in foreign accounts.

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614 F.Supp.2d 241
United States District Court, D. Connecticut.

UNITED STATES of America, Plaintiff,
v.
Richard SIMONELLI, Defendant.

Civil No. 3:06cv653 (JBA).
|
Sept. 30, 2008.

Synopsis

Background: After defendant, a holder of foreign bank accounts, obtained a general discharge in bankruptcy, the United States filed civil case against defendant to collect penalty, plus interest and penalty interest for failure to file FBAR (report of foreign bank and financial accounts). Government filed motion for summary judgment.

Holding: In resolving an issue of first impression, the District Court, Janet Bond Arterton, J., held that debt for FBAR penalty was nondischargeable.

Motion granted.

Attorneys and Law Firms

***241** Wendy J. Kisch, John B. Hughes, U.S. Attorney's Office, New Haven, CT, for Plaintiff.

Joseph J. D'Agostino, Jr., Wallingford, CT, for Defendant.

RULING ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT [Doc # 20]

JANET BOND ARTERTON, District Judge.

I. Background

This case stands at the intersection of the Currency and Foreign Transactions Reporting Act, also known as the Bank Secrecy Act, 31 U.S.C. § 5311 *et seq.* ("Bank Secrecy Act"), and 11 U.S.C. § 523(a)(7), the provision of the Bankruptcy Codes that governs exceptions to discharge of debts after a debtor-petitioner is adjudged bankrupt. The material facts of the case are straightforward and undisputed, and the issue to be resolved is a legal one, apparently one of first impression.

The Bank Secrecy Act is a statutory and regulatory scheme that seeks to detect and prosecute criminal activity, pursue tax code enforcement, and engage in other "regulatory investigations or proceedings." 31 U.S.C. § 5311. Its focus on reports and records derives from the "increasing use of banks and other institutions as financial intermediaries by persons engaged in criminal activity." *Ratzlaf v. United States,* 510 U.S. 135, 138, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994). One part of the Act requires persons who have financial interests in, or authority over, banks, securities or other financial accounts in foreign countries to report such information to the federal government. To this end, the Act requires covered entities to report their foreign transactions and accounts in a document called the Report of Foreign Bank and Financial Accounts ("FBAR"). 31 U.S.C. § 5314(a).

During 1999, Defendant Richard Simonelli held three accounts at two banks in the Bahamas, Barclay's Bank and Leadenhall Bank & Trust, which rendered him a ***242** covered entity under the Bank Secrecy Act. As such, under 31 U.S.C. § 5314(a) Defendant was obligated to file with the Internal Revenue Service an FBAR disclosing these accounts.[1] Defendant did not file the required FBAR for calendar year 1999, and on April 7, 2004 consented to an assessment and collection of $25,000 under § 5321(a)(5) (2000), plus interest and penalties, for his willful failure to file the FBAR. On May 5, 2004, the Internal Revenue Service ("IRS"), acting as a delegate of the Secretary of the Treasury and pursuant to 31 U.S.C. § 5321(a)(5), made this assessment and demanded payment. (Def.'s Local R. 56(a)1 Stmt. ¶¶ 1–5.) After Defendant failed to make any payment, the Plaintiff United States of America, acting for the Secretary of the Treasury and the IRS, filed this civil case against Defendant in April 2006 to collect the FBAR penalty, plus interest and penalty interest.

After the IRS assessed the FBAR penalty on Defendant but before this suit was filed, Defendant obtained a general discharge in bankruptcy on December 26, 2005 under 11 U.S.C. § 727. *In re Simonelli,* No. 05–34621 (Bankr.D.Conn.2005). He claims that the FBAR penalty assessed was discharged at that time. In its motion for summary judgment, the government maintains that this FBAR penalty is excepted from bankruptcy discharge by 11 U.S.C. § 523(a)(7). (Pl.'s Mot. Summ. J. at 1; Pl.'s Mem.

in Supp. at 7–10.) In response, Defendant argues that his bankruptcy discharge relieves him of his obligation to pay the FBAR penalty under § 523(a)(7)(B) because the FBAR penalty is in actuality a "tax penalty."

In that the parties agree on the material facts recited above and their dispute presents a purely legal question, it is "particularly conducive to disposition by summary judgment." *Connecticut ex rel. Blumenthal v. Crotty,* 346 F.3d 84, 93 (2d Cir.2003).[2] For the reasons that follow, the Court concludes that the FBAR penalty was not discharged in bankruptcy and Plaintiff's Motion for Summary Judgment will be granted.

II. Statutory Framework

Under the Bankruptcy Code certain kinds of debts are not discharged when a petitioner is adjudged bankrupt. Specifically, 11 U.S.C. § 523(a)(7) establishes that a discharge under 11 U.S.C. § 727 does not relieve the debtor-petitioner of "any debt ... to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than" two kinds of "tax penalt[ies]." Defendant maintains that the FBAR penalty is one of these kinds of tax penalties and thus was discharged.

As the Supreme Court has explained, "[o]n its face, [§ 523(a)(7)] creates a broad exception [to discharge in bankruptcy] for all penal sanctions, whether they be denominated fines, penalties, or forfeitures. Congress included two qualifying phrases; the fines must be both 'to and for the benefit of a governmental unit,' and 'not compensation for actual pecuniary loss.' " *Kelly v. Robinson,* 479 U.S. 36, 52, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986). Thus, to be excluded from this broad class of penal sanctions whose discharge is prohibited, a debt must either fall outside that class or ***243** must fall within one of three exclusions. A debt for a penal sanction is dischargeable if it: (1) is not "payable to and for the benefit of a governmental unit,"[3] or (2) is "compensation for actual pecuniary loss,"[4] or (3) is one of two kinds of "tax penalt[ies]." The two kinds of "tax penalt[ies]" excluded from the § 523(a)(7) exception to discharge are certain kinds of "tax or customs dut[ies]" listed at § 523(a)(1), and penalties for taxes that are "imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition." § 523(a)(7)(A), (B). Defendant conceded at oral argument that neither (1) nor (2) would exclude his FBAR penalty, and focuses on (3).

III. Discussion

A. Defendant's Arguments

At oral argument Defendant clarified his position to be that his debt for the FBAR penalty is dischargeable under § 523(a)(7)(B), which discharges any debt for a "tax penalty" that is "imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition." He conceded that if the FBAR was not a "tax penalty" under this provision, it could not be discharged at all. The government conceded that if it is a "tax penalty," it was incurred with respect to a transaction or occurrence that occurred more than three years prior to the bankruptcy petition and would be dischargeable.

In support of his argument that the FBAR penalty is a tax penalty under § 532(a)(7)(B), Defendant claims that the IRS assessed the $25,000 to which he consented, in lieu of assessing taxes on him because his failure to file the FBAR deprived the IRS of any information about his foreign bank transactions, making it impossible for the IRS to know how much tax to assess on him. In Defendant's view, the IRS uses the FBAR documents to track money in offshore accounts (or transactions occurring outside the United States) of which the IRS otherwise has no knowledge but on which it would otherwise seek to assess taxes. Once the IRS knows, from reviewing the information contained in the FBAR, how much a person owed in taxes if the accounts had been located (or the transaction occurred) in the United States, it assesses that person a tax in this amount. When a person fails to file an FBAR, the IRS cannot track how much she would owe in taxes, and thus instead of collecting these would-be taxes, Defendant reasons, the IRS imposes a civil penalty—the FBAR penalty—as a rough approximation of those taxes it has lacked sufficient information to assess. Defendant thus argues that the FBAR penalty is imposed in lieu of taxes, and thus is, in fact, a tax. Relatedly, Defendant also argues that the FBAR penalty is a tax penalty because the IRS uses it to penalize persons who fail to file FBARs, frustrating the IRS's ability to track, assess and collect their would-be taxes.

Defendant relies on the statute and regulations pursuant to which the IRS assessed the FBAR penalty. At oral argument he pointed to 31 U.S.C. §§ 5311 and ***244** 5321 and 31 C.F.R. § 103.24. As discussed above, § 5311 lays out the Bank Secrecy Act's multiple purposes and § 5321 authorizes the maximum and minimum assessments of the FBAR penalty, which it denominates a "penalty." [5] In 31 C.F.R. § 103.24 the Secretary of the Treasury delegates to the IRS the authority to assess and collect civil penalties under 31 U.S.C. § 5321, and to "investigate possible civil violations" of the Bank Secrecy Act. These provisions say nothing about the Bank Secrecy Act serving as a mechanism to collect otherwise uncollected taxes, and do not contradict the Bank Secrecy Act's own articulation, at 31 U.S.C. § 5311, of its purposes.

B. Whether Defendant's debt for the FBAR penalty is for a "penalty" or "tax"

A plain text reading of the Bank Secrecy Act is that the FBAR penalty is a "penalty" for purposes of 11 U.S.C. § 523(a)(7). The statutory penalty for willful failure to comply with § 5314(a) is a "civil money penalty" whose parameters are outlined in § 5321(a)(5). The Secretary's regulations specify that the penalty for a failure to file an FBAR is "a civil penalty." *See* 29 C.F.R. §§ 103.56(g) & 103.57 (2004). The Bank Secrecy Act and its implementing regulations thus expressly denominate the penalty imposed on Defendant to be a "civil penalty." [6]

Defendant argues that, notwithstanding the FBAR penalty's statutory denomination as a "penalty," the FBAR penalty is, in essence, actually a tax. (Def.'s Mem. in Supp. Obj. Pl.'s Mot. Summ. J. at 1.) He points to *United States v. Sotelo,* 436 U.S. 268, 98 S.Ct. 1795, 56 L.Ed.2d 275 (1978), for the proposition that a pecuniary burden imposed on a debtor can be characterized as a "tax" even if the statute under ***245** which it is imposed denominates it a "penalty." (Def.'s Mem. in Supp. Obj. Pl.'s Mot. Summ. J. at 4–5.) Beyond that general proposition, however, *Sotelo* is not applicable here. That case involved a debtor who, before filing for bankruptcy, had collected funds from his employees in the form of withheld taxes, but had failed to pay them over to the IRS. The Internal Revenue Code imposed a "penalty" on him equal to the amount of taxes he failed to pay over. *Sotelo,* 436 U.S. at 270 n. 1, 98 S.Ct. 1795. The Supreme Court held that the collected funds' "essential character" was taxes because the funds were taxes when the debtor withheld them from his employees, and as a result they were taxes dischargeable under bankruptcy law. *Id.* at 275, 98 S.Ct. 1795.

In this case, by contrast, the debt to be collected from Defendant was imposed pursuant to a non-tax law (the Bank Secrecy Act), that Defendant seeks to recharacterize as a tax (rather than a non-tax) and its dischargeability involves a different Bankruptcy Code section.

Alternatively, Defendant urges the Court to use the four-part definition of a "tax" from *In re Lorber Industries of California, Inc.,* 675 F.2d 1062 (9th Cir.1982) to determine whether his FBAR penalty is a "tax" rather than a "non-tax charge[ ]." *In re Lorber* concerned the priority of debts, including "taxes," to be repaid out of a debtor's estate after a petitioner is adjudged bankrupt. *See id.* at 1063. According to *In re Lorber,* a tax is characterized as:

> (a) An involuntary pecuniary burden, regardless of name, laid upon the individuals or property;
>
> (b) Imposed by, or under authority of the legislature;
>
> (c) For public purposes, including the purposes of defraying expenses of government or undertakings authorized by it;
>
> (d) Under the police or taxing power of the state.

Id. at 1066. [7]

The FBAR penalty is not an "involuntary pecuniary burden;" the Bank Secrecy Act does not impose any pecuniary burden on covered entities who fulfill their obligations under the Act, only those who violate federal law by failing to file FBARs when the Act requires them to do so. The term "involuntary" connotes an inability of an individual to avoid assessment of a pecuniary burden in carrying out otherwise lawful activities. *See Boston Reg'l Med. Ctr., Inc. v. Mass. Div. of Health Care Fin. & Policy (In re Boston Reg'l Med. Ctr., Inc.),* 365 F.3d 51, 60 (1st Cir.2004) (rejecting argument that a pecuniary burden was "voluntary" if a covered entity could avoid it by "ceas [ing] all... operations," because under that argument, "the federal income tax would not qualify as a 'tax' because the taxpayer may voluntarily minimize his or her tax liability by earning less income or by taking advantage of deductions"). [8] Here, simply, Defendant ***246** could have continued to hold his foreign bank accounts and avoid assessment of the FBAR penalty if he had filed an FBAR.[9] The FBAR penalty is therefore not "involuntary" and thus falls outside *In re Lorber's* definition of "tax."[10]

Finally, Defendant argues that § 5321(a)(5) (2000) allows the government to collect "taxes in situations where assessment based on actual taxes due may be impossible to determine as a result of the barriers created by the nature of the accounts." (Def.'s Mem. in Supp. Obj. Pl.'s Mot. Summ. J. at 6.) In Defendant's view, the "tax" collected by the IRS under the Bank Secrecy Act could equal 100 percent of the value of the transaction or account, and would be collectible only where the person failed to file an informational document with the government. Although Defendant argues that the negotiated FBAR penalty to which he stipulated incorporated his potential tax liabilities, he provides no authority or evidence in support of this assertion.

For the reasons stated above, Defendant's attempt to characterize the Bank Secrecy Act as "a mechanism to collect [covered entities'] taxes due" (Def.'s Mem. in Supp. Obj. Pl.'s Mot. Summ. J. at 6) is unavailing. The IRS's assessment of the FBAR penalty is not, as Defendant argues, "government collecting, for lack of better terminology, back taxes." (*Id.* at 4.) Given the text, framework, and history of the Bank Secrecy Act, as well as the plain meanings of the terms "tax" and "penalty" and the operation of § 5321(a)(5), the "better terminology" to describe the FBAR penalty is as a "civil money penalty."

C. The "tax penalty" exclusion from § 523(a)(7)'s exceptions to discharge.

A debt may be discharged if the debt is for one of two kinds of "tax penalt [ies]." Defendant argues that his debt is dischargeable under this exclusion. In order to be a tax penalty, the FBAR penalty would have to be linked in some way to an underlying tax. For Defendant's argument to have any viability, the FBAR itself would have to be a tax. The FBAR is a document, not a tax: indeed, the document specifically instructs filers: "Do *NOT* file with your Federal Tax Return." (Department of the Treasury Form TD F 90–22.1 (Report of Foreign Bank and Financial Accounts).) The Act requires covered entities to file the FBAR with the government, but not to remit money or property. ***247** Neither the FBAR nor the Bank Secrecy Act impose any pecuniary burden on covered entities who fulfill their obligations under the Act. Because there is no tax underlying the FBAR penalty, the FBAR penalty cannot be considered a "tax penalty." Because the Court concludes that the FBAR penalty is not a "tax penalty,"[11] the fact that more than three years have elapsed since the "transaction or occurrence" before the bankruptcy petition filing, is of no import.

IV. Conclusion

Defendant's debt for the FBAR penalty is for a "penalty" within the meaning of 11 U.S.C. § 523(a)(7), and therefore falls within that section's broad class of debts excepted from discharge. Defendant's debt does not fall within any of the three exclusions to the § 523(a)(7) class of excepted debts. Therefore, § 523(a)(7) bars discharge of Defendant's debt stemming from the May 2004 assessment of the FBAR penalty.

Accordingly, Plaintiff's motion for summary judgment [Doc. # 20] is GRANTED. The Clerk is directed to close this case and enter Judgment in favor of Plaintiff in the amount of $25,000.00, plus interest pursuant to 31 U.S.C. §§ 3717(a)(1), (e)(2) and (f). To the extent that Defendant wishes to pursue the issue raised at oral argument of whether the accrual of interest was stayed during the pendency of the automatic bankruptcy stay, he may do so in a Motion for Modification of Judgment setting forth the legal basis for such a stay. Such motion shall be filed within 30 days.

IT IS SO ORDERED.

All Citations

614 F.Supp.2d 241, 102 A.F.T.R.2d 2008-6577

Footnotes

[1] Specifically, 31 U.S.C. § 5314(a) obligates entities to file an FBAR with the IRS if they "make[ ] a transaction or maintain[ ] a relation for any person with a foreign financial agency."

2 The well-known summary judgment standard is familiar to the Court and will be applied without recitation in detail. *See, e.g., Milardo v. City of Middletown,* 528 F.Supp.2d 41, 44–45 (D.Conn.2007).

3 A debt is dischargeable even if it is a “fine, penalty or forfeiture” if it is not “payable to and for the benefit of a governmental unit.” Because the FBAR penalty is payable to the IRS and because it is, by virtue of the fact that it incentivizes compliance with the Act, for the benefit of the federal government, this exclusion is not applicable here.

4 A debt is dischargeable if it is “compensation for actual pecuniary loss.” Although Defendant argues that the IRS assessed the FBAR penalty on him in lieu of collecting taxes on his offshore accounts, he does not claim that his debt is “compensation for actual pecuniary loss.”

5 When Defendant failed to file the FBAR, he violated 31 U.S.C. § 5314(a). Under the version of 31 U.S.C. § 5321(a)(5) in effect at the time Defendant was penalized, the statute authorized the Secretary of the Treasury to “impose a civil money penalty on any person who willfully violates or any person willfully causing any violation of any provision of section 5314.” For failures to file an FBAR, the value of that “civil money penalty” was required to be no more than “the greater of (I) an amount (not to exceed $100,000) equal to the balance in the account at the time of the violation; or (II) $25,000.” 31 U.S.C. §§ 5321(a)(5)(A), (B)(ii) (2000). The Secretary's regulations specify that the penalty for a failure to file an FBAR is a “civil penalty.” *See* 29 C.F.R. §§ 103.56(g) (2004) (authorizing the IRS “to assess and collect civil penalties under 31 U.S.C. [§] 5321 ... [and] investigate possible civil violations of these provisions”); 103.57(g)(2) (2004) (imposing, for violations of 31 U.S.C. § 5314 and 31 C.F.R. § 103.24, “a civil penalty” within the parameters articulated in 31 U.S.C. § 5321(a)(5) (2000)).

After the IRS assessed the FBAR penalty on Defendant in May 2004, Congress amended § 5321(a)(5), but the provision still denominates the FBAR penalty a “penalty.” *See* American Jobs Creation Act of 2004, Pub.L. 108–357, § 821(a), 118 Stat. 1418, 1586 (Oct. 22, 2004). The current version of the provision authorizes penalties for willful violations of § 5314 up to the greater of (1) half the value of the account or transaction that should have been reported, or (2) $100,000. 31 U.S.C. § 5321(a)(5) (2006).

6 The FBAR penalty also fits the definition of a “penalty” in *Black's Law Dictionary.* A penalty is “[p]unishment imposed on a wrongdoer, usu[ally] in the form of imprisonment or fine; esp[ecially], a sum of money exacted as a punishment for either a wrong to the state or a civil wrong (as distinguished from compensation for the injured party's loss).” BLACK'S LAW DICTIONARY 1168 (8th ed.2004). Defendant's failure to file an FBAR was a wrong to the state; while Defendant's omission violated 31 U.S.C. § 5314, it resulted in no injured private party and no pecuniary harm, either to a private party or to the state. The FBAR penalty is assessed on Defendant as punishment, not as any sort of compensation for any pecuniary harm.

7 The Ninth Circuit's decision in *In re Lorber* was premised on a reading of the now-superseded Bankruptcy Act of 1898, as amended. Nonetheless, the Second Circuit adopted the *In re Lorber* test for purposes of the analogous provision of the current Bankruptcy Code of 1978, as amended, governing the priority of debts to be repaid out of a bankrupt's estate. *See LTV Steel Co. v. Shalala (In re Chateaugay Corp.),* 53 F.3d 478, 498 (2d Cir.1995).

8 Under MASS. GEN. LAWS ch. 118G, § 18 (1996), the law at issue in *Boston Reg'l Med. Ctr., Inc.,* all covered hospitals contributed to or received credits from a Massachusetts Uncompensated Care Pool based on how much health care they provided to indigent patients. *Boston Reg'l Med. Ctr., Inc.,* 365 F.3d at 54. Covered hospitals which failed to contribute to or credit the Uncompensated Care Pool would lose their licenses. *Id.* at 54 n. 3. If a hospital wanted to engage in its otherwise lawful activity of providing health care, it was obligated to pay into or credit the Uncompensated Care Pool. The law thus imposed an involuntary pecuniary burden on all covered entities.

9 Defendant argues that the FBAR penalty assessment is involuntary under *In re Lorber* because “a tax amount would have been imputed upon him whether he voluntary [*sic*] agreed to the negotiated amount due or not.” (Def.'s Mem. in Supp. Obj. Pl.'s Mot. Summ. J. at 5.) Defendant therefore tautologically assumes the FBAR is a tax, for purposes of arguing that it is a tax.

10 The FBAR penalty is also not a tax under the even broader definition of the term in *Black's Law Dictionary,* which defines “tax” as “[a] monetary charge imposed by the government on persons, entities, transactions, or property to yield public revenue.” BLACK'S LAW DICTIONARY 1496 (8th ed.2004). Neither the Bank Secrecy Act generally, nor the penalty associated with violations of 31 U.S.C. § 5314(a) specifically, is designed “to yield public revenue.” The Act requires covered entities to file documents listing their foreign transactions and accounts.; it does not contemplate any mechanism for “yield[ing] public revenue” *except* in the event that a covered entity, like Defendant, fails to comply with its reporting requirements. The FBAR penalty better fits the *Black's Law Dictionary* definition of “penalty.” *See supra* note 6.

11 The Court's conclusion that the penalty at issue in this case is a civil penalty, and not a tax, is bolstered by the fact that the statutory and regulatory framework governing FBARs bears none of the hallmarks of a “tax.” Indeed, different legal

presumptions apply to IRS assessments in tax assessment cases than in FBAR violation cases. *Compare United States v. Fior D'Italia,* 536 U.S. 238, 242, 122 S.Ct. 2117, 153 L.Ed.2d 280 (2002) ("It is well established in the tax law that an assessment is entitled to a legal presumption of correctness"), *with United States v. Dollar Bank Money Market Account,* 980 F.2d 233, 238 n. 2 (3d Cir.1992) ("the government has the burden [of proof regarding *means rea*]" in both civil and criminal FBAR violation cases).

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2015 WL 1510007
United States District Court, W.D. Washington,
at Seattle.

James MOORE, Plaintiff,
v.
UNITED STATES of America, Defendant.

No. C13–2063RAJ.
|
Signed April 1, 2015.

Attorneys and Law Firms

Anthony V. Diosdi, Moskowitz LLP, San Francisco, CA, Keith Allen Kemper, Ellis Li & McKinstry, Seattle, WA, for Plaintiff.

Adam D. Strait, Jennifer Y. Golden, Washington, DC, for Defendant.

ORDER

RICHARD A. JONES, District Judge.

I. INTRODUCTION

***1** This matter comes before the court on the Government's motion for summary judgment. Although the Government requested oral argument, Plaintiff James Moore did not, and the court finds this case suitable for partial disposition based on the material already before it. For the reasons stated below, the court GRANTS the Government's motion in part and DENIES it in part. Dkt. # 32. Because the court is aware of no factual disputes that would necessitate a trial, the court VACATES the trial date and all other pending pretrial deadlines. Part IV of this order includes instructions to the parties to supplement the record so that the court may conduct judicial review in accordance with § 706(2) of the Administrative Procedure Act ("APA").

II. BACKGROUND

Among the responsibilities of the Internal Revenue Service is the enforcement of a portion of the Bank Secrecy Act of 1970 requiring reports from people within the United States who "make[ ] a transaction or maintain a relation for any person with a foreign financial agency." 31 U.S.C. § 5314(a). That statute has led to regulations that require a person subject to the statute in any calendar year (essentially any person residing in the United States with foreign accounts totaling more than $550,000) to file a report with the IRS by June 30 of the following year. 31 C.F.R. § 103.24(a), § 103.27(c).[1] The IRS has prescribed form TD F 90–22.1 ("Report of Foreign Bank and Financial Account") for that task. The IRS refers to this yearly report as an "FBAR." The IRS can impose a civil penalty on a person who fails to file FBARs. 31 U.S.C. § 5321(5)(A). For non-willful violations, the penalty cannot exceed $10,000. 31 U.S.C. § 5321(5)(B)(i).

Mr. Moore filed this lawsuit to contest the IRS's decision to assess the maximum penalty of $10,000 against him four times, once for each year from 2005 through 2008.

A. Mr. Moore Has Had a Foreign Account Since 1989, But He Filed No FBARs Until 2010.

There is no dispute that for nearly two decades, Mr. Moore maintained a foreign account subject to FBAR requirements. Its predecessor was an account Mr. Moore opened at a Bahamian bank in about 1989 when he moved to The Bahamas. He opened that account in the name of a Bahamian corporation that he created (and solely controlled) for the purpose of investing in a resort in The Bahamas. He soon transferred the balance to an "investment account" with a Bahamian branch of a Swiss bank, again holding the account in the name of his Bahamian corporation. Mr. Moore moved back to the United States in 1990, but the account remained in The Bahamas. In about 2003, when the Swiss bank ceased its Bahamian operations, the account migrated to Switzerland, where it has remained ever since. At all relevant times, the balance in the account exceeded $300,000, but was less than $550,000.

There is also no dispute that Mr. Moore filed no FBARs until at least 2009. It was around that time that he became aware of an effort by the IRS to encourage people who had not been reporting foreign accounts to come forward. *See United States v. Simon,* 727 F.3d 682, 686 (7th Cir.2013) (describing IRS's 2009 Offshore Voluntary Disclosure Program). Through his counsel, he approached the IRS. Ultimately, he amended six years of tax returns (from 2003 through 2008) to report income for each of those years from his foreign account. Mr. Moore and the Government appear to agree that those amendments increased the taxes he owed by about $18,000. Even assuming there is any dispute over Mr. Moore's tax liabilities, that dispute is not before the court. In addition to amending his tax returns, Mr. Moore in 2010 filed late FBARs for 2003 through 2008, as well as his first timely-filed FBAR, for 2009.

B. The IRS Investigates, Proposes a $40,000 Penalty, Then Assesses That Penalty.

***2** At some point, the IRS requested an interview with Mr. Moore. He agreed, and IRS Agent Shu Lin Tjoa interviewed him, with his counsel present, by telephone in October 2011. Although Mr. Moore contends that he was not aware that the IRS was considering an FBAR penalty, he admits that he knew that the IRS intended to "enforce something in regards to me." Moore Depo. at 146–47. The interview took no more than five minutes. *Id.* at 147.

Agent Tjoa prepared an FBAR Penalty Summary Memo recommending that the IRS impose a penalty of $10,000 for each of the four years from 2005 to 2008. Mr. Moore had no access to the Summary Memo until he received it in connection with this lawsuit. The Summary Memo is an eight-page, relatively detailed account of Agent Tjoa's reasons for recommending a $40,000 penalty.

On December 13, 2011, the IRS sent Mr. Moore a letter stating that it was "proposing a penalty" totaling $40,000. In contrast to the Summary Memo, the letter provided almost no information about the basis for that penalty. It identified the applicable portions of the Bank Secrecy Act and the years in question. It did not explain why the IRS had selected the maximum penalty. The letter demanded that Mr. Moore either accept the penalty or "request a conference with our Appeals Office" by no later than January 28, 2012. It also explained that if Mr. Moore did nothing by January 28, 2012, it would "assess the penalty and begin collection procedures."

The IRS ignored the terms of its own letter and assessed a $10,000 penalty against Mr. Moore on January 23, 2012. That penalty covered only 2005. Agent Daisy Batman declares that the IRS imposed that penalty after Mr. Moore refused to agree to an extension of the applicable statute of limitations. No one explains why the IRS did not honor its agreement to delay assessment of the penalty pending the "appeal" deadline. The court assumes, because the parties do not assert otherwise, that the six-year limitations period for assessing an FBAR civil penalty for 2005 would have run on July 1, 2012, six years after the June 30, 2006 deadline for submitting an FBAR for 2005. 31 U.S.C. § 5321(b)(1) ("The Secretary of the Treasury may assess a civil penalty ... at any time before the end of the 6–year period beginning on the date of the transaction with respect to which the penalty is assessed."). In any event, the IRS does not argue that a statute of limitations would have expired between its assessment of a $10,000 penalty on January 23, 2012 and the January 28, 2012 response deadline it gave to Mr. Moore.

Mr. Moore requested an "appeal"[2] of the proposed assessment. Although the IRS had already assessed the 2005 penalty, it is apparent that it permitted Mr. Moore to contest that assessment along with his request that it not impose penalties for 2006 through 2008. In both his January 2012 request for an appeal and his December 2012 letter in support of the appeal, Mr. Moore's counsel provided detailed argument in support of his request that the IRS either assess no penalty or assess a reduced penalty. Among other things, counsel insisted that Mr. Moore satisfied the requirements of 31 U.S.C. § 5321(b)(5)(B)(ii)(I), which prohibits the imposition of a penalty for an FBAR violation "due to reasonable cause...." The IRS's response, in a December 18, 2012 letter, was terse:

***3** Dear Taxpayer:

> I have completed my review of your request to adjust the penalty(s) assessed against you. Based on the facts presented, including additional information you submitted, I find that no basis for abatement of the penalty(s) is warranted within the protective framework of reasonable cause. Your case is now closed in Appeals.

The remainder of the letter provided payment information and a statement that Mr. Moore could sue in federal court, along with an invitation to participate in a "Appeals customer satisfaction survey." The letter said nothing about when the IRS would assess the penalties. It assessed $10,000 penalties for 2006, 2007, and 2008 on January 24, 2013.

Mr. Moore filed this suit in late 2013. His complaint contended that the IRS violated the Fifth Amendment's Due Process Clause, the Fourteenth Amendment's Equal Protection Clause, and the Eighth Amendment's Excessive Fines Clause. He also contended that the IRS violated the APA, and that the Bank Secrecy Act unlawfully delegated judicial power to the IRS. He asked for a refund of $10,500 he paid toward the 2005 penalty, and for the court to set aside the remaining $30,000 in penalties.

The Government has moved for summary judgment against all of Mr. Moore's claims, as well as on its counterclaims seeking to reduce the 2006, 2007 and 2008 penalties to judgment. In opposing that motion, he did not mention his equal protection claim or his claim of unlawfully delegated judicial authority. The court deems those claims abandoned.

The court reaches the following conclusions as to the Government's request for summary judgment on Mr. Moore's remaining claims:

1) As a matter of law, Mr. Moore committed non-willful violations of the Bank Secrecy Act and its subject to civil penalties in accordance with the Act.

2) The IRS has failed to provide a record from which the court can determine, via the judicial review provisions at § 706(2) of the APA, if it acted arbitrarily or capriciously in determining the amount of the penalties it assessed.

4) The IRS's assessment of penalties did not violate the Due Process Clause of the Fifth Amendment or the Eighth Amendment's Excessive Fines Clause.

This order concludes with instructions to the parties to address the impact of both the IRS's early assessment of the 2005 penalty and the lack of an administrative record that provides an adequate basis for the assessment of all four penalties.

III. ANALYSIS

On a motion for summary judgment, the court must draw all inferences from the admissible evidence in the light most favorable to the non-moving party. *Addisu v. Fred Meyer, Inc.,* 198 F.3d 1130, 1134 (9th Cir.2000). Summary judgment is appropriate where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(a). The moving party must initially show the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The opposing party must then show a genuine issue of fact for trial. *Matsushita Elect. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). The opposing party must present probative evidence to support its claim or defense. *Intel Corp. v. Hartford Accident & Indem. Co.,* 952 F.2d 1551, 1558 (9th Cir.1991). The court defers to neither party in resolving purely legal questions. *See Bendixen v. Standard Ins. Co.,* 185 F.3d 939, 942 (9th Cir.1999).

A. On De Novo Review, the Court Concludes that Mr. Moore Violated the Law By Not Filing FBARs and is Subject to a Civil Penalty.

***4** No binding case law provides standards for judicial review of FBAR civil penalty assessments. The Government's proposal is as follows: the court should determine de novo whether Mr. Moore is subject to an FBAR penalty, but should review the IRS's determination of the amount of that penalty only for abuse of discretion.[3] The court will adopt the first part of that proposal. It does so only because Mr. Moore has not objected to de novo review and because no standard of review is more favorable to him. The court therefore declines to decide whether a court must conduct de novo review of the IRS's assessment of a civil FBAR penalty.

1. “Reasonable Cause” is an Escape Hatch for FBAR Penalty Liability.

The Bank Secrecy Act permits the assessment of penalties for violation of the reporting requirements in 31 U.S.C. § 5314, but mandates that “[n]o penalty shall be imposed” if “such violation was due to reasonable cause” *and* “the amount of the transaction or balance in the account at the time of the transaction was properly reported.” 31 U.S.C. § 5321(a)(5)(B)(ii). The requirement regarding proper reporting of the transaction or balance is not at issue in this case. Mr. Moore concedes that he violated the reporting requirements, but contends that the Government cannot penalize him for that violation because he had “reasonable cause.”

“Reasonable cause” is nowhere defined in the Bank Secrecy Act or in regulations interpreting it. That phrase, however, appears repeatedly in statutes governing the

IRS's tax assessment role. For example, 26 U.S.C. § 6664(c)(1) prohibits penalties for any portion of an underpayment of tax "if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion." Another statute, applicable to foreign trusts, prohibits penalties for "any failure which is shown to be due to reasonable cause and not due to willful neglect." 26 U.S.C. § 6677(d). And, in the statute that the Government identifies as an analogue, Congress prohibited monthly penalties for failing to file tax returns where "such failure is due to reasonable cause and not due to willful neglect...." 26 U.S.C. § 6651(a)(1). In 1985, the Supreme Court noted that the meaning of the terms "reasonable cause" and "willful neglect" "ha[d] become clear over the near–70 years of their presence in the statutes." *United States v. Boyle,* 469 U.S. 241, 245, 105 S.Ct. 687, 83 L.Ed.2d 622 (1985). It also noted that regulations defined "reasonable cause" for purposes of § 6651(a)(1). *Id.* ("[T]he relevant Treasury Regulation calls on the taxpayer to demonstrate that he exercised 'ordinary business care and prudence' but nevertheless was 'unable to file the return within the prescribed time.' ").

There is no reason to think that Congress intended the meaning of "reasonable cause" in the Bank Secrecy Act to differ from the meaning ascribed to it in tax statutes. As with the tax statutes, Congress entrusted enforcement of the Bank Secrecy Act to the Treasury Department. If it intended Treasury to interpret "reasonable cause" differently in the newer statute, it left no clues to which any party has pointed. The court thus takes guidance from tax statutes and authority interpreting them, and concludes that a person has "reasonable cause" for an FBAR violation when he committed that violation despite an exercise of ordinary business care and prudence.

2. Mr. Moore Ignored Notice of His Duty to Report His Foreign Account.

***5** The court now examines the evidence relevant to whether Mr. Moore had reasonable cause for his FBAR violations.

When the Government posed an interrogatory to Mr. Moore asking for all facts supporting his assertion of "reasonable cause," he responded as follows:

> [I] established a Bahamian Corporation, Dornlas Hardick Ltd[.,] through Graham Thompson Ltd. and capitalized it with $300,000 previously taxed in the United States. [I] believed the establishment of a legal Bahamian Corporation was sufficient to isolate the corporate assets from [my] personal assets, and that [I] was not required to disclose it on [my] personal tax return.

Gov't Interrog. No. 1. At his deposition, however, Mr. Moore established that he had no objective basis for that belief. Although he contended that in about 1990 he asked Graham Thompson, the Bahamian law firm who assisted him in incorporating, about the "tax implications of running a business in the Bahamas and staying an American citizen," Moore Depo. at 28, he points to no advice he received that made him believe he was free from any obligation to report the account to authorities in the United States. He admitted that Graham Thompson gave him no advice as to whether it was necessary to report to United States authorities any account held by his corporation. Moore Depo. at 55–56. Indeed, he admitted that Graham Thompson gave him no advice about United States law. Moore Depo. at 67, 150–51. Although he steadfastly asserts that he believed that his corporation shielded him from any responsibility to report the account to the Government, he admitted that since at least 2003, he has no idea if his corporate entity still exists. Moore Depo. at 113–14. When Mr. Moore's account migrated to Switzerland, he met with bank representatives, but again declined to ask about his obligation to report the account to United States authorities. Moore Depo. at 38, 45.

Mr. Moore's tax materials show that he clung to his belief that he did not have to report the account even in the face of plain notice that he was mistaken. Prior to the 2006 tax year, Mr. Moore prepared his own income tax returns. On his Form 1040 for the 2003 tax year, he filled out Schedule B, relating to interest and dividends. Schedule B, which is a single page, contains a section prominently labeled "Foreign Accounts and Trusts." That section contains this statement: "You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; or **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust." The section contained just two questions, one of which was as follows:

> At any time during 2003, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? *See* page B–2 for exceptions and filing requirements for form TD F 90–22.1.

***6** Mr. Moore checked neither "Yes" nor "No" in response. His signature on his Form 1040 is adjacent to a statement that his signature was a declaration, under penalty of perjury, that he had "examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete."

Mr. Moore does not deny that he noticed the portion of Schedule B devoted to foreign accounts; he claims that he believed that because his foreign account was held in the name of his Bahamian corporation, that portion did not apply to him. Moore Depo. at 118–19. Had he at least read page B–2 of the instructions (as the question directed him), he would have discovered that he should answer "Yes" to the question on Schedule B if he "own[ed] more than 50% of the stock in any corporation that owns one or more foreign bank accounts" or if he "had an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)." Mr. Moore admitted that he understood, at a minimum, that he owned more than 50% of the stock of his Bahamian corporation. Moore Depo. at 123.

Although Mr. Moore did not file schedule B in subsequent years that he prepared his own taxes; his 2003 tax return does not stand alone as evidence of Mr. Moore's refusal to acknowledge his control over his foreign bank account. Beginning in the 2006 tax year, he used a tax preparer for his returns. For each of those years, the tax preparer sent Mr. Moore a "tax organizer"—a questionnaire designed to assess Mr. Moore's tax needs. Mr. Moore completed the questionnaire in its entirety. The questionnaire for the 2006 tax year is not in the record. In the questionnaire for the 2007 tax year, in response to a question asking if he had "an interest in or signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account," he checked "No." He did so again the following year when he filled out the questionnaire for his 2008 tax return. There is no evidence that Mr. Moore disclosed the existence of his foreign account to his tax preparer.

3. Viewing the Evidence in the Light Most Favorable to Mr. Moore, He Did Not Have Reasonable Cause for His FBAR Violations.

Mr. Moore did not, as a matter of law, have reasonable cause for his failure to file FBARs prior to 2009. Clinging to advice given in 1989 or 1990 that he admits had nothing to do with United States law is not an exercise of ordinary business care or prudence. Even if that were not the case, however, no fact finder could conclude that ignoring the question on Schedule B of his 2003 tax return was an exercise of ordinary business care or prudence. Again, that question asked if he had "signature or other authority over a financial account in a foreign country...." That phrase is not difficult to understand. As a matter of law, it placed Mr. Moore at least on notice that he should inquire further as to whether his corporation's foreign account was subject to disclosure. His decision to avoid further inquiry is not an exercise of ordinary business care or prudence. He admits that if he had done even the most minimal inquiry (looking on page B–2 of the instructions for form 1040, as his tax form explicitly directed him), he would have learned unequivocally that he needed to report his foreign account. Mr. Moore's *"Williams I"*). The Act permits steeper civil penalties for willful violations of FBAR requirements. 31 U.S.C. § 5321(a)(5)(C). The appellate court in *Williams* reversed the conclusion that the defendant had not acted willfully, finding that the district court had "clearly erred." *Williams II,* 489 Fed. Appx. At 660. Among the evidence the court relied on was that the defendant had testified that he paid no attention to the same question on Schedule B of Form 1040 that Mr. Moore did not answer. *Id.* at 656–57, 659. It noted that a taxpayer is charged with knowledge of the contents of his tax return, meaning that a failure to read portions of a tax return was tantamount to a "conscious effort to avoid learning about reporting requirements...." *Id* . at 659 (quoting *United States v. Sturman,* 951 F.2d 1466, 1476 (6th Cir.1991)); *see also United States v. Crooks,* 804 F.2d 1441, 1448 (9th Cir.1986) (noting that taxpayer's "signature on [his tax] return is sufficient to establish knowledge once it has been shown that the return was false").

***7** Much like Mr. Moore, the defendant in *Williams* had answered "no" to a "tax organizer" question asking whether he had signatory authority over a foreign account. *Id.* at 656. The court found that to be evidence of conduct meant to mislead. *Williams II,* 489 Fed. Appx. at 659. Indeed, the only evidence materially distinguishing the defendant in *Williams II* from Mr. Moore is that defendant pleaded guilty to criminal tax evasion for failing to report the income from the foreign account he had not disclosed. *Id.* at 657, 660. That is an important distinction, to be sure, but it does not change the other lessons of *Williams II.* Evidence that a taxpayer ignored relevant questions on Schedule B and in tax organizers is evidence of willful conduct. In this court's view, it suffices as a matter of law to demonstrate a lesser FBAR violation—one made without "reasonable cause."

B. Section 706 of the APA Guides the Court's Review of the IRS's Assessment of Penalties, Including the Amount of the Penalties .

Having decided that Mr. Moore is subject to an FBAR penalty, what remains of his suit is his challenge to the IRS's method of assessing the penalty and his challenge to the amount of that penalty. Again, no binding case law addresses the standard that applies to judicial review of either issue in the context of FBAR penalties. As the court has mentioned, the Government suggests that the court review the amount of the penalty only for abuse of discretion. The Government does not mention a standard of review as to the methods it employed to assess Mr. Moore's penalty. The APA, however, provides a comprehensive guide to the court's review of the IRS's penalty assessments.

1. Parts (A)-(D) of § 702 of the APA Govern Judicial Review in this Case.

The APA makes agency action presumptively subject to judicial review. 5 U.S.C. § 702 ("A person ... adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof."). The only exceptions are where a statute precludes judicial review or the "agency action is committed to agency discretion by law." 5 U.S.C. § 701(a). Both are narrow exceptions, *Citizens to Preserve Overton Park, Inc. v. Volpe,* 401 U.S. 402, 410, 91 S.Ct. 814, 28 L.Ed.2d 136 (1971), and no one argues that the exceptions apply in this case.

Although the APA creates more than one standard of review, all agency action is subject to review to determine if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. § 706(2)(A); *Volpe,* 401 U.S. at 413–14. Similarly, all agency action must meet applicable statutory, procedural, and constitutional requirements. 5 U.S.C. § 706(2)(B)-(D); *Volpe,* 401 U.S. at 414. In certain circumstances, a court reviews an agency action for "substantial evidence," 5 U.S.C. § 706(2)(E), but no one argues that standard applies here.[4] *Volpe,* 401 U.S. at 414 ("Review under the substantial-evidence test is authorized only when the agency action is [rulemaking] or when the agency action is based on a public adjudicatory hearing."). Finally, a court may conduct a de novo trial of facts underlying an agency action, 5 U.S.C. § 706(2)(F), but that standard of review applies only where the agency's adjudicative factfinding procedures are inadequate. *Volpe,* 401 U.S. at 415. Here, the court finds no evidence of inadequate factfinding procedures. The IRS interviewed Mr. Moore, gave him plain notice of the penalty he was facing, permitted him to contest that penalty before assessing it (except as to the 2005 penalty), and permitted him to present his arguments against the penalty both in a written statement and in a telephone interview. Taking guidance from other cases finding similar factfinding procedures adequate, the court concludes that the IRS's factfinding was adequate for purposes of avoiding trial de novo via § 706(2)(F) of the APA. *See Pac. Architects & Eng'rs, Inc. v. Dep't of State,* 906 F.2d 1345, 1348 (9th Cir.1990); *see also Acumenics Research & Tech. v. Dep't of Justice,* 843 F.2d 800, 805 (4th Cir.1988) (cited favorably in *Pac. Architects*).

2. No Statute Other than the APA Dictated the Procedures for the IRS to Use to Assess Mr. Moore's Penalties.

***8** The court will consider the IRS's procedures for assessing Mr. Moore's penalties again when it discusses his claim that those procedures violated the Due Process Clause. For now, the court notes that no codified procedures bind the IRS when it assesses FBAR penalties. In contrast to well-worn procedures for assessing tax deficiencies, a person searching the Code of Federal Regulations or United States Code for information on the procedure for FBAR penalty assessment will come up nearly empty-handed. *See Williams. v. Comm'r,* 131 T.C. 54, 57–58, 2008 WL 4443057 (2008) (noting that because FBAR penalties are beyond the scope of the deficiency procedures of 26 U.S.C. §§ 6212–14, United States Tax Court has no jurisdiction to review their assessment). The Bank Secrecy Act suggests that penalties must first be "assess [ed]," 31 U.S.C. § 5321(b)(1), and provides that the Government may "commence a civil action to recover a civil penalty assessed" within two years of the assessment," 31 U.S.C. § 5321(b)(2). Beyond that, statutes and regulations are silent as to what procedure is necessary. In circumstances like these, agencies have considerable latitude to fashion their own procedures,[5] subject only to constitutional limits. *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.,* 435 U.S. 519, 543–44, 98 S.Ct. 1197, 55 L.Ed.2d 460 (1978).

In circumstances where no other law governs agency procedure, only the requirements of the Due Process Clause and § 555 of the APA apply. *Pension Benefit Guaranty Corp. v. LTV Corp.,* 496 U.S. 633, 654–55, 110 S.Ct. 2668, 110 L.Ed.2d 579 (1990). Section 555 of the APA provides minimal procedural guarantees for "informal adjudication," a phrase that covers agency adjudication not subject to § 554, § 556 and § 557 of the APA. *See id.; see also United States v. Iron Mountain Mines,* 987 F.Supp.2d 1250, 1259 (E.D.Cal.1997) ("Informal adjudication ... is a 'residual category including all agency actions that are not rulemaking and that need not be conducted through 'on the record' hearings.' ") (quoting *Izaak Walton League v. Marsh,* 655 F.2d 346, 361 n. 37 (D.C.Cir.1981)).

As to Mr. Moore, the only portion of § 555 that is relevant is the requirement that an agency must give "[p]rompt notice ... of the denial in whole or in part of a written application, petition, or other request ... made in connection with any agency proceeding." 5 U.S.C. § 555(e). That portion also requires that, "[e]xcept in affirming a prior denial or when the denial is self-explanatory, the notice shall be accompanied by a brief statement of the grounds for denial." *Id.* The court has already observed that the IRS's December 2012 statement denying Mr. Moore's "appeal" of its proposed penalties was a very brief statement. For reasons the court now discusses, it concludes that it was not a "brief statement" that satisfied § 555(e).

3. The Court Cannot, On the Record Before It, Determine if the IRS Acted Arbitrarily, Capriciously or Abused Its Discretion in Assessing the Penalties.

***9** To determine if an agency acted arbitrarily or capriciously or in abuse of its discretion, the court conducts a "thorough, probing, in-depth review." *Volpe,* 401 U.S. at 415. The court presumes that the agency acted correctly, and is not permitted to substitute its judgment for the agency's. *Id.* at 415, 417. The court must nonetheless be certain that the agency acted within the scope of its authority, and its must determine whether the "decision was based on a consideration of relevant factors and whether there has been a clear error of judgment." *Id.* at 415–16; *see also Ocean Advocates v. Army Corps of Engineers,* 361 F.3d 1108, 1118 (9th Cir.2004) (explaining review under § 706(2)(A) of the APA). The court's conclusion that Mr. Moore lacked reasonable cause is sufficient to answer any question about the IRS's authority to impose penalties.

The court can only guess, however, as to whether the IRS considered relevant factors or made a clear error of judgment. The record before the court contains no administrative explanation of the IRS's decision to impose penalties. The IRS's December 2012 "appeals" letter to Mr. Moore contains three sentences of "explanation" that do nothing to illuminate what the IRS considered or why it arrived at its decision. The letter at least mentions the "reasonable cause" standard; it says nothing at all about why it choose a $40,000 maximum penalty as opposed to a smaller amount. The court looks for a "rational connection between the facts found and the choice [the agency] made." *Nat'l Ass'n of Home Builders v. Norton,* 340 F.3d 835, 841 (9th Cir.2003). That connection must, however, come from the administrative record. *Id.*

The administrative record is, with one exception, devoid of any explanation of the IRS's reasons for imposing the maximum penalty. Agent Tjoa's 2011 Summary Memo is in the record before the court, but (so far as the court is aware), Mr. Moore did not see the Summary Memo until the IRS produced it in discovery in this case. Even then, the IRS redacted portions of the Summary Memo. The Summary Memo at least arguably provides an explanation of Agent Tjoa's decision to recommend the maximum penalty. Indeed, Agent Tjoa cited the portions of the IRM that are relevant to determining the amount of an FBAR penalty, and explained many other facets of her recommendation. What the Government ignores in its motion, however, is that the Summary Memo is not an explanation *of the ultimate decision to impose a penalty.* [6] The Summary Memo was, at least on the record before the court, the basis for the IRS to require Mr. Moore to either accept the assessment of penalty or "appeal" it before the assessment. The issue before the court is the basis for the IRS's decision to actually impose the penalties. As to the 2005 penalty, the court can only guess. The IRS disregarded its own promise and assessed the penalty before Mr. Moore could request an "appeal."

***10** As to its decision on "appeal" to assess four penalties, the IRS has already refused to produce the only document (so far as the court is aware) that addresses the material Mr. Moore submitted in support of his appeal or provides explanation of the reasons for imposing the maximum penalty. On January 8, 2015, the court denied Mr. Moore's motion to compel production of an "Appeals Memo" that Agent Batman authored at some point in the "appeal" process. The IRS claimed that the deliberative process privilege protected the Appeals Memo. The court agreed. What the court did not know at the time is that the Appeals Memo is apparently the only contemporaneous source of explanation for the IRS's decision to assess maximum penalties against Mr. Moore.

The Government asks the court to rubber-stamp a decision that lacks any explanation in the administrative record. That the Government offers an explanation for that decision in the briefing before the court is irrelevant. What the court requires is evidence from which it could conclude that the IRS did not act arbitrarily, capriciously, or in abuse of its discretion when it imposed $40,000 in penalties on Mr. Moore. That evidence is absent.

The court cannot, however, overturn the agency's decision merely because it failed to articulate a basis for it:

> If the record before the agency does not support the agency action, if the agency has not considered all relevant factors, or if the reviewing court simply cannot evaluate the challenged agency action on the basis of the record before it, the proper course, except in rare circumstances, is to remand to the agency for additional investigation or explanation. The reviewing court is not generally empowered to conduct a de novo inquiry into the matter being reviewed and to reach its own conclusions based on such an inquiry.

Florida Power & Light Co. v. Lorion, 470 U.S. 729, 744, 105 S.Ct. 1598, 84 L.Ed.2d 643 (1985). When there is "such failure to explain administrative action as to frustrate effective judicial review, the remedy ... [is] to obtain from the agency, either through affidavits or testimony, such additional explanation of the reasons for the agency decision as may prove necessary." *Camp v. Pitts,* 411 U.S. 138, 142–143, 93 S.Ct. 1241, 36 L.Ed.2d 106 (1973). What is preferable is contemporaneous evidence of the factors the agency considered when it made its decision. *Volpe,* 401 U.S. at 420; *see Alaska Dep't of Environmental Conservation v. EPA,* 540 U.S. 461, 497, 124 S.Ct. 983, 157 L.Ed.2d 967 (2004) ("Even when an agency explains its decision with less than ideal clarity, a reviewing court will not upset the decision on that account if the agency's path may reasonably be discerned.") (internal quotations omitted). That may, in appropriate cases, permit the court to rely on contemporaneous evidence (like the Appeals Memo) that the agency did not disclose during the decisionmaking process. For example, in *Tourus Records, Inc. v. Drug Enforcement Admin.,* 259 F.3d 731, 737–38 (D.C.Cir.2001), the court permitted an agency to supplement its bare-bones written decision with memoranda that explained the basis for that decision. In any event, that is preferable to an after-the-fact rationalization of the agency's decision. *See Volpe,* 401 U.S. at 420.

***11** The court will permit the Government to supplement the record to provide some basis for the court to conduct review of its penalty assessment. Specific instructions for that supplementation will come in Part IV of this order. For now, the court concludes only that *unless the Government provides evidence articulating its reasons for assessing a maximum penalty against Mr. Moore, the court will have no recourse but to hold that it acted arbitrarily and capriciously.*

The Government may also choose to supplement the record to provide contemporaneous explanation of its decision to assess the 2005 penalty without providing the "appeal" it promised Mr. Moore. On the record before the court, that decision is baffling. The only reason the Government offered, its concern that the statute of limitations would expire, is nonsensical on the record before the court. The statute of limitations would not have expired until at least the end of June 2012; the IRS assessed the penalty in January 2012. The court acknowledges that the IRS's inexplicable conduct was perhaps harmless. The IRS apparently considered Mr. Moore's "appeal" of the 2005 penalty just as it considered the "appeal" as to later years. Nonetheless, the IRS assessed a penalty without providing Mr. Moore the "appeal" it promised. The Government can perhaps supplement the record to provide an explanation for its failure to honor its promise, or clear explanation that the failure was harmless. *If it does not, the court will rule that assessing the 2005 penalty in January 2012 was arbitrary and capricious.*

4. The Penalty Assessment Procedures Satisfied the Due Process Clause.

The Due Process Clause requires only "such procedural protections as the particular situation demands." *Mathews v. Eldridge,* 424 U.S. 319, 334, 96 S.Ct. 893, 47 L.Ed.2d 18 (1976). Determining what process is necessary requires a consideration of the private interest at stake, the risk that the procedures will lead to an erroneous deprivation of that interest, the probable value of different procedures, and the governmental interest in avoiding unnecessary fiscal or administrative burdens. *Id.*

The IRS used two procedures. As to the 2006, 2007, and 2008 penalties, it conducted an interview with Mr. Moore and his counsel to determine his reasons for not filing FBARs, issued a notice proposing to assess $40,000 in FBAR penalties and the opportunity to internally "appeal" that decision before assessment, conducted an "appeal" process where Mr. Moore presented his arguments against imposition of the penalty both in writing and by telephone, and issued a notice of assessment of the penalty. As to the 2005 penalty, the IRS provided no meaningful pre-deprivation review. It nonetheless allowed him to contest the assessment through its internal "appeal" process. Mr. Moore also had the opportunity to seek judicial review of all of the IRS's decisions.

The IRS's penalty assessment procedures served all of the purposes of due process. It ensured that Mr. Moore received notice of the penalty and an opportunity to contest it. *See Memphis Light, Gas & Water Div. v. Craft,* 436 U.S. 1, 13, 98 S.Ct. 1554, 56 L.Ed.2d 30 (1978). No formal trial-like hearing is necessary, it suffices that the Government provided "some kind of hearing" at some time before "finally depriv[ing]" Mr. Moore of his property. *Id.* at 16 (quoting *Wolff v. McDonnell,* 418 U.S. 539, 557–58, 94 S.Ct. 2963, 41 L.Ed.2d 935 (1974)). The opportunity that the IRS gave Mr. Moore to present his arguments in writing and by telephone is adequate, under the circumstances. *Id* . at 16 n. 17 (noting that the "opportunity for informal consultation with designated personnel empowered to correct a mistaken determination" is sufficient in some circumstances); *Buckingham v. Sec'y of Dep't of Agriculture,* 603 F.3d 1073, 1082 (9th Cir.2010) (noting that due process does not always require an adversarial hearing, a full evidentiary hearing, or a formal hearing). The opportunity for judicial review after assessment of the penalties is further insurance against a deprivation of due process. Even as to the 2005 penalty that the IRS assessed without an opportunity for pre-deprivation review, the availability of both the opportunity to contest that assessment in the administrative "appeal" and to obtain later judicial review satisfies due process. *See Memphis Light,* 436 U.S. at 19–20 (explaining that post-deprivation review suffices in some circumstances).

***12** Mr. Moore offers no cogent argument that these procedures are inadequate. He neither cites *Mathews* nor attempts to conduct the analysis it requires. His invocation of the Due Process Clause consists of just four objections: (1) that the IRS's use of its own ORDER—21 employees to assess penalties means that their decisions are biased, (2) that even the explanation Agent Tjoa provided in the Summary Memo is inadequate support for the penalties she assessed, (3) that the IRS's terse notice of the denial of his "appeal" violated due process, and (4), that the IRS's attempts to collect on its penalties before judicial review violated due process.

It is long-settled that an agency's use of its own employees to investigate and adjudicate matters entrusted to it does not necessarily violate due process. *Withrow v. Larkin,* 421 U.S. 35, 55–56, 95 S.Ct. 1456, 43 L.Ed.2d 712 (1975). There is no evidence that any of the IRS employees involved in assessing penalties against Mr. Moore bore any bias against him. *See Stivers v. Pierce,* 71 F.3d 732, 741 (9th Cir.1995) (stating requirements for proving that an agency decisionmaker had a bias sufficient to deny a petitioner due process).

Mr. Moore's second and third objections conflate the lack of an adequate explanation for the IRS's decisions with a violation of due process. Even the IRS's bare-bones notice that it was denying Mr. Moore's appeal sufficed to inform him that penalties had been assessed and that his only remaining recourse was judicial review. Mr. Moore cited no authority for the proposition that the Due Process Clause requires more.

Mr. Moore's final objection is that the IRS denied him Due Process by attempting to collect on its penalties without permitting him to complete judicial review. Once the IRS assessed its penalties, they began to accrue interest and perhaps additional penalties for non-payment. [7] Nonetheless, the Due Process Clause prohibits enforcement of an administrative decision in advance of judicial review only where “the practical effect of coercive penalties for noncompliance [is] to foreclose all access to the courts.” *Thunder Basin Coal Co. v. Reich,* 510 U.S. 200, 218, 114 S.Ct. 771, 127 L.Ed.2d 29 (1994). Mr. Moore offers no evidence that the interest and penalties he may accrue are so punitive as to leave him with no realistic choice except to pay the assessments. He decries that the Government has threatened to garnish his Social Security benefits to pay the penalties. There is no evidence that the Government has attempted to make good on that threat. Even if it had, there is no evidence that Mr. Moore could not remedy the harm from garnishment with a decision in his favor in this court.

5. Even the Maximum Penalty the IRS Assessed Does Not Violate the Eighth Amendment.

Finally, the court considers Mr. Moore's contention that the $40,000 penalty violates the Excessive Fines Clause of the Eighth Amendment. The court assumes without deciding that civil FBAR penalties are “fines” within the meaning of the Eighth Amendment, *i.e.* “punishment for an offense.” *United States v. Bajakajian,* 524 U.S. 321, 328, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998). Even under that assumption, the penalties are invalid only if they are “grossly disproportional to the gravity of the defendant's offense.” *Id.* at 337. Although no rigid inquiry governs the court's proportionality inquiry, it should consider the “severity of the offense, the statutory maximum penalty available, and the harm caused by the offense.” *Horne v. Dep't of Agriculture,* 673 F.3d 1071, 1081 (9th Cir.2011), *rev'd on other grounds at* ––– U.S. ––––, 133 S.Ct. 2053, 186 L.Ed.2d 69 (2013); *see also United States v. Mackby,* 339 F.3d 1013, 1016–19 (9th Cir.2003).

***13** Mr. Moore falls well short of convincing the court that his FBAR penalties are disproportionate to his offense. He failed to report an account worth between $300,000 and $550,000. A small penalty is unlikely to serve as much deterrent for a person holding an account of that size. In *Bajakajian,* the defendant forfeited the entirety of about $350,000 in currency because he failed to report it before transporting it out of the country. *Id.* at 324–25. The Court found that to be an excessive fine. *Id.* at 337. The court has no reason to believe it would have reached the same conclusion as to a fine nearly an order of magnitude smaller. Mr. Moore would forfeit about 10% of the value of his account for failing to report it. That does not strike the court as disproportional, much less grossly disproportional. Admittedly, the Government has wholly failed to point out the harm that Mr. Moore's failure to report caused, and has given the court no basis to compare the severity of Mr. Moore's offense to similar violations. [8] Nonetheless, Congress authorized both the FBAR reporting mandate and penalties of up to $10,000 without regard to the size of the unreported account. The court concludes that the Government's interest in enforcing its laws is at least roughly proportional to the penalty it imposed here. *See Mackby,* 339 F.3d at 1019 (noting the government's cost of enforcing the law against the person as justification for a fine). The court has no basis to conclude that Mr. Moore's $40,000 penalty is grossly disproportionate.

IV. SUPPLEMENTAL BRIEFING

No later than 14 days following the issuance of this order, the parties shall meet and confer. They shall discuss, at a minimum, whether they can reach agreement as to supplementing the record in accordance with this order.

No later than 28 days following the issuance of this order, the Government shall supplement the record. Its supplementation shall consist solely of the following:

1) A brief of five pages or fewer that describes contemporaneous evidence for the IRS's penalty assessment decision, or, alternatively, proposes other evidence from which the court could conclude that the IRS did not act arbitrarily, capriciously, or in

abuse of its discretion in assessing the maximum penalty against Mr. Moore.

2) A declaration or declarations containing the contemporaneous or other evidence described in the brief.

No later than 14 days following the Government's supplementation of the record, Mr. Moore may submit a brief of five pages or fewer addressing (in light of the expanded record) whether the IRS's penalty assessment was arbitrary, capricious, or an abuse of discretion.

V. CONCLUSION

For the reasons stated above, the court GRANTS the Government's motion for summary judgment (Dkt.# 32) in the following respects:

1) The court rules that Mr. Moore violated the Bank Secrecy Act by failing to file FBARs for 2005 through 2008, and that he had no reasonable cause for that violation. He is subject to the assessment of a civil penalty.

***14** 2) The court grants summary judgment against Mr. Moore's claims invoking the Due Process Clause and Excessive Fines Clause.

3) The court rules that Mr. Moore abandoned any claim based on the Equal Protection Clause of the Fourteenth Amendment or based on Congress's allegedly unlawful delegation of judicial power to the Treasury Department or the IRS.

What remains undecided is Mr. Moore's claim invoking the APA and requesting that the court set aside or otherwise modify the IRS's assessment of penalties in accordance with that Act's judicial review provisions at 5 U.S.C. § 706. The parties shall comply with Part IV of this order to bring that claim to a resolution. Because the court has no indication that there are factual disputes appropriate for resolution at a trial, the court VACATES the trial date and all deadlines related to trial preparation.

All Citations

Not Reported in F.Supp.3d, 2015 WL 1510007, 115 A.F.T.R.2d 2015-1375, 2015-1 USTC P 50,258

Footnotes

[1] The Bank Secrecy Act makes the Secretary of the Treasury responsible for issuing regulations on foreign financial reporting. 31 U.S.C. § 5314(b). Until 2010, Treasury regulations applicable to FBARs were at Part 103 of Title 31 of the Code of Federal Regulations. Among other things, those regulations make the IRS responsible for enforcing the statute's reporting requirements. 31 C .F.R. § 103.56(g). In 2010, those regulations were moved to Part 1010 of Title 31 of the Code of Federal Regulations. So far as the court is aware, the substance of the regulations relevant to this suit did not change. The Government relies on the pre–2010 regulations; Mr. Moore does not object. The court thus cites the older regulations.

[2] When referring to the “appeal” the IRS offered Mr. Moore, the court uses quotation remarks to emphasize that the procedure does not resemble a traditional appeal. The IRS's December 13, 2011 letter did not impose any penalties, it proposed them. The IRS's offer of an “appeal” was akin to an order to show cause why it should not impose penalties for the first time.

[3] A few district court decisions on civil FBAR liability take approaches not dissimilar from what the Government recommends. In *United States v. McBride,* 908 F.Supp.2d 1186 (D.Utah 2012), the court adjudicated the Government's suit to collect an FBAR penalty in a bench trial. Although the trial was de novo, the court did not discuss whether it owed deference to the administrative determination that the defendant had violated the Bank Secrecy Act. By contrast to its extensive findings and conclusions regarding liability, the court devoted just a paragraph to its conclusion that the penalties the IRS assessed were proper. *Id.* at 1214. The court did not discuss the standard of review applicable to the amount of the penalty.

In *United States v. Hom,* No. C 13–03721 WHA, 2014 U.S. Dist. LEXIS 77489, 2014 WL 2527177 (N.D.Cal. Jun. 4, 2014), the court granted the Government's motion for summary judgment that the defendant was liable for a civil FBAR penalty, suggesting no deference to the IRS's administrative decision that he was liable. The court deferred to the IRS's assessment of a $40,000 penalty without discussion.

In several decisions in *United States v. Williams,* judges in the Fourth Circuit and the Eastern District of Virginia considered a civil FBAR penalty. The district court concluded that “a *de novo* standard of review is appropriate given that 31 U.S.C. § 5321 provides for no adjudicatory hearing before an FBAR penalty is assessed." *United States v. Williams,* No. 1:09–cv–437, 2010 U.S. Dist. LEXIS 90794, at *4, 2010 WL 3473311 (E.D.Va. Sept. 1, 2010). The district court initially had no occasion to consider the amount of the penalty, because it concluded after a bench trial that the defendant was not liable for a willful FBAR violation. The Fourth Circuit reversed, concluding that the trial court had clearly erred in concluding that the defendant did not act willfully. *United States v. Williams,* 489 Fed. Appx. 655, 660 (4th Cir.2012). The appellate panel suggested no concern with the trial court's de novo review. On remand, the district court reviewed the amount of the penalty "for abuse of discretion under the 'arbitrary and capricious' standard of the Administrative Procedure Act." *United States v. Williams,* No. 1:09–cv–437, 2014 U.S. Dist. LEXIS 105666, at *4 (E.D.Va. Jun. 26, 2014).

[4] The "substantial evidence" standard applies only where the formal administrative adjudication procedures of § 554, § 556, and § 557 of the APA apply. *Portland Audubon Society v. Endangered Species Comm.,* 984 F.2d 1534, 1540 (9th Cir.1993). Those procedures only apply when a statute requires an adjudication, on the record, after the opportunity for an agency hearing. *Id.; see also National Wildlife Found. v. Burford,* 871 F.2d 849, 855 (9th Cir.1989). Mr. Moore points to no statute or other authority suggesting that formal adjudication procedures are required before imposing FBAR penalties.

[5] The Internal Revenue Manual contains detailed procedures for the assessment of FBAR penalties, as well as standards for determining the amount of those penalties. *See* IRM 4.26.17 (stating procedures), 4.26.16 (stating substantive standards, including standards for determining penalty amount). The IRM does not have the force of law, *Fargo v. Comm'r,* 447 F.3d 706, 713 (9th Cir.2006), although the IRS may take guidance from it, *Keller v. Comm'r,* 568 F.3d 710, 720–21 (9th Cir.2009). No one argues that either the APA or any other source of law required the IRS to follow the IRM when assessing Mr. Moore's FBAR liability. As the court will later discuss, the Agent Tjoa's 2011 Summary Memo stated that she followed the IRM, but the record does not reveal whether the IRS followed it when it ultimately penalized Mr. Moore.

[6] The APA's informal adjudication procedures exempt a decision "affirming a prior denial" from the requirement that an agency provide a "brief statements of the grounds for denial" of a request for relief. 5 U.S.C. § 555(e). The Government invokes that section, but does not acknowledge that there is no "prior denial" in the record in this case. The only denial of Mr. Moore's request that no penalty be imposed came in the December 2012 letter closing the "appeal" process.

[7] The IRS asserts in its reply brief that as to the 2005 penalty, it did not begin to assess interest or demand payment until Mr. Moore's "appeal" was complete. Mr. Moore had no opportunity to respond to that assertion. The parties should clarify this point in their supplemental briefing. If the Government's assertion is correct, Mr. Moore likely suffered no prejudice as a result of the IRS's premature assessment of the 2005 penalty.

[8] Mr. Moore points out that his liability for the unpaid taxes on the account, even including penalties, was smaller than his FBAR penalty. That is beside the point. FBAR is not a tax requirement, it is a requirement that allows the Government to track accounts held abroad. Nothing prevents Congress or the IRS from choosing to penalize that reporting offense more harshly than underpayment of taxes.

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489 Fed.Appx. 655
This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007. See
also U.S.Ct. of Appeals 4th Cir. Rule 32.1.
United States Court of Appeals,
Fourth Circuit.

UNITED STATES of America, Plaintiff–Appellant,
v.
J. Bryan WILLIAMS, Defendant–Appellee.

No. 10–2230.
|
Argued: March 21, 2012.
|
Decided: July 20, 2012.

Synopsis
Background: Government brought action seeking to enforce civil penalties assessed against taxpayer for his failure to report his interest in two foreign bank accounts for tax year 2000. The United States District Court for the Eastern District of Virginia, Liam O'Grady, J., 2010 WL 3473311, entered judgment in favor of taxpayer, and government appealed.

Holding: The Court of Appeals, Shedd, Circuit Judge, held that taxpayer's undisputed actions established reckless conduct, which satisfied the proof requirement for wilfulness under Internal Revenue Code section requiring annual report of any financial interests in any bank, securities, or other financial accounts in a foreign country.

Reversed.

Agee, Circuit Judge, filed dissenting opinion.

***655** Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria. Liam O'Grady, District Judge. (1:09–cv–00437–LO–TRJ).

Attorneys and Law Firms

ARGUED: Robert William Metzler, United States Department of Justice, Washington, D.C., for Appellant. David Harold Dickieson, Schertler & Onorato, LLP, Washington, D.C., for Appellee. **ON BRIEF:** John A. DiCicco, Acting Assistant Attorney General, Deborah K. Snyder, United States Department of Justice, Washington, D.C.; Neil H. MacBride, United States Attorney, Alexandria, Virginia, for Appellant. Lisa H. Schertler, Schertler & Onorato, LLP, Washington, D.C., for Appellee.

Before MOTZ, SHEDD, and AGEE, Circuit Judges.

Opinion

Reversed by unpublished opinion. Judge SHEDD wrote the majority opinion, in which Judge MOTZ concurred. Judge AGEE wrote a dissenting opinion.

Unpublished opinions are not binding precedent in this circuit.

***656** SHEDD, Circuit Judge:

****1** The Government brought this action seeking to enforce civil penalties assessed against J. Bryan Williams for his failure to report his interest in two foreign bank accounts for tax year 2000, in violation of 31 U.S.C. § 5314. Following a bench trial, the district court entered judgment in favor of Williams. The Government now appeals. Because we conclude that the district court clearly erred in finding that the Government failed to prove that Williams willfully violated § 5314, we reverse.

I

Federal law requires taxpayers to report annually to the Internal Revenue Service ("IRS") any financial interests they have in any bank, securities, or other financial accounts in a foreign country. 31 U.S.C. § 5314(a). The report is made by filing a completed form TD F 90–22.1 ("FBAR") with the Department of the Treasury.[1] *See id.* § 5314; 31 C.F.R. § 1010.350. The FBAR must be filed on or before June 30 of each calendar year with respect to foreign financial accounts maintained during the previous calendar year, 31 C.F.R. § 1010.306(c), and the Secretary of the Treasury may impose a civil money penalty on any person who fails to timely file the report, 31 U.S.C. § 5321(a)(5)(A). Moreover, in cases where a person "willfully" fails to file the FBAR, the Secretary may impose an increased maximum penalty, up to $100,000 or fifty percent of the balance in the account at the time of the violation. *Id.* § 5321(a)(5)(C). The authority to enforce such assessments has been delegated to the IRS. 31 C.F.R. § 1010.810(g).

In 1993, Williams opened two Swiss bank accounts in the name of ALQI Holdings, Ltd., a British Corporation (the "ALQI accounts"). From 1993 through 2000, Williams deposited more than $7,000,000 into the ALQI accounts, earning more than $800,000 in income on the deposits. However, for each of the tax years during that period, Williams did not report to the IRS the income from the ALQI accounts or his interest in the accounts, as he was required to do under § 5314.

By the fall of 2000, Swiss and Government authorities had become aware of the assets in the ALQI accounts. Williams retained counsel and on November 13, 2000, he met with Swiss authorities to discuss the accounts. The following day, at the request of the Government, the Swiss authorities froze the ALQI accounts.

Relevant to this appeal, Williams completed a "tax organizer" in January 2001, which had been provided to him by his accountant in connection with the preparation of his 2000 federal tax return. In response to the question in the tax organizer regarding whether Williams had "an interest in or a signature or other authority over a bank account, or other financial account in a foreign country," Williams answered "No." J.A. 111. In addition, the 2000 Form 1040, line 7a in Part III of Schedule B asks:

> At any time during 2000, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions for exceptions and filing requirements for Form TD F 90–22.1.

***657 **2** J.A. 131. On his 2000 federal tax return, Williams checked "No" in response to this question, and he did not file an FBAR by the June 30, 2001, deadline. Subsequently, upon the advice of his attorneys and accountants, Williams fully disclosed the ALQI accounts to an IRS agent in January 2002. In October 2002 he filed his 2001 federal tax return on which he acknowledged his interest in the ALQI accounts. Williams also disclosed the accounts to the IRS in February 2003 as part of his application to participate in the Offshore Voluntary Compliance Initiative.[2] At that time he also filed amended returns for 1999 and 2000, which disclosed details about his ALQI accounts.

In June 2003, Williams pled guilty to a two-count superseding criminal information, which charged him with conspiracy to defraud the IRS, in violation of 18 U.S.C. § 371, and criminal tax evasion, in violation of 26 U.S.C. § 7201, in connection with the funds held in the ALQI accounts from 1993 through 2000. As part of the plea, Williams agreed to allocute to all of the essential elements of the charged crimes, including that he unlawfully, willfully, and knowingly evaded taxes by filing false and fraudulent tax returns on which he failed to disclose his interest in the ALQI accounts. In exchange for his allocution, Williams received a three-level reduction under the Sentencing Guidelines for acceptance of responsibility.[3]

In his allocution, Williams admitted the following:

> I knew that most of the funds deposited into the Alqi accounts and all the interest income were taxable income to me. However, the calendar year tax returns for #93 through 2000, I chose not to report the income to my—to the Internal Revenue Service in order to evade the substantial taxes owed thereon, until I filed my 2001 tax return.
>
> *I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon,* until I filed my 2001 tax return.
>
> ....
>
> I knew what I was doing was wrong and unlawful. I, therefore, believe that I am guilty of evading the payment of taxes for the tax years 1993 through 2000. I also believe that I acted in concert with others to create

> a mechanism, the Alqi accounts, which I intended to allow me to escape detection by the IRS. Therefore, I am—I believe that I'm guilty of conspiring with the people would (sic) whom I dealt regarding the Alqi accounts to defraud the United States of taxes which I owed.

J.A. 55 (emphasis added).

In January 2007, Williams finally filed an FBAR for each tax year from 1993 through 2000. Thereafter, the IRS assessed two $100,000 civil penalties against him, pursuant to § 5321(a)(5), for his failure to file an FBAR for tax year 2000.[4] ***658** Williams failed to pay these penalties, and the Government brought this enforcement action to collect them. Following a bench trial, the district court entered judgment in favor of Williams, finding that the Government failed to establish that Williams willfully violated § 5314. The Government timely appealed.

II

****3** The parties agree that Williams violated § 5314 by failing to timely file an FBAR for tax year 2000. The only question is whether the violation was willful. The district court found that (1) Williams "lacked any motivation to willfully conceal the accounts from authorities" because they were already aware of the accounts and (2) his failure to disclose the accounts "was not an act undertaken intentionally or in deliberate disregard for the law, but instead constituted an understandable omission given the context in which it occurred."[5] J.A. 378–79. Therefore, the district court found that Williams's violation of § 5314 was not willful.

"Willfulness may be proven through inference from conduct meant to conceal or mislead sources of income or other financial information," and it "can be inferred from a conscious effort to avoid learning about reporting requirements." *United States v. Sturman,* 951 F.2d 1466, 1476 (6th Cir.1991) (internal citations omitted) (noting willfulness standard in criminal conviction for failure to file an FBAR). Similarly, "willful blindness" may be inferred where "a defendant was subjectively aware of a high probability of the existence of a tax liability, and purposefully avoided learning the facts point to such liability." *United States v. Poole,* 640 F.3d 114, 122 (4th Cir.2011) (affirming criminal conviction for willful tax fraud where tax preparer "closed his eyes to" large accounting discrepancies). Importantly, in cases "where willfulness is a statutory condition of civil liability, [courts] have generally taken it to cover not only knowing violations of a standard, but *reckless* ones as well." *Safeco Ins. Co. of America v. Burr,* 551 U.S. 47, 57, 127 S.Ct. 2201, 167 L.Ed.2d 1045 (2007) (emphasis added).Whether a person has willfully failed to comply with a tax reporting requirement is a question of fact. *Rykoff v. United States,* 40 F.3d 305, 307 (9th Cir.1994); *accord United States v. Gormley,* 201 F.3d 290, 294 (4th Cir.2000) ("[T]he question of willfulness is essentially a finding of fact.").

We review factual findings under the clearly erroneous standard set forth in Federal Rule of Civil Procedure 52(a). ***659** *Walton v. Johnson,* 440 F.3d 160, 173–74 (4th Cir.2006) (en banc). "Our scope of review is narrow; we do not exercise de novo review of factual findings or substitute our version of the facts for that found by the district court." *Id.* at 173. "If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently." *Id.* (quoting *Anderson v. City of Bessemer City,* 470 U.S. 564, 573–74, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985)). However, notwithstanding our circumscribed review or the deference we give to a district court's findings, those findings are not conclusive if they are "plainly wrong." *Id.* (quoting *Jiminez v. Mary Washington College,* 57 F.3d 369, 379 (4th Cir.1995)). The clear error standard still requires us to engage in "meaningful appellate review," *United States v. Abu Ali,* 528 F.3d 210, 261 (4th Cir.2008), and where objective evidence contradicts a witness' story, or the story itself is "so internally inconsistent or implausible on its face that a reasonable factfinder would not credit it, ... the court of appeals may well find clear error even in a finding purportedly based on a credibility determination." *United States v. Hall,* 664 F.3d 456, 462 (4th Cir.2012) (citing *Anderson,* 470 U.S. at 575, 105 S.Ct. 1504). Thus, "[a] finding is clearly erroneous when, although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed." *F.C. Wheat Maritime Corp. v. United States,* 663 F.3d 714, 723 (4th Cir.2011).

****4** Here, the evidence as a whole leaves us with a definite and firm conviction that the district court clearly erred in finding that Williams did not willfully violate § 5314. Williams signed his 2000 federal tax return, thereby declaring under penalty of perjury that he had "examined this return and accompanying schedules and statements" and that, to the best of his knowledge, the return was "true, accurate, and complete." "A taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents." *Greer v. Commissioner of Internal Revenue,* 595 F.3d 338, 347 n. 4 (6th Cir.2010); *United States v. Doherty,* 233 F.3d 1275, 1282 n. 10 (11th Cir.2000) (same). Williams's signature is prima facie evidence that he knew the contents of the return, *United States v. Mohney,* 949 F.2d 1397, 1407 (6th Cir.1991), and at a minimum line 7a's directions to "[s]ee instructions for exceptions and filing requirements for Form TD F 90–22.1" put Williams on inquiry notice of the FBAR requirement.

Nothing in the record indicates that Williams ever consulted Form TD F 90–22.1 or its instructions. In fact, Williams testified that he did not read line 7a and "never paid any attention to any of the written words" on his federal tax return. J.A. 299. Thus, Williams made a "conscious effort to avoid learning about reporting requirements," *Sturman,* 951 F.2d at 1476, and his false answers on both the tax organizer and his federal tax return evidence conduct that was "meant to conceal or mislead sources of income or other financial information," *id.* ("It is reasonable to assume that a person who has foreign bank accounts would read the information specified by the government in tax forms. Evidence of acts to conceal income and financial information, combined with the defendant's failure to pursue knowledge of further reporting requirements as suggested on Schedule B, provide a sufficient basis to establish willfulness on the part of the defendant."). This conduct constitutes willful blindness to the FBAR requirement. *Poole,* 640 F.3d at 122 ("[I]ntentional ignorance and actual knowledge are equally culpable under the law.")

***660** Williams's guilty plea allocution further confirms that his violation of § 5314 was willful. During that allocution, Williams acknowledged that he willfully failed to report the existence of the ALQI accounts to the IRS or Department of the Treasury as part of his larger scheme of tax evasion. This failure to report the ALQI accounts is an admission of violating § 5314, because a taxpayer complies with § 5314 by filing an FBAR with the Department of the Treasury. In light of his allocution, Williams cannot now claim that he was unaware of, [6] inadvertently ignored, or otherwise lacked the motivation to willfully disregard the FBAR reporting requirement.

Thus, we are convinced that, at a minimum, Williams's undisputed actions establish reckless conduct, which satisfies the proof requirement under § 5314. *Safeco Ins.,* 551 U.S. at 57, 127 S.Ct. 2201. Accordingly, we conclude that the district court clearly erred in finding that willfulness had not been established.

III

****5** For the foregoing reasons, we reverse the judgment of the district court and remand this case for proceedings consistent with this opinion.

REVERSED.

AGEE, Circuit Judge, dissenting:

****5** The majority correctly recites that we review only for clear error the district court's dispositive factual finding that Williams' failure to file the FBAR was not willful. Maj. Op. at 658–59. The majority also correctly notes the limited scope of review under that standard. *Id.* In my view, however, my colleagues in the majority do not adhere to that standard, instead substituting their judgment for the judgment of the district court. As appellate judges reviewing for clear error, we are bound by the standard of review and therefore I respectfully dissent.

We recently explained how circumscribed our review under the clear error standard must be:

> "This standard plainly does not entitle a reviewing court to reverse the finding of the trier of fact simply because it is convinced that it would have decided the case differently." *Anderson v. Bessemer City,* 470 U.S. 564, 573, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985). "If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently." *Id.* at 573–74, 105 S.Ct. 1504.

> "When findings are based on determinations regarding the credibility of witnesses," we give "even greater deference to the trial court's findings." *Id.* at 575, 127 S.Ct. 2201.

United States v. Hall, 664 F.3d 456, 462 (4th Cir.2012). Applying this standard to the case at bar, I conclude the district court's judgment should be affirmed.

***661** The majority opinion rightly points out that there is evidence supporting the conclusion that Williams' failure to file the FBAR was willful, particularly if adopting the majority's conclusion that a "willful violation" can include "willful blindness to the FBAR requirement" or "intentional ignorance." Maj. Op. at 659. That evidence could have led a reasonable factfinder to conclude that the violation was willful, as the majority believes. [1]

But there is also evidence supporting the opposite view. First, there is Williams' direct testimony that he was unaware of the FBAR requirement in June 2001 (when it was supposed to be filed) and that he did not willfully (or recklessly) fail to file it. The district judge, who had the opportunity to observe Williams' demeanor while testifying, expressly found that "Williams' testimony that he only focused on the numerical calculations on the Form 1040 and otherwise relied on his accountants to fill out the remainder of the Form is credible...." J.A. 379.

Significantly, the district court also found that there was no objective incentive for Williams to continue to conceal the ALQI account in June 2001, because at that time he knew that the United States government had requested the ALQI accounts be frozen, and thus Williams knew the United States government knew about those accounts. As the district court reasoned, if Williams had known about the FBAR requirement, there would have been little incentive for him under those circumstances to refuse to comply with it as of June 2001.

****6** Additional evidence supporting the district court's finding includes the undisputed evidence that, after June 2001, Williams and his advisors began formal disclosures of the ALQI accounts, including the filing of amended income tax returns, but they did not backfile FBAR reports. These disclosures included direct disclosures of the ALQI accounts to the IRS in January 2002. The district court explained the significance of this disclosure to the IRS: "[t]hough made after the June 30, 2001" FBAR filing deadline, the disclosure "indicates to the Court that Williams continued to believe the assets had already been disclosed. That is, it makes little sense for Williams to disclose the ALQI accounts merely six months after the deadline he supposedly willfully violated." J.A. 378. This was a logical and supported finding for the district court to make on the record before it.

The district court's decision was set forth in a detailed opinion that fully explained the evidence supporting its findings. Had I been sitting as the trier of fact in this bench trial, I may well have decided differently than did the district judge. But I cannot say that I am left with a "definite and firm conviction" that he was mistaken. Thus, I cannot agree with the majority that the Government has established clear error.

I also address briefly the two other grounds for reversal asserted by the United States and rejected by the district court: collateral estoppel and judicial estoppel. [2] Specifically, the Government ***662** points to Williams' criminal conviction and, in particular, the language in his plea allocution, *see* Maj. Op. at 657, as requiring a finding that both types of estoppel apply. I disagree.

We review the district court's denial of judicial estoppel only for abuse of discretion, *see Jaffe v. Accredited Sur. & Cas. Co.,* 294 F.3d 584, 595 n. 7 (4th Cir.2002), and its denial of collateral estoppel de novo, *Tuttle v. Arlington Cnty. Sch. Bd.,* 195 F.3d 698, 703 (4th Cir.1999).

Judicial estoppel generally requires three elements:

> First, the party sought to be estopped must be seeking to adopt a position that is inconsistent with a stance taken in prior litigation. The position at issue must be one of fact as opposed to one of law or legal theory. Second, the prior inconsistent position must have been accepted by the court. Lastly, the party against whom judicial estoppel is to be applied must have intentionally misled the court to gain unfair advantage.

Zinkand v. Brown, 478 F.3d 634, 638 (4th Cir.2007) (citations and internal quotations omitted).

Similarly, a party seeking to apply collateral estoppel must establish five elements:

> (1) the issue sought to be precluded is identical to one previously litigated; (2) the issue [was] actually determined in the prior proceeding; (3) determination of the issue [was] a critical and necessary part of the decision in the prior proceeding; (4) the prior judgment [is] final and valid; and (5) the party against whom estoppel is asserted ... had a full and fair opportunity to litigate the issue in the previous forum.

****7** *Sedlack v. Braswell Servs. Grp., Inc.,* 134 F.3d 219, 224 (4th Cir.1998); *Collins v. Pond Creek Mining Co.,* 468 F.3d 213, 217 (4th Cir.2006). "The doctrine ... may apply to issues litigated in a criminal case which a party seeks to relitigate in a subsequent civil proceedings.... [For example], a defendant is precluded from retrying issues necessary to his plea agreement in a later civil suit." *United States v. Wight,* 839 F.2d 193, 196 (4th Cir.1987).

> In my view, the district court correctly concluded that there remains a factual incongruence between those facts necessary to [Williams'] guilty plea to tax evasion and those establishing a willful violation of § 5314. That Williams intentionally failed to report income in an effort to evade income taxes is a separate matter from whether Williams specifically failed to comply with disclosure requirements contained in § 5314 applicable to the ALQI accounts for the year 2000.

J.A. 379. Put differently, Williams never allocuted to failing to file the FBAR form, and certainly did not admit willfully failing to file it. Neither his plea agreement nor his allocution even referred to the FBAR or § 5314. Indeed, the Treasury Department itself notes that the FBAR is a separate reporting requirement and not a tax return, nor is it to be attached to a taxpayer's tax returns. *See* J.A. 225, 237, 246. In short, pleading guilty to hiding the existence of the two accounts for income tax purposes does not necessarily establish that Williams willfully failed to file a FBAR for 2000. Indeed, other separate and distinct tax penalties (including penalties for fraud) were separately sought by the IRS from Williams for his failure to report the income in the accounts, pursuant to 26 U.S.C. §§ 6662 and 6663. *See Williams v. Comm'r of Internal Revenue,* 97 T.C.M. (CCH) 1422, *4 (Apr. 16, 2009). ***663** The FBAR-related penalty is not a tax penalty, but a separate penalty for separate conduct.

Thus, viewed as distinct issues, collateral estoppel is inapplicable here because Williams' willfulness in failing to file the FBAR is not an issue "identical to one previously litigated." *Sedlack,* 134 F.3d at 224. Likewise, judicial estoppel is inapplicable because there is nothing about Williams' stance on willfulness here that is "inconsistent with [the] stance taken" in his criminal proceedings. *Zinkand,* 478 F.3d at 638. Accordingly, I would further hold that the district court did not err in declining to apply either collateral estoppel or judicial estoppel.

For all of these reasons, I respectfully dissent and would affirm the judgment of the district court.

All Citations

489 Fed.Appx. 655, 2012 WL 2948569, 110 A.F.T.R.2d 2012-5298, 2012-2 USTC P 50,475

Footnotes

[1] TD F 90–22.1, which is a form issued by the Department of the Treasury, is titled "Report of Foreign Bank and Financial Accounts" and is commonly referred to as the "FBAR." The regulations relating to the FBAR were formerly published at 31 C.F.R. §§ 103.24 and 103.27, but were recodified in a new chapter effective March 1, 2011. *See* Transfer & Reorganization of Bank Secrecy Act Regulations, 75 Fed.Reg. 65806 (Oct. 26, 2010). For ease, our citations are to the recodified sections.

[2] The IRS rejected the application and turned it over to the attorney for the United States who was conducting a grand jury investigation of Williams.

3 Williams also agreed to pay all taxes and criminal penalties due for tax years 1993 through 2000, but he has since refused to pay some of those taxes and penalties and has engaged the IRS in litigation over that issue. *See Williams v. Commissioner of Internal Revenue,* 97 T.C.M. (CCH) 1422 (Apr. 16, 2009).

4 The statute of limitations for assessing penalties for tax years 1993 through 1999 had expired by the time the IRS assessed the civil penalties. *See* 31 U.S.C. § 5321(b)(1) and (2).

5 In making its determination, the district court emphasized Williams's motivation rather than the relevant issue of his intent. *See Am. Arms Int'l v. Herbert,* 563 F.3d 78, 83 (4th Cir.2009) ("[M]alice or improper motive is not necessary to establish willfulness."). To the extent the district court focused on motivation as proof of the lack of intent, it simply drew an unreasonable inference from the record. In November 2000, Swiss authorities met with Williams to discuss the ALQI accounts and thereafter froze them at the request of the United States Government. Although the Government knew of the *existence* of the accounts, nothing in the record indicates that, when the accounts were frozen, the Government knew the extent, control, or degree of Williams's interest in the accounts or the total funds held in the accounts. As Williams admitted in his allocution, his decision not to report the accounts was part of his tax evasion scheme that continued until he filed his 2001 tax return. Thus, his failure to disclose information about the ALQI accounts on his 2000 tax return in May 2001 was motivated by his desire not to admit his interest in the accounts, even after authorities had been aware of them for over six months. Rarely does a person who knows he is under investigation by the Government immediately disclose his wrongdoing because he is not sure how much the Government knows about his role in that wrongdoing. Thus, without question, when Williams filed in May of 2001, he was clearly motivated not to admit his interest in the ALQI accounts.

6 In fact, seven months before his criminal allocution, Williams sent a letter to the IRS requesting to participate in the Offshore Voluntary Compliance Initiative "[p]ursuant to Rev. Proc.2003–11." J.A. 183–84. On the first page of Revenue Procedure 2003–11, the IRS specifically informs applicants that a primary benefit of the Initiative is that participating taxpayers can avoid penalties for having failed to timely file an FBAR. Clearly, Williams was aware of the FBAR at the time of his allocution. Further, to the extent Williams asserts he was unaware of the FBAR requirement because his attorneys or accountants never informed him, his ignorance also resulted from his own recklessness. Williams concedes that from 1993–2000 he never informed his accountant of the existence of the foreign accounts—even after retaining counsel and with the knowledge that authorities were aware of the existence of the accounts.

1 Some of that evidence, of course, is subject to two interpretations. For example, the majority reasons that Williams' reference in his allocution to the "Department of the Treasury" is necessarily an admission he violated § 5314. Because the IRS is a bureau of the Department of the Treasury, however, the reference in his plea could instead be interpreted as a simple acknowledgement of that fact. Indeed, there was no reference in the criminal proceedings to Section 5314 or the FBAR at all.

2 In light of its holding that the district court clearly erred in finding the violation not willful, the majority did not have cause to address either estoppel argument. Because I would affirm the district court and the Government contends that both types of estoppel prevent Williams from challenging the willfulness of his violation, it is necessary to address those points.

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727 F.3d 682
United States Court of Appeals,
Seventh Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
James A. SIMON, Defendant–Appellant.

No. 11–1837.
|
Argued Feb. 10, 2012.
|
Decided Aug. 15, 2013.

Synopsis

Background: Defendant was convicted, by a jury in the United States District Court for the Northern District of Indiana, Robert L. Miller, Jr., J., of filing false income tax returns, failing to file reports of foreign bank accounts, mail fraud and financial aid fraud. He appealed.

Holdings: The Court of Appeals, Rovner, Circuit Judge, held that:

[1] evidence that defendant was ineligible for extensions of the deadlines for filing reports of his foreign bank accounts (FBAR) was sufficient to support conviction for failing to file such reports;

[2] district court did not err in excluding evidence of loans allegedly made to defendant's business entities; and

[3] evidence that defendant failed to disclose on his tax returns that he held signature authority over foreign accounts was sufficient to support conviction for filing false tax returns.

Affirmed.

Attorneys and Law Firms

***683** David E. Hollar, Office of the United States Attorney, Hammond, IN, for Plaintiff–Appellee.

Anthony J. LaSpada, Tampa, FL, Ronald S. Safer, Schiff Hardin LLP, Chicago, IL, for Defendant–Appellant.

Before RIPPLE and ROVNER, Circuit Judges, and COLEMAN, District Judge.[*]

Opinion

ROVNER, Circuit Judge.

A jury convicted James A. Simon of filing false income tax returns, failing to file reports of foreign bank accounts, mail fraud and financial aid fraud. He challenges the legal basis for his convictions on failing to file reports of foreign bank accounts and also contests the district court's decision to limit the evidence he could present in his defense on the false income tax return counts. He also contends that the court erred in its rulings on jury instructions, and he maintains that a reversal on some counts necessarily requires reversal on other counts. We affirm.

I.

James Simon is a Certified Public Accountant, a professor of accounting, and an entrepreneur whose business dealings require a flowchart to unravel. At the center of Simon's financial life was JAS Partners, a Colorado limited partnership. Simon and his wife Denise[1] each owned one percent of JAS Partners. The Simon Family Trust (hereafter "the Trust"), based in the Cook Islands, owned the other ninety-eight percent. The Trust existed for the benefit of Simon, his wife and their children; the trustees were a Cook Islands corporation and a retired attorney. Simon's sisters, Sherri Johnson and Sandra Simon, each owned forty-three percent of Elekta Ltd, a Gibralter company for which Simon served as the managing director. The Simon sisters are retired teachers who entrusted the entirety of the business to their brother. Elekta owned nineteen percent of JS Elekta, a Cyprus corporation, also managed by Simon. JS Elekta, in turn, owned seventy-five percent of Ichua Company, a Cyprus corporation also managed by Simon. Ichua owned 100% of Intellecom, a Ukrainian telecommunications business entity.[2] Simon thus was the managing director of three foreign companies, Elekta, JS Elekta and Ichua. In his capacity as managing director, he held signature authority over foreign bank accounts for each of these companies.

For tax years 2003 through 2006, the Simon family received approximately $1.8 million from JAS Partners, Elekta, JS Elekta, Ichua and William R. Simon ***684** Farms, Inc., most of this recorded as loans in Simon's personal financial records. Simon and his family spent approximately $1.7 million during this same period of time. Yet Simon paid just $328 in income taxes for 2005, and claimed refunds for the other three years, at the same time pleading poverty to financial aid programs in order to gain need-based scholarships for his children at private schools. The government charged Simon with four counts of filing false tax returns, in violation of 26 U.S.C. § 7206(1) and 18 U.S.C. § 2; four counts of failing to file reports related to foreign bank accounts, in violation of 31 U.S.C. §§ 5314, 5322 and 18 U.S.C. § 2; eleven counts of mail fraud, in violation of 18 U.S.C. §§ 1341 and 2; and four counts of financial aid fraud, in violation of 20 U.S.C. § 1097 and 18 U.S.C. § 2. In his defense, Simon sought to demonstrate that the money he received from various entities was loaned to him and thus was not taxable. Alternately, he characterized the money he received as partnership distributions that were not taxable because they did not exceed his basis in the partnership. At worst, he explained, he mischaracterized some of the transactions, but not in a manner that violated any criminal law. As for any failure to file reports regarding his signature authority over foreign bank accounts, Simon contended that the IRS did not require him to file these reports by the dates alleged by the government, that the IRS had extended the filing deadlines for the tax years in question past the date of his indictment, and that he filed the reports within the extended time period. The other counts, he contended, were largely dependent on the false income tax counts, and he therefore maintained that a failure to prove the income tax counts necessarily required reversal of the other counts.

In ruling on pre-trial motions, the district court rejected Simon's claim regarding the extended deadlines for filing reports of foreign bank accounts as a matter of law. The court concluded that the relief the IRS granted from civil liability for certain failures to report foreign bank accounts could not relieve Simon of criminal liability for offenses completed before the IRS granted the civil relief. The court also found that evidence related to the funding of some of Simon's business entities would be excluded except to the extent that Simon himself provided that funding. A jury subsequently found Simon guilty of four counts of filing false tax returns; guilty of three counts (one count was dismissed) of failing to file reports related to foreign bank accounts; guilty of eight counts (and not guilty of three counts) of mail fraud; and guilty of four counts of financial aid fraud. Simon appeals.

II.

On appeal, Simon first contends that his convictions for failing to file reports of foreign bank accounts must be reversed because he filed the required documents within the time allotted by extensions granted by the IRS. He characterizes the issue as one of conflicting interpretations of the law by the Treasury Department and the Justice Department. He maintains that the courts should defer to the agency entrusted with implementing the statute at issue, in this case the Treasury Department, and that deferring to Treasury would require reversal of those counts. Second, Simon argues that evidentiary errors and jury instruction errors require reversal of his convictions for filing false tax returns. He complains that the court's rulings *in limine* prevented him from presenting a valid defense to the charges when he was not allowed to present certain evidence of his basis in JAS Partners. He also challenges the government's second theory underlying the false ***685** tax return counts: that the returns were false because Simon failed to check the "yes" box on Schedule B of his return in response to a question regarding whether he had signature authority over foreign bank accounts. If the conviction on the foreign bank reporting counts must be reversed, then the conviction on the false returns must also be reversed, he argues, because it was no more necessary to check the "yes" box revealing his signature authority over foreign accounts than it was to file reports for those accounts. Third, he maintains that the evidentiary errors he asserted on the false return counts led to an error in the jury instructions. Finally, Simon contends that if the false tax return counts are reversed, then he is also entitled to a new trial on the mail fraud and student loan fraud counts, because these convictions were dependent on the validity of the false tax return convictions.

A.

[1] The Bank Secrecy Act of 1970, 31 U.S.C. § 5311, *et seq.* (the "Act"), requires "certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." 31 U.S.C. § 5311. Section 5314 of the Act provides that the Secretary of the Treasury ("Secretary") "shall require ... a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the ... person makes a transaction or maintains a relation for any person with a foreign financial agency." Although the Act specifies the information that must be collected, it provides to the Secretary the discretion to prescribe the classification of persons subject to the law and regulations, the foreign countries to which record requirements may be applied, the magnitude and types of the transactions subject to record and reporting requirements, and the manner in which the information should be kept, among other things. *See* 31 U.S.C. § 5311(a)-(b). The persons required by the Act and its accompanying regulations to keep the designated records also must disclose them "as required by law." 31 U.S.C. § 5314(c). Willful violations of the disclosure requirements carry criminal and civil penalties. *See* 31 U.S.C. § 5322.

In each year from 2005 through 2007, Simon had signature authority over foreign bank accounts. Regulations in place at that time provided that Simon was required to file with the Commissioner of Internal Revenue (hereafter "IRS") a Form TDF 90–22.1, "Report of Foreign Bank and Financial Accounts," also known as an "FBAR." *See* 31 C.F.R. § 103.24(a).[3] The deadline for filing FBARs was "June 30 of each calendar year with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year." 31 C.F.R. § 103.27(c).[4]

Simon concedes that he did not file the required FBARs for each calendar year from 2005 through 2007 by June 30 of the next year in each instance.[5] He nonetheless ***686** contends that he did not violate the law because the IRS issued guidance in 2009 and 2010 that granted retroactive extensions for filing FBARs for the 2008 and earlier calendar years. The initial guidance, which we discuss below, was published in the form of frequently asked questions and answers, and this document purported to extend the deadline for filing FBARs to September 29, 2009. An IRS notice then extended the FBAR filing date to June 30, 2010, and a second IRS notice later extended the deadline even further to June 30, 2011. *See* IRS Notice 2009–62, 2009–35 I.R.B. 260, 2009 WL 2414299 (hereafter "Notice 2009–62"); IRS Notice 2010–23, 2010–11 I.R.B. 441, 2010 WL 672300 (hereafter "Notice 2010–23"). By then, Simon asserts, he had filed the required FBARs and thus could not, as a matter of law, face prosecution for his failure to meet the original deadlines. Indeed, he filed the FBARs prior to his indictment and within the extended deadlines set forth in Notices 2009–62 and 2010–23 (collectively the "Notices"). The government counters that Simon's crimes were complete before the IRS issued the Notices, and that the Notices cannot serve to absolve a person of his then-existing criminal liability for completed acts. The government also contends that amendment of a regulation does not relieve criminal liability for conduct occurring prior to the amendment, even when the amendment purports to have retroactive application. Moreover, the government maintains that the Notices specified only that the IRS would not impose *civil* penalties for persons whose failure to comply was not willful, but that nothing in the Notices evidenced an intention to relieve from criminal liability taxpayers who willfully failed to file their FBARs. Finally, the Notices did not apply to taxpayers like Simon, the government contends, who had not reported all of their taxable income, had not paid all of their taxes, and instead willfully violated the FBAR provisions.

We turn to the language of the Notices themselves as well as earlier guidance that the IRS published on FBAR issues. In March 2009, the IRS initiated the "2009 Offshore Voluntary Disclosure Program," intended to "get those taxpayers hiding assets offshore back into the system."[6] *See* http://www.irs. gov/uac/Statement-from-IRSCommissioner-Doug-Shulman-on-Offshore-Income (last visited July 12, 2013). On May 6, 2009, the IRS posted on its website a series of Frequently Asked Questions ("FAQs") explaining the program to taxpayers in plain language. Several of the FAQs addressed FBAR issues, and one purported to extend the FBAR filing deadline:

> Q9. I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs in prior years to report my personal foreign bank account or to report the fact that I have signature authority over bank accounts owned by my employer. May I come forward under the voluntary disclosure practice to correct this?

> A9. The purpose for the voluntary disclosure practice is to provide a way for taxpayers who did not report taxable income in the past to voluntarily come forward and resolve their tax matters. Thus, If [sic] you reported and paid tax on all taxable income but did not file FBARs, do not use the voluntary disclosure process.
>
> For taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, you ***687** should file the delinquent FBAR reports according to the instructions ... and attach a statement explaining why the reports are filed late. Send copies of the delinquent FBARs, together with copies of tax returns for all relevant years, by September 23, 2009, to the Philadelphia Offshore Identification Unit....
>
> The IRS will not impose a penalty for the failure to file the FBARs.

See http://www.irs.gov /uac/Voluntary-Disclosure:-Questions-and-Answers (last visited July 12, 2013). FAQ 7 instructs that taxpayers who are already under examination by the IRS are not eligible for the Voluntary Disclosure Program, and FAQ 14 explains that there are criminal penalties for failing to file FBARs.

Notice 2009–62 purports to address "technical issues" for certain FBAR filers and states that the Notice "provides temporary relief to those filers while formal guidance is developed." Notice 2009–62 also states that it "extends the due date for filing an FBAR for one year until June 30, 2010, for U.S. persons having signature authority over, but no financial interest in, a foreign financial account[.]" After referencing the earlier issued FAQs, Notice 2009–62 clarified that affected persons "have until June 30, 2010, to file an FBAR for the 2008 and earlier calendar years with respect to these foreign financial accounts. Thus, eligible persons that avail themselves of the administrative relief provided in this notice may need to file FBARs for the 2008, 2009 and earlier calendar years on or before June 30, 2010, to the extent provided in future guidance." Finally, the filing extension provided in the Notice expressly "supplements the filing extension to September 23, 2009, previously provided by the IRS on its public website."

The "future guidance" referenced in Notice 2009–62 came the next year in Notice 2010–23. Public comment received after issuance of Notice 2009–62 led the IRS and Treasury Department to provide additional administrative relief:

> Persons with signature authority over, but no financial interest in, a foreign financial account for which an FBAR would otherwise have been due on June 30, 2010, will now have until June 30, 2011, to report those foreign financial accounts. The deadline of June 30, 2011, applies to FBARs reporting foreign financial accounts over which the person has signature authority, but no financial interest, for the 2010 and prior calendar years.
>
> ...
>
> Provided the taxpayer has no other reportable foreign financial accounts for the year in question, a taxpayer who qualifies for the filing relief provided in this notice should check the "no" box in response to FBAR-related questions found on federal tax forms for 2009 and earlier years that ask about the existence of a financial interest in, or signature authority over, a foreign financial account.

Notice 2010–23. A third notice later extended further the deadline for FBARs for 2009 and earlier calendar years to November 1, 2011. *See* IRS Notice 2011–54, 2011–29 I.R.B. 53, 2011 WL 2409318 (hereafter "Notice 2011–54").

The government contends that Simon was not eligible for either the Voluntary Disclosure Practice or the administrative relief set forth in the FAQs and the Notices. Second, the government asserts, the crime was complete when Simon did not file the three FBARs on June 30 of the year following each calendar year at issue. Any subsequent notice issued by the IRS could not relieve criminal liability already ***688** incurred under the government's interpretation. Finally, the government insists that any relief granted by the FAQs and the Notices was strictly civil, and that the IRS could not and did not promise to retroactively relieve from criminal liability any persons who had already completed a criminal act when they willfully failed to meet the original deadlines.

Simon counters that the Treasury Department and IRS expressly granted retroactive relief to taxpayers like himself who had signature authority over foreign financial accounts. Simon characterizes the issue as one of conflicting interpretations of the regulations by the Treasury Department and the Justice Department. The Treasury Department, he contends, retroactively extended the deadline for filing FBARs for taxpayers like himself who properly reported all of their taxable income but failed to file FBARs by the original deadlines. In such a scenario, the FAQs directed taxpayers not to use the Voluntary Disclosure Practice but to simply file the FBARs by the new deadlines published in the FAQs and subsequent Notices. *See* FAQ 9; Notice 2009–62; Notice 2010–23. For these otherwise compliant taxpayers who simply failed to file FBARs by the original deadlines, the IRS promised it would "not impose a penalty for the failure to file the FBARs." FAQ 9. Simon reads that promise as applying to both civil and criminal penalties. This asserted conflict between the Treasury Department and the Justice Department presents an issue of first impression, Simon contends, that can be answered by extending the principles set forth in *Director, Office of Workers' Compensation Programs v. Ball,* 826 F.2d 603 (7th Cir.1987). Under *Ball,* Simon maintains that we must defer to the interpretation given to the regulations by the agency that is charged with administration of the statute and regulations. Although *Ball* involved two parts of the same agency, namely, the Director of the Department of Labor and the Review Board of that same department, Simon urges us to apply that principle here to defer to the Treasury Department's interpretation of the regulations here.

The government counters that there is no conflict between the Justice Department and the Treasury Department in the interpretations of the regulations. The Treasury Department never opposed Simon's prosecution and, in fact, the case agent and several testifying witnesses were IRS employees. As the government reads the regulations and the Notices, any relief granted was from civil penalties only. Moreover, the Notices expressed no intention to refrain from prosecuting persons like Simon who were already being investigated for wilfully violating the tax laws and wilfully failing to file FBARs. The government also maintains that the IRS could not, as a matter of law, extinguish criminal liability for crimes that were completed before any regulations were repealed or amended with new deadlines. Relying on *United States v. Hark,* 320 U.S. 531, 64 S.Ct. 359, 88 L.Ed. 290 (1944), and a number of similar cases, the government argues that the amendment of a regulation does not relieve criminal liability for conduct occurring prior to the amendment. [7]

***689** We need not address the thorny issue of whether an IRS Notice can retroactively wipe out criminal liability for an already completed crime because, as we discuss below, Simon is not one of the persons to whom the IRS granted retroactive relief. That is, even if we assume solely for the purpose of this appeal that the IRS has the power to retroactively relieve criminal liability by publishing FAQs or Notices, we agree with the government that Simon was not in the class of persons to whom the relief was granted. As Simon himself notes, the IRS Notices and FAQs address relief for two groups of taxpayers. First, through the Voluntary Disclosure Practice, taxpayers who failed to report all of their taxable income could come forward to belatedly report the income and resolve their tax liabilities while minimizing their chances of criminal prosecution. FAQs 3 & 4. But persons who were already under civil examination by the IRS were not eligible to participate in the Voluntary Disclosure Practice. FAQ 7. Second, persons who properly reported all of their income and paid all of their taxes but simply failed to timely file their FBARs could file their "delinquent" FBARs, along with a statement explaining why the FBARs were late. [8] In that instance, the IRS stated it would "not impose a penalty for the failure to file the FBARs." FAQ 9. Simon agrees that he was not eligible for the Voluntary Disclosure Practice. He claims it did not apply to him because he reported all of his taxable income; the government asserts he was not eligible because the IRS had already initiated a civil examination. No matter the reason, the government and Simon agree that he was not eligible for a program that, at most, minimized his chances for criminal prosecution.

Nor was Simon in the second group of taxpayers eligible for administrative relief. As we will discuss below, because he had not "properly reported all [his] taxable income," he was not eligible to avoid penalties (civil or criminal) for filing delinquent FBARs as described in the FAQs and the subsequent Notices that extended the filing dates further. *See* FAQ 9 ("Q9. I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs ... A9. For taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, you should file the delinquent FBAR reports according to the instructions ... by September 29, 2009"); FAQ 43 ("Taxpayers who reported and paid tax on all their 2008 taxable income but only recently learned of their FBAR filing obligation and have insufficient time to gather the necessary information to complete the FBAR, should file the delinquent FBAR report according to the instructions ... by September 23, 2009"); Notice 2009–62; Notice 2010–23. FAQs 9 and 43, which extend the filing deadline to ***690** September 29, 2009, both refer to FBARs filed under the extended deadline as "delinquent" and both apply by their terms only to taxpayers who reported all of their income, paid all of their taxes and "only recently learned" that they should be filing FBARs. Notice 2009–62 specifically references FAQs 9 and 43, and expressly notes that the new filing extension to June 30, 2010 "supplements the filing extension to September 23, 2009, previously provided by the IRS on its public website." Notice 2010–62, in turn, notes that it is extending the relief provided in Notice 2009–62, extending the June 30, 2010 deadline to June 30, 2011.

Thus, the extensions described in the Notices applied only to the persons described in FAQs 9 and 43, persons who had properly reported all of their income, paid their taxes, and "only recently" learned of their obligations to file FBARs. Moreover, the late-filed FBARs were considered "delinquent" even if filed by the extended deadlines, but the IRS would not impose penalties[9] for FBARs filed within these narrow parameters, so long as the affected taxpayers met the new deadlines and explained why the FBARs were late. As we will discuss below, at trial, the government proved that Simon had not "properly reported" all of his taxable income, and had not paid all of the taxes due, and he concedes that he never filed a statement explaining why his FBARs were late. Thus, as a factual matter, he was not eligible for any of the administrative relief described in the FAQs and the Notices. Indeed, by the time the IRS had decided to extend the FBAR deadlines for otherwise-complaint taxpayers, Simon was already under investigation by the IRS and was not even eligible for the Voluntary Disclosure Practice, a special program that minimized but did not eliminate the risk of criminal prosecution. So even if we assume that the IRS could grant "administrative relief" in a notice that would erase already-incurred criminal liability, it is clear in this instance that the IRS Notices did not extend that relief to taxpayers like Simon who had not reported all of their taxable income, had not paid all of their taxes and had not filed statements explaining why their FBARs were delinquent.

To the extent that the Notices and FAQs were relevant to the issue of wilfulness, the district court granted the government's motion *in limine* to exclude the Notices, and Simon has not appealed that ruling. In any case, Simon could not have seen the 2009 and 2010 Notices until several years after he had already violated the law requiring him to file FBARs for the 2005, 2006 and 2007 tax years. He could not have mistakenly relied on the advice given in the Notices because it had yet to be issued. To the extent the Notices were evidence that he lacked wilfulness because the Notices demonstrated that many taxpayers found the FBAR requirements confusing, Simon was not harmed by the exclusion ***691** of this evidence because he was able to bring forth other evidence that taxpayers found the requirements confusing. In sum, we need not decide whether the IRS had the power to retroactively eliminate criminal liability for FBAR violations because we affirm the judgment on the grounds that the extensions granted expressly did not apply to otherwise noncompliant taxpayers like Simon.

B.

[2] We turn to Simon's claim of evidentiary error. Simon was charged with four counts of filing false tax returns, in violation of 26 U.S.C. § 7206(1) and 18 U.S.C. § 2. The government sought to prove that the returns were false in two respects. First, Simon failed to indicate on Schedule B that he had access to foreign bank accounts. Second, he failed to report all of his income. On this second theory, Simon sought to introduce evidence that any money he received from JAS Partners and the other business entities was not taxable because it was loaned to him by those entities and he was obliged to repay it. If the funds could not be legally characterized as loans, he wished to argue in the alternative that the money he withdrew from JAS Partners did not exceed his basis in the partnership, and thus the funds were non-taxable partnership distributions.

Prior to trial, the government moved *in limine* to exclude evidence regarding loans to Simon's business entities. Up to that point, Simon's defense appeared to be that the money he received from all of the business entities was not taxable income but rather constituted loans. The government conceded that legitimate loans *by* the businesses to Simon would not be taxable but that loans *to* the businesses by others were irrelevant to Simon's loan defense and would serve to confuse the jury. R. 77. Simon countered that loans to his business entities by others were relevant circumstantial evidence of how he usually conducted business. In other words, Simon contended that his history of borrowing and lending as a course of dealing in his businesses provided circumstantial evidence of whether the money he received personally from the assorted business entities were loans or taxable income. He also intended to demonstrate that, if he had loaned money to his business entities, repayment of those loans was not taxable income to him. R. 86. *See also* R. 95.

Prior to the start of trial and after hearing argument, the court entered a preliminary ruling on the matter:

> As to the evidence of loans to Mr. Simon's business entities, I think the motion is well taken to the extent I —if I understand it, the motion is directed to whether the business entities received loans with which they then made the money transfers, and I'll just [sic] call it that trying to find some neutral description, the money transfers to Mr. Simon, and I think the issues for jury determination relate to whether the money-the money transfers from the entities to Mr. Simon were loans or income and not how the entities acquired the money, and I think it might well be confusing.
>
> This is the closest of the issues I'm ruling on, and I may well re-evaluate this during trial. But to the extent the Government's motion is directed to how the money came into the hands of the business entities, specifically whether it was a loan, I think, to the extent the business was doing something and got money as a result of it, that, obviously, would not create the same jury confusion.

Trial Tr. at 148–49. Simon's counsel sought to clarify and asked, "Are you saying that we cannot show, for example, that ***692** Mr. Simon's trust loaned the money to JS [sic] Partners that subsequently loaned or distributed monies to Mr. Simon?" Trial Tr. at 149. The court replied:

> Yes, I am, and let me clarify it. I am saying that, and I may well re-evaluate when I understand better. But as I understand it now—and again, I read the briefs. I gave everybody a chance for argument. And I understand it, at this point, how the money got to JS Elektra [sic] wouldn't have anything to do with whether it would be a loan from JS Elektra [sic] to Mr. Simon. Now maybe there's more to it that I haven't understood yet, and I'll be happy to reconsider it as we go along, but we've had two chances to educate me, and, at this point I don't understand what the relevancy would be as to how JS Elektra [sic] got it, and the time for educating me has passed because I've got a jury waiting for opening statements.

Trial Tr. at 149–50.

Trial commenced and the government presented its case-in-chief. Before the defense presented its first witness, counsel for Simon again raised the issue of money loaned to JAS Partners. Counsel informed the court that the defense's first witness would be Don Willis, a man who loaned $445,000 to JAS Partners in 2003 and 2004. Counsel contended that Simon signed for these loans on behalf of the partnership and was personally responsible for the loans as a general partner. Because Simon was personally liable on the loans, counsel contended, money that Simon received from JAS Partners was non-taxable to him:

> These documents—and we're going to have experts that are going to testify to the fact that JAS Partners, when they borrow the money from Mr. Willis—and there's another one, Mr. Scheumann—and Mr. Simon signed on the note as general partner, it's like him borrowing the money himself, and, therefore, he could borrow it back from the partners or he could take the money as a distribution, and there's no tax effect on it, Judge, and that's the key to this whole case. There's no tax effect on his taking money from JAS Partners. It's his.
>
> And the other thing ... is that JAS Partners was comprised of James and Denise Simon and the Simon Family Trust, which was a 98 percent partner. The Simon Family Trust, which Mr. Simon funded, when it was established, he put in about 2,000,000 plus dollars of his own money, after-tax dollars. When they loaned money to JAS Partners, the same thing, Judge. It's Mr. Simon's money. He could take it out. He's a general partner. So it's all non-taxable, and that's the whole issue in the case.

Trial Tr. at 626–27. The government disagreed with this characterization of the law. Hearing what it perceived to be a new facet of the defense, the court then adjourned trial for the day and allowed the parties to file authority in support of their respective positions. The court then heard another round of arguments the next day.

In the new round of briefing, the government took the position that "the manner in which a partnership receives or categorizes funds bears no relation to the characterization of a payment of those funds from a partnership to its partner." R. 113, at 1. The government therefore sought to exclude all references to the characterization of funds that flowed between Simon's various business entities before those funds reached Simon's personal accounts. The government noted that, under the tax code, when a partner who is not acting in his capacity as a partner engages in business with a partnership, the transaction will be treated as if he were not a partner. 26 U.S.C. § 707(a)(1); ***693** 26 C.F.R. § 1.707–1. Thus, in deciding whether a partnership's loan to a partner was a true loan, the court would look at the substance of the transaction and determine whether there was an unconditional obligation to repay the loan. *See Mangham v. Commissioner of Internal Revenue,* 1980 WL 4125 (Tax Ct. July 29, 1980). *See also DeSantis v. Commissioner of Internal Revenue,* 1997 WL 119799 (Tax Ct. Mar. 18, 1997). The factors assessed in determining whether a loan is *bona fide* include whether there is a sum certain, the likelihood of repayment, a definite date of repayment, and the manner of repayment. *Ibid.* Thus, the government argued, the manner in which JAS Partners (or any of the other business entities) obtained the money that it loaned to Simon was irrelevant to determining whether the loans to Simon were *bona fide* and non-taxable.

Simon countered that the court should allow evidence regarding (1) the nature of any third-party loans to JAS Partners; (2) the identity of the creditor; (3) whether the loans were guaranteed by Simon or his wife; and (4) whether they were *bona fide* liabilities for tax purposes. Simon also contended that partnership distributions to partners are tax-free to the extent that they did not exceed the partner's basis in the partnership. *See* 26 U.S.C. § 731 ("In the case of a distribution by a partnership to a partner—(1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution"). Simon noted that a partner's adjusted basis is generally determined by 26 U.S.C. §§ 705. A partner's adjusted basis increases, Simon contended, when the partner's share of partnership liability increases. *See* 26 U.S.C. § 751 ("Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership."). Under Simon's theory, when a third party loaned money to JAS Partners, and Simon, as a general partner, became liable to repay that amount, his basis in the partnership increased by that amount. Any distributions to Simon up to the amount of those loans would be non-taxable under Simon's formulation because the distributions would not exceed Simon's basis in the partnership. Simon continued to maintain that the money he received from JAS Partners was in the form of legitimate loans that he intended to repay. But if the jury determined that the JAS Partners loans were not *bona fide,* then he intended to argue in the alternative that the disbursements could be recast as non-taxable constructive distributions that did not exceed his basis in the partnership. He therefore argued that evidence regarding loans by third parties to the partnership was relevant to his basis in the partnership and thus to the question of whether loans or distributions from JAS Partners to him were taxable. R. 114.

The next day, before resuming testimony, the court ruled on the evidentiary challenge. The court framed the issue as whether there was legal support for Simon's proposition that a loan to a partnership is a loan to a general partner. As the court interpreted Simon's written filing, the nature of outside loans is important for tax purposes because loans can affect the partner's adjusted basis in the partnership. In particular, Simon argued that a partner's guarantee of a partnership loan is the equivalent of a recourse liability under the Treasury regulations. The court quoted Simon's argument that "outside loans to the partnership are directly relevant in determining whether such debt should be ***694** included in the general partner's tax bases [sic] and to ultimately determine whether subsequent partnership distributions to them are tax free." Trial Tr. at 638–39. *See also* Defendant's Memorandum of Law Regarding Evidence of Loans to a Partnership, R. 114, at 3. The court concluded that this argument was a "long way from a loan to a partnership being the same as a loan to the general partner." Trial Tr. at 639. Without additional legal support for the proposition that loans to JAS Partners increased Simon's basis in the partnership, the court was unwilling to allow evidence of those loans. The court was concerned that any minimal value of this evidence would be outweighed by the risk of confusing the jury. Trial Tr. at 640. More importantly, though, the court noted that there was a factual gap in the defendant's theory because Simon had no witness to testify about his basis in the partnership. Trial Tr. at 639. The court was also concerned that Simon's experts intended to testify to general legal principles, and so the court confirmed its earlier ruling on the motion, and extended it to exclude "all testimony, expert or otherwise, regarding the manner in which partnerships function for tax purposes, and the tax treatment of partnerships, as well as any testimony about JAS Partners receiving loans *from anyone other than the Simons.*" Trial Tr. at 640–41 (emphasis added). The court thus did not prevent Simon from presenting factual evidence regarding funds that he personally and directly supplied to the partnership. The court denied the government's motion to exclude evidence about JAS Partners and its purpose under the Economic Substance Doctrine. Finally, the court addressed the government's objection to the proposed testimony of Simon's expert Howard Richshafer. The court concluded that Richshafer, an expert on tax controversy, would not be barred but that he could not "tell a jury about the law." Trial Tr. at 642–43. Instructing the jury on the law was solely within the province of the trial court, and the court therefore precluded Richshafer from testifying to a general overview and operating rules of the tax code, the meaning of certain legal doctrines, an overview of grantor trust rules under the tax code, and a number of other legal matters.

As trial was about to resume, counsel for Simon asked whether he would be allowed to present evidence that the Simon Family Trust sold its interest in a company called Eye Pro, and that the proceeds then were loaned by the Trust to JAS Partners. Trial Tr. at 647–48. Counsel clarified Simon's theory that the sale of Eye Pro and other contributions to JAS Partners with after-tax dollars created a sufficient basis in JAS Partners to allow Simon to remove money from the partnership tax-free. The court then asked counsel to detail every piece of evidence that would be excluded by counsel's understanding of the court's ruling *in limine.* Counsel responded that he wished to present evidence of a $2 million after-tax contribution to the Simon Family Trust that went into the partnership when the Trust and Partnership were established; the sale of the Eye Pro business by the Simon Family Trust and the subsequent loaning of the proceeds of that sale to JAS Partners; loans to JAS Partners by three individuals; an inheritance to Simon from his mother's estate that went into the Simon Family Trust and was then loaned to JAS Partners; and the sale of a home for $147,000 that went into the Simon Family Trust and was then loaned to JAS Partners.

With regard to the sale of Eye Pro, the court asked, "If the stock to the business belonged to the family trust and the stock or the proceeds from the stock were given to the partnership, why doesn't that create a basis for the trust, rather than for Mr. ***695** Simon, if the stock belonged to the trust?" Counsel replied:

> It's a grantor trust, Judge. The taxes have already been paid on that, and Mr. Simon contributed his after-tax dollars to this grantor trust, and so there's no tax consequence. When he puts it into the partnership, it increases his basis. It's like him just putting after-tax dollars that he had right into the partnership. What he did, he added to the trust, but he put the trust assets into the partnership.
>
> The point is, it's after-tax dollars, so there's no tax consequence that affects Mr. Simon in this way. It's just like putting—the money goes into the partnership, and then he takes it out, and it's the money that he already paid tax on, so it shouldn't be taxed.

Trial Tr. at 658. After hearing still more argument from both Simon and the government, the court concluded that Simon was free to argue to the jury that the money Simon received from JAS Partners was a loan or that it was a distribution but that he had failed to provide legal support for his argument that money transferred from the Simon Family Trust to JAS Partners and loans from outside parties to JAS Partners increased Simon's basis in the partnership. The court therefore reaffirmed its ruling *in limine.*

On appeal, Simon contends that the court erroneously barred evidence (including expert testimony) related to his defense theory that the distributions he received were not taxable because the court misunderstood the legal issue. Specifically, he maintains that the court did not understand that partnership distributions are tax-free to the extent that they did not exceed the partner's adjusted basis of his interest in the partnership. The adjusted basis, in turn, is determined by the adjusted basis of property contributed to the partnership when it is formed, and further adjusted when the partner's share of partnership liabilities changes, as when there is a loan to the partnership. The specific basis evidence that Simon sought to introduce included loans by third parties to JAS Partners, $2 million in assets from the Simon Family Trust that was transferred to JAS Partners, an inheritance from his mother that was loaned to JAS Partners through the Trust, and the proceeds of the sale of a house that were transferred to JAS Partners through the Trust.

The government does not now disagree with the general proposition that a partner is taxed on distributions removed from a partnership only to the extent that the distributions exceed the partner's adjusted basis in the partnership. 26 U.S.C. § 731(a). In reviewing the written and oral exchanges at trial surrounding this issue, it is apparent that the district court (against all odds, given the manner in which it was argued) also understood this general legal proposition but simply did not agree that the evidence Simon sought to introduce was relevant to demonstrating his adjusted basis in the partnership. That is, the court found that Simon did not demonstrate how distributions among and between third party lenders, the Simon Family Trust and JAS Partners affected *Simon's* basis in the trust. The court expressly allowed Simon to present evidence regarding his own personal contributions to JAS Partners because it was clear to the court that Simon's own direct contributions would increase his basis in the partnership. But Simon failed to timely provide legal support for his convoluted, ever-evolving argument that third-party loans to JAS Partners and funds channeled through the Simon Family Trust into JAS Partners increased his basis in JAS Partners.

***696** **[3]** **[4]** We review the court's decision to admit or exclude evidence for abuse of discretion. *United States v. Thornton,* 642 F.3d 599, 604 (7th Cir.2011); *United States v. Boone,* 628 F.3d 927, 932 (7th Cir.2010); *United States v. Cooper,* 591 F.3d 582, 590 (7th Cir.2010); *United States v. Wescott,* 576 F.3d 347, 355 (7th Cir.2009). We will reverse and order a new trial only if any evidentiary errors are not harmless. *Thornton,* 642 F.3d at 604; *Boone,* 628 F.3d at 932; *Cooper,* 591 F.3d at 590; Fed.R.Crim.P. 52(a). Of course, a decision that rests on an error of law is always an abuse of discretion. *United States v. Smith,* 454 F.3d 707, 714–15 (7th Cir.2006). Thus, if Simon is correct that the district court misunderstood the legal basis for the admission of the evidence, the decision to preclude Simon from presenting the evidence could constitute an abuse of discretion. However, the court fully understood Simon's theory that the disbursements he received from JAS Partners were either legitimate loans or partnership distributions that did not exceed his basis in the partnership. The court excluded the evidence of loans to JAS Partners by Willis and Scheumann because Simon failed to supply legal support for his claim that loans to the partnership increased his basis as a general partner. Indeed, after arguing that the loans increased his basis because "a partnership liability guaranteed by a partner is classified as a recourse liability under the Treasury regulations," and "recourse liabilities are includible in the tax basis of partnership interests held by general partners," defense counsel conceded that Simon did *not* guarantee the payment on loans to JAS Partners by Willis and Scheumann. *See* R. 114, at 3 (arguing that recourse liabilities, including a partnership liability guaranteed by a partner, increase a partner's basis in the partnership); Trial Tr. at 655 ("Mr. Scheumann and Mr. Willis, when they loaned money to the partnership, and Mr. Simon being a general partner in the partnership and, therefore as a general partner—I think I may have misstated, Your Honor, with regard to this, but what I meant to say was that *he didn't guarantee the payment.* As a general partner, he would be liable for the promissory note that the partnership had with Mr. Willis and Mr. Scheumann.") (emphasis added). Simon also failed in the district court to present any legal support for his claims that money he funneled through the Simon Family Trust to JAS Partners in undefined transactions increased his basis in JAS Partners. His sole support for that claim was an assertion that the Simon Family Trust is a grantor trust, but he cited no statutes, regulations or case law connecting that asserted fact to his personal basis in JAS Partners. *See* Trial Tr. at 664 (where the court noted, "We're here on Day Four of the trial, and I've seen no law at all. I've heard that there's experts that would testify that that is what the law is, but that's a separate order *in limine,* no law to support this theory and, accordingly, will leave the order *in limine* where it is.").

[5] **[6]** Nor did he supply factual support for his basis in JAS Partners. Nothing in the record put the district court on notice that Simon's experts or fact witnesses would present factual support for his basis in JAS Partners. Simon sought to demonstrate his basis theory primarily through experts, including Herbert Long and Howard Richshafer. Simon's Notice of Proposed Testimony of Herbert Long, however, covered only his theory that the disbursements from JAS Partners were legitimate loans that Simon intended to repay and had the ability to repay. R. 82. A review of Simon's Notice of Proposed Testimony of Howard Richshafer reveals that Simon intended for Richshafer to instruct ***697** the jury largely on legal principles. R. 104. For example, Richshafer was to testify to "a general overview and the operating rules of Subchapter K of the Internal Revenue Code" and give "an overview of the grantor trust rules under Subchapter J of the Internal Revenue Code," among other things. R. 104, ¶¶ 5, 8. The court was correct to preclude any witness from generally explaining the law to the jury. *United States v. Farinella,* 558 F.3d 695, 700 (7th Cir.2009). "District judges, rather than witnesses, must explain to juries the meaning of statutes and regulations." *Farinella,* 558 F.3d at 700. *See also United States v. Caputo,* 517 F.3d 935, 942 (7th Cir.2008) (the meaning of the statute and regulations is a subject for the court, not for testimonial experts); *United States v. Jungles,* 903 F.2d 468, 477 (7th Cir.1990) (trial court properly excluded expert's simple recitation of legal principles surrounding the "independent contractor" relationship). The jury is to apply the law as it is given by the court in its instructions, and may not apply a legal opinion given by a witness, including an expert witness. *Farinella,* 558 F.3d at 700. Nonetheless, the court did allow Simon to present evidence of his own direct contributions to the partnership.

In the end, Simon simply failed to connect the dots of his complex transactions, and failed to timely supply legal authority that would support his theory that the transactions among and between his various business entities increased his basis in JAS Partners. The district court therefore committed no legal error and did not abuse its discretion in refusing to allow Simon to present this evidence to the jury. To the contrary, the district court took extreme care in deciding whether to allow this evidence, and gave Simon multiple opportunities to provide legal support for his claim that this evidence was relevant to his partnership distribution defense theory.

Moreover, a significant portion of the unreported income was entirely unrelated to JAS Partners. In particular, Simon received more than $663,000 from Elekta and JS Elekta, which were corporations, not partnerships. His main theory of defense for those disbursements was that they were loans that he intended to repay, a theory that he was fully able to present to the jury and that the jury clearly rejected. It is thus difficult to discern how Simon could have been harmed by the court's decision to exclude evidence related to JAS Partners when a significant portion of the income he failed to report (approximately one-third of the total amount) came from unrelated corporations. The partnership distribution defense could not have applied to money Simon received from Elekta and JS Elekta, providing a further reason for affirming Simon's conviction on the false tax return counts. *See Thornton,* 642 F.3d at 605 (in determining whether an evidentiary error is harmless, we consider whether, in the mind of the average juror, the prosecution's case would have been significantly less persuasive had the improper evidence been excluded); *United States v. Klebig,* 600 F.3d 700, 722 (7th Cir.2009) (same). Again, though, we find no error in the court's decision to exclude certain evidence. But if the court had committed error in excluding evidence relating to the funding of JAS Partners, it is unlikely that error would have affected the verdict in light of the abundant evidence of unreported income Simon received from Elekta and JS Elekta.

[7] Finally, the government also asserted that Simon's tax returns were false because he did not disclose on Schedule B that he held signature authority over foreign accounts. Part III of Schedule B, labeled "Foreign Accounts and Trusts," ***698** specifies that filers "must complete this part if you ... (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust." Filers are asked to check either a "yes" or "no" box in response to the question, "At any time during [the filing year in question] did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?" Filers are then directed to further instructions regarding the filing requirements for FBARS. Simon concedes he did not check the "yes" box for any of the years in question even though he had signature authority over a number of foreign accounts during those years. Both Simon and the government treated this issue as coterminous with the FBAR issue. That is, if Simon prevailed on the FBAR issue, he could prevail on the Schedule B issue. On the other hand, if he lost on the FBAR issue, he also lost on his Schedule B defense. Notice 2010–23 specified:

> Provided the taxpayer has no other reportable foreign financial accounts for the year in question, a taxpayer who qualifies for the filing relief provided in this notice should

> check the "no" box in response to FBAR-related questions found on federal tax forms for 2009 and earlier years that ask about the existence of a financial interest in, or signature authority over, a foreign financial account.

Notice 2010–23, at ¶ 3. We have already determined that Simon was not a taxpayer "who qualifies for the filing relief provided in this notice" and so he was also not entitled to any relief for his failure to check the proper box on Schedule B. He has presented no separate argument concerning the government's charge that his tax returns were false in part because he failed to check the proper box on Schedule B. We therefore affirm his convictions on the false return counts.

C.

[8] **[9]** Simon also contends that the court erred when it overruled his objection to a jury instruction regarding materiality. The instruction states, "A line on a tax return is a material matter if the information required to be reported on that line is capable of influencing the correct computation of the amount of tax liability of the individual or the verification of the accuracy of the return." Trial Tr. at 1053, 1080. The instruction came from the Seventh Circuit Pattern instructions, and defines materiality specifically for 26 U.S.C. § 7206, the statute under which Simon was charged. Simon offered the instruction himself prior to the start of trial, but later objected because he had not been "allowed to put in the basis of Mr. Simon's interest in JAS Partners," and thus the jury could not determine the correct computation of his tax liability. Trial Tr. at 1053–54. "We review jury instructions *de novo,* but we will reverse a conviction only if the instructions as a whole misled the jury as to the applicable law." *United States v. Joshua,* 648 F.3d 547, 554 (7th Cir.2011). Simon does not contend that the instruction misstated the law. Instead, his objection to the instruction is simply an extension of his argument regarding the court's decision to limit the evidence he could present regarding his basis in JAS Partners. As we have already concluded, the court did not err in limiting this evidence because Simon failed to timely supply legal support for the relevance of the evidence. The court committed no error in giving a pattern jury instruction defining materiality for the jury.

Simon also contends that the court's inclusion of this instruction, in combination with the *in limine* ruling, deprived Simon ***699** of his right to have the jury instructed on his theory of defense. There are a few problems with this contention. First, the court did not preclude Simon in general from making out his defense regarding distributions from the partnership that were not taxable to the extent that they did not exceed his basis in the partnership. The court simply limited certain pieces of evidence by requiring that Simon supply legal support demonstrating that a particular item or category of evidence was relevant to the computation of his basis. The court thus expressly allowed Simon to present evidence of his own direct contributions to JAS Partners because Simon supplied statutory support showing the relevance of this evidence. The court also explicitly allowed Simon to present his defense that money he received from JAS Partners was a non-taxable distribution. *See* Trial Tr. at 663 ("the Defense is free to shift at any time right through final argument from saying, 'This was a loan,' to, 'This was a distribution.' There's no prohibition against that. The Defendant doesn't have to disclose its defense other than alibi or insanity upfront.").

More importantly, the jury was not instructed on Simon's distribution theory not because of any error by the district court but because Simon did not ask for jury instructions setting forth this theory until the final day of trial, even though he earlier had multiple opportunities to submit proposed jury instructions to the court. R. 87 (Defendant's Proposed Jury Instructions, submitted prior to the start of trial); R. 105 (Defendant's Supplemental Proposed Jury Instructions, submitted on the first day of trial). The court then refused to give the instructions because they were untimely, especially in light of the court's ruling days earlier that experts would not be allowed to explain the law, and that only the court could explain the law to the jury. Trial Tr. at 643 (where the court declined to allow Simon's experts to "tell a jury about the law," noting that "telling the jury about the law is my job, as the trial judge, and not the job of a witness, no matter how much expertise the witness brings to the stand."). R. 122 (Defendant's Supplemental Proposed Jury Instructions, submitted on the last day of trial); Trial Tr. at 1065–66 (where the court concluded, "I don't think I can find, in light of last Tuesday's ruling on the motion in limine, that it was a last minute discovery yesterday or today that witnesses weren't going to be able to testify to what the law is, so I will sustain the objection to those late-filed instructions.”). The court was concerned that the government had no adequate opportunity to respond to the late-filed instructions, and it was within the court's discretion to disallow the instructions under these circumstances. Trial Tr. at 1066. Notably, Simon has not appealed from the court's ruling that his final round of proposed instructions was untimely. But even if the court had found that the additional proposed instructions were timely, they were woefully incomplete in explaining the relevant law to the jury. Only two instructions addressed Simon's tax-free partnership distribution theory. The first stated, “If a loan from a partnership to a partner does not constitute a loan, the transaction can constitute a tax free distribution if it doesn't exceed its partners [sic] adjusted tax basis in the partnership.” R.122, at 4. The second stated, “To determine whether partnership distributions are tax free to a partner, the partners [sic] adjusted basis of his interest in the partnership must be determined.” R. 22, at 11. Even if we take both of these propositions as true (and ignore the inherent contradiction in the first one), neither explains how the jury is to go about calculating Simon's basis, a crucial step in making out his ***700** defense. Simon apparently intended to have his tax experts explain the law regarding the calculation of basis to the jury, and the court properly excluded this testimony. That obliged Simon to propose legally-supported jury instructions on his defense, so that the court could instruct the jury. Having failed to submit the instructions, he cannot now complain that the court deprived him of his defense.

D.

We finally turn to Simon's claims that reversal on some counts requires reversal on other counts. In particular, Simon argues that reversal on the FBAR counts alone would require reversal on the false income tax return counts because it would be unclear whether the jury convicted because he failed to report all of his income or because he failed to check the box on Schedule B indicating that he had signature authority over foreign accounts. He also contends that reversal on the false return counts would require a new trial on the fraud counts because those counts were based, in part, on Simon falsely understating his income. *See Yates v. United States,* 354 U.S. 298, 311–12, 77 S.Ct. 1064, 1 L.Ed.2d 1356 (1957), *overruled on other grounds by Burks v. United States,* 437 U.S. 1, 98 S.Ct. 2141, 57 L.Ed.2d 1 (1978) (a verdict must be set aside in cases where the verdict is supportable on one ground, but not on another, and it is impossible to tell which ground the jury selected). Because we have determined that both the FBAR counts and the false tax return counts will stand, there is no basis to challenge the remaining counts under *Yates.* The judgment of the district court is therefore

AFFIRMED.

All Citations

727 F.3d 682, 112 A.F.T.R.2d 2013-5734, 2013-2 USTC P 50,480

Footnotes

* The Honorable Sharon Johnson Coleman, of the United States District Court for the Northern District of Illinois, sitting by designation.

[1] Denise committed suicide several days after federal agents executed a search warrant at the Simon family home.

[2] Persons unrelated to the case owned the other fourteen percent of Elekta, the remaining eighty-one percent of JS Elekta and the other twenty-five percent of Ichua.

[3] In 2010, several regulations relevant to Simon's prosecution were superceded by new regulations. For example, in this instance, 31 C.F.R. § 103.24 was replaced by 31 C.F.R. § 1010.350. Nevertheless, section 103.24 was in effect at all times relevant to this appeal.

[4] This regulation was superseded in 2010 by 31 C.F.R. § 1010.306(c).

[5] The court dismissed Count 5 of the indictment, for failure to file an FBAR for foreign accounts in 2004, prior to trial. Simon was convicted on the three remaining counts for 2005, 2006 and 2007.

[6] In its publications, the IRS sometimes refers to the Voluntary Disclosure Program as the “Voluntary Disclosure Practice,” and we will also use those terms interchangeably.

[7] The government notes that the Notices were “no more authoritative than a regulation.” Brief of the Plaintiff–Appellee, at 25. This is an understatement. Official guidance from the Treasury Department and the IRS comes in many forms. Regulations are typically issued first in proposed form in a Notice of Proposed Rulemaking; public comment is invited and is considered in both written form and through possible public hearings. Final regulations are then published in the Federal Register, and we generally defer to an agency's interpretations issued in this form, when the regulations are issued pursuant to a specific directive from Congress. *See Bankers Life & Cas. Co. v. United States,* 142 F.3d 973, 977–83 (7th Cir.1998). *See also* www.irs.gov/uac/Understanding-IRS-Guidance-A-Brief-Primer, (“IRS Primer”) (last visited July 12, 2013). The Treasury Department also issues guidance through revenue rulings, revenue procedures, private letter ruling, technical advice memoranda, notices and announcements. IRS Primer; *Bankers Life,* 142 F.3d at 978; *First Chicago NBD Corp. v. Commissioner of Internal Revenue,* 135 F.3d 457, 459 (7th Cir.1998) (revenue rulings, unlike regulations that are subject to notice and comment, are entitled only to “some weight”). Although we have not yet addressed the level of deference due to IRS Notices, because they are issued without prior notice and comment, they are likely due no more deference than revenue rulings.

[8] Simon concedes he never filed a statement explaining why his FBARs were late.

[9] The IRS is empowered only to levy civil penalties, of course. Only the Justice Department may pursue criminal charges, and generally does so after the IRS has investigated a taxpayer and referred the case to the Justice Department. *See* 31 U.S.C. § 5321 (setting forth the power of the Secretary of the Treasury to impose civil fines for certain violations of the tax code); 31 U.S.C. § 5322 (setting forth criminal penalties for violations of the tax code); FAQ 4 (“The Voluntary Disclosure Practice is a longstanding practice of IRS Criminal Investigation of taking timely, accurate, and complete voluntary disclosures into account in deciding whether to recommend to the Department of Justice that a taxpayer be criminally prosecuted. It enables noncompliant taxpayers to resolve their tax liabilities and minimize their chances of criminal prosecution. When a taxpayer truthfully, timely, and completely complies with all provisions of the voluntary disclosure practice, the IRS will not recommend criminal prosecution to the Department of Justice.”).

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263 F.Supp.3d 881
United States District Court, C.D. California.

UNITED STATES of America, Plaintiff,
v.
August BOHANEC and Maria Bohanec, Defendants.

Case No. 2:15–CV–4347 DDP (FFMx)
|
Signed December 8, 2016

Synopsis
Background: United States brought action against taxpayers to collect a civil penalty assessed for willful failure to report their interest in foreign bank accounts during tax year.

[Holding:] Following bench trial, the District Court, Dean D. Pregerson, J., held that taxpayers were at least recklessly indifferent to their statutory duty to report their interest in foreign bank accounts during tax year, thus warranting enhanced civil monetary penalties.

Ordered accordingly.

Attorneys and Law Firms

***882** Andrew Pribe, AUSA—Office of US Attorney, Los Angeles, CA, for Plaintiff.

Edward M. Robbins, Jr., Robert S. Horwitz, Hochman Salkin Rettig Toscher and Perez PC, Beverly Hills, CA, for Defendants.

*883 FINDINGS OF FACT AND CONCLUSIONS OF LAW

DEAN D. PREGERSON, UNITED STATES DISTRICT JUDGE

Plaintiff, United States of America, seeks to collect a civil penalty assessed to Defendants August Bohanec and Maria Bohanec (collectively, "Defendants" or "the Bohances") for willful failure to report their interest in foreign bank accounts during tax year 2007, as required under 31 U.S.C. § 5314 and its implementing regulations. This matter was tried before the court on November 1, 2016. Having considered the submissions and arguments of the parties, as well as the evidence in the record, the court hereby makes the following findings of facts and conclusions of law.

I. FINDINGS OF FACT [1]

1. August Bohanec was born in 1933 in Slovenia.

2. August Bohanec immigrated to the United States in 1961 and became a naturalized citizen of the United States in the mid-to-late 1960s.

3. Before immigrating to the United States, August Bohanec was trained as a tool-and-die maker.

4. Maria Bohanec was born in 1943 in Mexico.

5. Maria Bohanec immigrated to the United States in the 1960s and became a naturalized citizen of the United States in the 1990s.

6. The highest level of education Maria Bohanec has is the 6th grade in Mexico.

7. August Bohanec and Maria Bohanec have been continuously married since at least 1970.

8. August Bohanec owns two camera-related patents. (Reporter's Transcript ("RT") 32:2–3.)

9. August Bohanec obtained the two patents without any assistance from a lawyer or anyone else. (RT 32:6–19.)

10. In the 1970s, the Bohanecs purchased a camera shop in Pasadena, California, called Alvin's ("the camera shop").

11. The Bohanecs knew that they had to file tax returns for the camera shop business and that if they earned money, they had to pay taxes. (RT 7:11–13, 22–23.)

12. The Bohanecs always had a tax preparer prepare the camera shop's tax returns. (RT 7:17–19, 24–25; 8:1–2.)

13. The Bohanecs initially sold many different brands of cameras at the camera shop.

14. The camera shop lost sales to larger discount stores that sold Japanese cameras. (RT 25:7–11.)

15. The Bohanecs came to an agreement with Leica, a German camera manufacturer, to become an exclusive Leica dealer.

16. The camera shop was the only exclusive Leica dealer in the world. (RT 25:15–17.)

17. The Bohanecs initially obtained their Leica merchandise from Leica's distributor in New Jersey, which was the exclusive distributor of Leica products in the United States.

18. After other retailers complained about the deals the camera shop received from Leica's New Jersey distributor, the distributor began restricting ***884** supply to the Bohanecs' camera shop. (RT 25:24–25; 26:1–6.)

19. Leica had a subsidiary in Canada called Leitz Canada.

20. Through the camera shop, the Bohanecs became acquainted with the president of Leitz Canada, Walter Kluck ("Kluck").

21. Sometime in the late 1970s or the early-to-mid 1980s, Kluck offered to sell Leica cameras to the Bohanecs directly from Leitz Canada.

22. By purchasing Leica cameras from Leitz Canada, the camera shop was able to avoid the supply constraints imposed by Leica's exclusive United States distributor. (RT 26:12–20.)

23. The camera shop gained a worldwide reputation for repairing and refurbishing certain Leica camera parts. (RT 27:3–6.)

24. The camera shop shipped to customers around the world, including in the United States, the Philippines, England, South Korea, and Hong Kong. (RT 8:9–21.)

25. During the 1980s, the Bohanecs brokered transactions between Leitz Canada and various camera retailers around the world. Kluck contacted the Bohanecs requesting their assistance in finding international buyers, for which the Bohanecs would earn a commission.

26. Commissions for international sales were deposited into an account at UBS AG in Switzerland in the Bohanecs' name.

27. UBS AG is a Swiss financial-services company.

28. Kluck opened the Swiss account on the Bohanecs' behalf. (RT 11:3–4, 29:1–3.)

29. The Bohanecs did not provide UBS AG with their home address. (RT 29:10–14.)

30. The Bohanecs did not tell anyone in the United States, other than their two children, of the existence of the Swiss account. (RT 33:9–21.)

31. By the time the Bohanecs had the Swiss account, they no longer used a bookkeeper or kept any books. (RT 13:1–8.)

32. The Bohanecs never discussed the Swiss account with an accountant, lawyer, or banker. (RT 13:14–21, 29:20–25, 30:1–8.)

33. In addition to the Leitz Canada commission deposits, the Bohanecs directed their international customers, on at least a few occasions, to deposit money directly into the Swiss UBS account.

34. The Bohanecs did not report the commission income they received from Leitz Canada on their federal income-tax returns.

35. The UBS account was managed by Walter Kluck while he was alive and, thereafter, by UBS.

36. At some point, Kluck told the Bohanecs that the Bohanecs' UBS account had a balance in excess of $700,000.

37. The Bohanecs closed Alvin's Camera sometime in the late 1980s.

38. Beginning in the early 2000s and continuing through at least 2009, the Bohanecs sold Leitz cameras and parts on Ebay.

39. The Bohanecs would occasionally withdraw money from their UBS account.

40. In June 2003, the Bohanecs transferred $10,000 from their UBS account in Switzerland to their daughter, Yolanda Reischer–Bohanec. Exhibit 11 is a copy of the UBS notice regarding this transfer.

41. In July, 2003, the Bohanecs transferred $25,000 from their UBS account ***885** in Switzerland to August Bohanec's account at Steiermärkische Bank in Austria. Exhibit 12 is a copy of the UBS notice regarding this transfer.

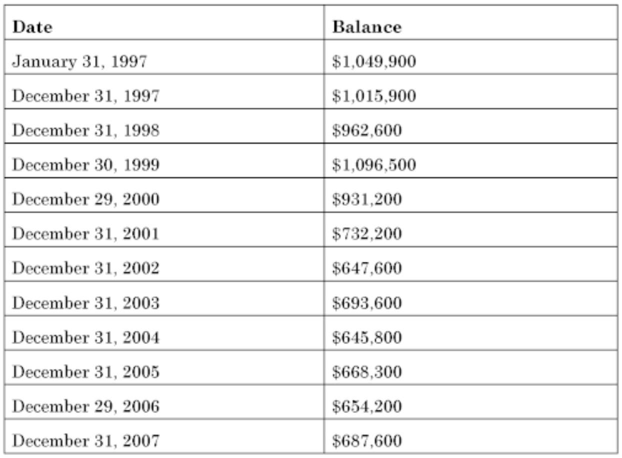
42. In December 2003, the Bohanecs transferred $20,000 from their UBS account in Switzerland to their bank account in Austria. Exhibit 13 is a copy of the UBS notice regarding this transfer.

43. In February 2006, the Bohanecs opened a bank account in Mexico and transferred $25,000 from their UBS account in Switzerland to Mexico for expenses related to a house they were building in Mexico. Exhibit 14 is a copy of the UBS notice regarding this transfer. (RT 18:18–23.)

44. In November 2006, the Bohanecs transferred $7,500 from their UBS account in Switzerland to their Bank of America account in Pasadena, California. Exhibit 15 is a copy of the UBS notice regarding this transfer.

45. In addition, from October 2004 through October 2008, the Bohanecs made several other withdrawals from their UBS account in Switzerland. Exhibits 17 through 22 are copies of statements from UBS with notations reflecting these withdrawals.

46. The UBS account had the following balances on the following dates as reflected in Exhibit 10:



Date	Balance
January 31, 1997	$1,049,900
December 31, 1997	$1,015,900
December 31, 1998	$962,600
December 30, 1999	$1,096,500
December 29, 2000	$931,200
December 31, 2001	$732,200
December 31, 2002	$647,600
December 31, 2003	$693,600
December 31, 2004	$645,800
December 31, 2005	$668,300
December 29, 2006	$654,200
December 31, 2007	$687,600

47. United States citizens who have a financial interest in, or signature authority over, a foreign bank account are required to file a Report of Foreign Bank and Financial Accounts ("FBAR").

48. The deadline for filing the FBAR for 2007 was June 30, 2008.

49. In 2007, in addition to the UBS account in Switzerland, August Bohanec had the bank account in Austria, into which were deposited periodic disability payments he received for an eye ***886** injury he sustained before immigrating to the United States.

50. In 2007, in addition to the bank accounts in Austria and Switzerland, the Bohanecs also maintained the bank account in Mexico, into which they would deposit money from their UBS account in Switzerland to build and maintain the house in Mexico.

51. The Bohanecs did not file an FBAR for 2007.

52. As of June 30, 2008, the Bohanecs' UBS account had a balance of $643,662 as reflected on Exhibit 8.

53. Before June 30, 2008, the most recent tax return the Bohanecs filed was for tax year 1998.

54. In their 1998 tax return, the Bohanecs reported an adjusted gross income of $62,237 and a federal income tax of $7,480, which was timely paid. A copy of the IRS transcript for this account is exhibit 38.

55. Part III to Schedule B of the 1998 tax form 1040 concerns foreign accounts and trusts. (Ex. 39.)

56. Question 7a in Part III to the Schedule B asks the following question: "At any time during 1998, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B–2 for exceptions and filing requirements for Form TD F 90–22.1." (Ex. 39.)

57. Page B–2 of the instructions for Schedule B for 1998 states: "See [FBAR] Form TD F 90–22.1 to find out if you are considered to have an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)." (Ex. 40.)

58. Page B–2 of the instructions for Schedule B for 1998 also states: "If you checked the Yes box on line 7a, file [FBAR] Form TD F 90–22.1 by June 30, 1999, with the Department of the Treasury at the address shown on that form." (Ex. 40.)

59. In May and June of 2009, the Bohanecs transferred a total of $522,796.55 from their UBS account to a new account at Steiermärkische Bank. Exhibit 16 is a letter from Steiermärkische Bank und Sparkassen AG enclosing records for these transfers.

56. On January 29, 2010, the Bohanecs closed the Austrian account at Steiermärkische Bank and transferred the balance of $523,677.40 to their account at Bank of America in Pasadena, California. Exhibit 16 is a letter from Steiermärkische Bank und Sparkassen AG enclosing records for these transfers.

57. Between the filing of their 1998 federal income-tax return and May 19, 2011, the Bohanecs did not file any federal income-tax returns.

58. Between the opening of the UBS account and May 19, 2011, the Bohanecs did not file any FBARs.

59. On January 6, 2010, the Bohanecs executed an application to participate in the IRS's Voluntary Disclosure Program for Offshore Accounts. Exhibit 23 is a copy of this application.

60. The Bohanecs' application, submitted under penalty of perjury, represented that the "original balance and all funds deposited into the [Swiss UBS] account were after-tax earnings from our used camera business." (Ex. 23.)

61. On January 19, 2010, the Bohanecs were preliminarily accepted into the Voluntary Disclosure Program for Offshore Accounts. Exhibit 24 is a copy of this application.

***887** 62. On May 19, 2011, the Bohanecs executed and filed FBARs for 2003, 2004, 2005, 2006, 2007, and 2008. Exhibits 25 through 30 are copies of these FBARs.

63. On May 19, 2011, the Bohanecs executed and filed federal income-tax returns for 2003, 2004, 2005, 2006, 2007, and 2008. Exhibits 31 through 36 are copies of these tax returns.

64. While the FBARs filed by the Bohanecs in May 2011 for 2003, 2004, 2005, 2006, 2007, and 2008 included the UBS account, they did not include the Austrian account, which was in existence during 2003 through 2008.

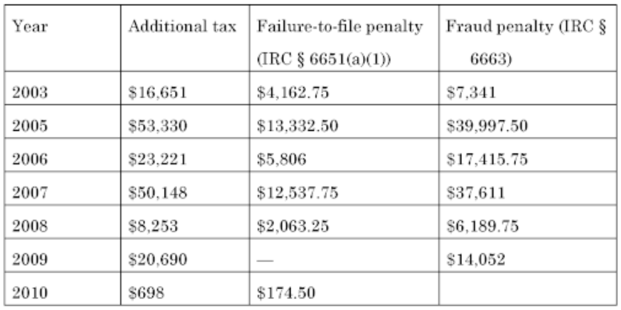
65. The FBARs for 2006, 2007, and 2008 filed by the Bohanecs in May 2011 did not include the Mexican account, which was in existence during 2006 through 2008.

66. The Bohanecs were ultimately rejected by the IRS for the Voluntary Disclosure Program for Offshore Accounts.

67. While the federal income-tax returns for 2003, 2004, 2005, 2006, 2007, and 2008 included the interest earned on the UBS accounts, they did not include the income earned by the Bohanecs from their EBay sales.

68. On October 3, 2013, the IRS issued a notice of deficiency for tax year 2003 through 2010. Exhibit 37 is a copy of this notice of deficiency.

69. As reflected in the October 3, 2013, notice of deficiency, after audit, the IRS determined the additional tax and penalties:



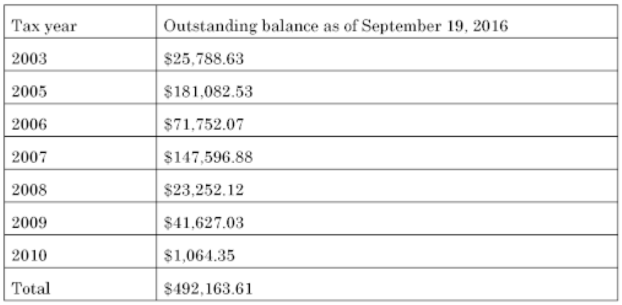
Year	Additional tax	Failure-to-file penalty (IRC § 6651(a)(1))	Fraud penalty (IRC § 6663)
2003	$16,651	$4,162.75	$7,341
2005	$53,330	$13,332.50	$39,997.50
2006	$23,221	$5,806	$17,415.75
2007	$50,148	$12,537.75	$37,611
2008	$8,253	$2,063.25	$6,189.75
2009	$20,690	—	$14,052
2010	$698	$174.50	

70. The Bohanecs did not file a suit in Tax Court challenging the tax deficiencies reflected in the October 3, 2013, notice of deficiency.

71. The IRS subsequently assessed the additional tax liabilities and penalties specified the October 3, 2013, notice of deficiency.

72. As of September 19, 2016, the outstanding balance on the Bohanecs' federal income-tax liabilities for 2003, 2005, 2006, 2007, 2008, 2009, and 2010 is as follows:

***888**



Tax year	Outstanding balance as of September 19, 2016
2003	$25,788.63
2005	$181,082.53
2006	$71,752.07
2007	$147,596.88
2008	$23,252.12
2009	$41,627.03
2010	$1,064.35
Total	$492,163.61

II. CONCLUSIONS OF LAW

73. Each year, U.S. citizens who hold a financial account in a foreign country must report certain details about the account to the Treasury Department. See 31 U.S.C. § 5314; 31 C.F.R. § 103.24 (2009).

74. The report must be made each year by filing an FBAR with the Treasury Department no later than June 30 of the following year. See 31 C.F.R. §§ 103.27(c), (d), (e) (2009).

75. Failure to file an FBAR can result in a fine up to $10,000. 31 U.S.C. § 5321(a)(5)(B).

76. If a foreign account holder "willfully" failed to report the account on an FBAR, the maximum penalty is increased from $10,000 to the greater of $100,000 or fifty percent of the balance in the account at the time of violation. 31 U.S.C. §§ 5321(a)(5)(C), (D)(ii).

[1] 77. The only dispute in this matter is whether the Bohanecs' failure to timely file an FBAR disclosing their financial interest in their foreign accounts for 2007 was willful.

78. Section 5321(a)(5) of Title 31 does not define willfulness. 31 U.S.C. § 5321(a)(5).

79. The Supreme Court has explained that "willfully is a word of many meanings whose construction is often dependent on the context in which it appears." Safeco Ins. Co. of America v. Burr, 551 U.S. 47, 57, 127 S.Ct. 2201, 167 L.Ed.2d 1045 (2007) (internal quotations and citation omitted).

80. Although Defendants assert that "willfulness" encompasses only intentional violations of known legal duties, and not reckless disregard of statutory duties, no court has adopted that principle in a civil tax matter. The only cases Defendants cite to support their argument that "willful" means that a defendant must have knowledge and specific intent are criminal cases. See Ratzlaf v. United States, 510 U.S. 135, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994) (structuring); United States v. Eisenstein, 731 F.2d 1540 (11th Cir. 1984) (felonious failure to file currency transaction reports).

81. Where willfulness is an element of civil liability, the Supreme Court generally understands the term as covering "not only knowing violations of a standard, but reckless ones as well." Safeco, 551 U.S. at 57, 127 S.Ct. 2201.

***889** **[2]** 82. "Recklessness" is an objective standard that looks to whether conduct entails "an unjustifiably high risk of harm that is either known or so obvious that it should be known." Safeco, 551 U.S. at 68, 127 S.Ct. 2201 (internal quotation marks and citation omitted).

83. Several other courts, citing Safeco, have held that "willfulness" under 31 U.S.C. § 5321 includes reckless disregard of a statutory duty. See United States v Williams, 489 Fed.Appx. 655, 658 (4th Cir. 2012); United States v. Bussell, No. CV 15–02034 SJO(VBKx), 2015 WL 9957826 at *5 (C.D. Cal. Dec. 8, 2015); see also United States v. McBride, 908 F.Supp.2d 1186, 1204, 1209 (D. Utah 2012).

84. Defendants argue that the Chief Counsel of the Internal Revenue Service has opined, prior to Safeco, that the willfulness standard for purposes of 31 U.S.C. § 5321 is the same as the criminal standard. IRS CCA 200603026. Chief Counsel Advice, however, may not be used or cited as precedent. 26 U.S.C. § 6110(k)(3); see also Elbaz v. Commissioner of Internal Revenue, T.C. Memo. 2015–49, 2015 WL 1197533 at *3 (T.C. 2015).

[3] 85. The Internal Revenue Manual's interpretation of "willfulness" for purposes of 31 U.S.C. § 5321, cited by Defendants, does not have the force of law, and is not relevant here. See Fargo v. Commissioner of Internal Revenue, 447 F.3d 706, 713 (9th Cir. 2006); Kimdun Inc. v. United States, No. 16–cv–01500–CAS(RAOx), 202 F.Supp.3d 1136, 1146–47, 2016 WL 4408816 at *8 (C.D. Cal. Aug. 15 2016).

[4] **[5]** 86. The Supreme Court has held that a heightened, clear and convincing burden of proof applies in civil matters "where particularly important individual interests or rights are at stake." Herman & MacLean v. Huddleston, 459 U.S. 375, 389, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983). Such interests include parental rights, involuntary commitment, and deportation. Id. The lower, more generally applicable preponderance of the evidence standard applies, however, where "even severe civil sanctions that do not implicate such interests" are contemplated. Id. at 390, 103 S.Ct. 683; see also Grogan v. Garner, 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). The monetary sanctions at issue here do not rise to the level of "particularly important individual interests or rights." Accordingly, the preponderance of the evidence standard applies. See also McBride, 908 F.Supp.2d at 1214.

87. The government has proved by a preponderance of the evidence that Defendants were at least recklessly indifferent to a statutory duty for the following reasons:

a. Defendants were reasonably sophisticated businesspeople. For a time, Defendants' camera shop was the only exclusive Leica dealer in the world. The deals Defendants negotiated with Leica's U.S. distributor were so favorable as to motivate other Leica retailers to protest. Defendants were able to circumvent Leica's supply restrictions by entering into an international agreement with Leitz Canada. Defendants had a worldwide reputation and sold and shipped to customers around the world. Defendants knew that they had to pay taxes if they earned money, and that they had to file tax returns. Defendants always used a tax preparer to prepare the camera shop's tax returns. Defendant August Bohanec was sufficiently sophisticated ***890** to obtain two patents without assistance. Defendants also managed the construction of a home along the coast of Mexico, including the hiring of a contractor and the opening of a Mexican bank account.

b. Defendants were at least reckless, if not willfully blind, in their conduct with respect to their Swiss UBS account and their reporting obligations regarding the account.[2] Defendants never provided UBS with their home address, and never told anyone other than their children of the existence of the UBS account, including the tax preparers Defendants hired to help them file tax returns. Defendants never asked a lawyer, accountant, or banker about requirements regarding the UBS account, and never used a bookkeeper or kept any books once the UBS account was opened.

c. Defendants' representations that they were unaware of or did not understand their obligations, and deferred entirely to Kluck, are not credible. Part III of Schedule B of Defendants' 1998 tax return put them on notice that they needed to file an FBAR. Defendants not only deposited commissions from their Leitz Canada deals into the UBS account, but also directed customers to deposit payment into the account and made several transfers and withdrawals from the UBS account to other foreign and domestic accounts. Self-serving testimony that Defendants believed that there were no requirements regarding the account because they were intended to use the funds in the account "for retirement" is sufficiently incredible, particularly in light of Defendants' level of sophistication, to call into question the veracity of the remainder of their testimony. (RT 14:7–23.)

d. Defendants' credibility is further undermined by their conduct with respect to their application to participate in the IRS' Voluntary Disclosure Program for Offshore Accounts. Defendants made several misrepresentations under penalty of perjury. Defendants misrepresented, for example, that all of the funds in the UBS account were after-tax proceeds from Defendants' used camera business, when in fact the account included Leitz Canada commissions that had never been reported on income tax returns. The application also failed to disclose Defendants' Austrian bank account. Furthermore, Defendants then proceeded to file false tax returns for 2003–2008 that did not include any of Defendants' income from internet sales. Defendants' FBARs for 2003–2008 did not disclose the Austrian account and the FBARs for 2006–2008 did not disclose the Mexican account.

III. CONCLUSION

Defendants' failure to timely file an FBAR for 2007 was willful. The maximum penalty is therefore increased to the greater of $100,000 or fifty percent of the balance in the foreign accounts on June 30, 2008.

IT IS SO ORDERED.

All Citations

263 F.Supp.3d 881, 118 A.F.T.R.2d 2016-6757, 2016-2 USTC P 50,498

Footnotes

[1] The parties stipulated to many of the facts described herein, which require no additional proof.

[2] See McBride, 908 F.Supp.2d at 1205 (“Where a taxpayer makes a conscious effort to avoid learning about reporting requirements, evidence of such willful blindness is a sufficient basis to establish willfulness.”) (internal quotation marks and citation omitted).

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114 S.Ct. 655
Supreme Court of the United States

Waldemar RATZLAF and
Loretta Ratzlaf, Petitioners,
v.
UNITED STATES.

No. 92–1196.
|
Argued Nov. 1, 1993.
|
Decided Jan. 11, 1994.

Synopsis

Defendant was convicted in the United States District Court for the District of Nevada, Edward C. Reed, Jr., Chief Judge, of structuring financial transactions to avoid currency reporting requirements, and he appealed. The Court of Appeals for the Ninth Circuit, 976 F.2d 1280,affirmed. Certiorari was granted. The Supreme Court, Justice Ginsburg, held that to establish the defendant "willfully violated" the antistructuring law, government must prove defendant acted with knowledge that his conduct was unlawful.

Reversed and remanded.

Justice Blackmun dissented and filed opinion in which the Chief Justice and Justice O'Connor and Justice Thomas joined.

****656** *Syllabus*[*]

As here relevant, federal law requires a domestic bank involved in a cash transaction exceeding $10,000 to file a report with the Secretary of the Treasury, 31 U.S.C. § 5313(a), 31 CFR § 103.22(a); makes it illegal to "structure" a transaction—*i.e.,* to break up a single transaction above the reporting threshold into two or more separate transactions—"for the purpose of evading the reporting requiremen[t]," 31 U.S.C. § 5324(3); and sets out criminal penalties for "[a] person willfully violating" the antistructuring provision, § 5322(a). After the judge at petitioner Waldemar Ratzlaf's trial on charges of violating §§ 5322(a) and 5324(3) instructed the jury that the Government had to prove both that the defendant knew of the § 5313(a) reporting obligation and that he attempted to evade that obligation, but did not have to prove that he knew the structuring in which he engaged was unlawful, Ratzlaf was convicted, fined, and sentenced to prison. In affirming, the Court of Appeals upheld the trial court's construction of the legislation.

Held: To give effect to § 5322(a)'s "willfulness" requirement, the Government must prove that the defendant acted with knowledge that the structuring he or she undertook was unlawful, not simply that the defendant's purpose was to circumvent a bank's reporting obligation. Section 5324 itself forbids structuring with a "purpose of evading the [§ 5313(a)] reporting requirements," and the lower courts erred in treating the "willfulness" requirement essentially as words of no consequence. Viewing §§ 5322(a) and 5324(3) in light of the complex of provisions in which they are embedded, it is significant that the omnibus "willfulness" requirement, when applied to other provisions in the same statutory subchapter, consistently has been read by the Courts of Appeals to require both knowledge of the reporting requirement *and* a specific intent to commit the crime or to disobey the law. The "willfulness" requirement must be construed the same way each time it is called into play. Because currency structuring is not inevitably nefarious, this Court is unpersuaded by the United States' argument that structuring is so obviously "evil" or inherently "bad" that the "willfulness" requirement is satisfied irrespective of the defendant's knowledge of the illegality of structuring. The interpretation adopted in this case does not dishonor the venerable principle that ignorance of the law generally is no ***136** defense to a criminal charge, for Congress may decree otherwise in particular contexts, and has done so in the present instance. Pp. 659–663.

976 F.2d 1280 (C.A.9 1992), reversed and remanded.

GINSBURG, J., delivered the opinion of the Court, in which STEVENS, SCALIA, KENNEDY, and SOUTER, JJ., joined. ****657** BLACKMUN, J., filed a dissenting opinion, in which REHNQUIST, C.J., and O'CONNOR and THOMAS, JJ., joined, *post,* p. 663.

Attorneys and Law Firms

Stephen R. LaCheen, Philadelphia, PA, argued, for petitioners.

Paul J. Larkin, Jr., Washington, DC, argued, for respondent.

Opinion

Justice GINSBURG delivered the opinion of the Court.

[1] Federal law requires banks and other financial institutions to file reports with the Secretary of the Treasury whenever they are involved in a cash transaction that exceeds $10,000. 31 U.S.C. § 5313; 31 CFR § 103.22(a) (1993). It is illegal to "structure" transactions —*i.e.,* to break up a single transaction above the reporting threshold into two or more separate transactions—for the purpose of evading a financial institution's reporting requirement. 31 U.S.C. § 5324. "A person willfully violating" this antistructuring provision is subject to criminal penalties. § 5322. This case presents a question on which Courts of Appeals have divided: Does a defendant's purpose to circumvent a bank's reporting obligation suffice to sustain a conviction for "willfully violating" the antistructuring provision?[1] We hold that the "willfulness" ***137** requirement mandates something more. To establish that a defendant "willfully violat[ed]" the antistructuring law, the Government must prove that the defendant acted with knowledge that his conduct was unlawful.

I

On the evening of October 20, 1988, defendant-petitioner Waldemar Ratzlaf ran up a debt of $160,000 playing blackjack at the High Sierra Casino in Reno, Nevada. The casino gave him one week to pay. On the due date, Ratzlaf returned to the casino with cash of $100,000 in hand. A casino official informed Ratzlaf that all transactions involving more than $10,000 in cash had to be reported to state and federal authorities. The official added that the casino could accept a cashier's check for the full amount due without triggering any reporting requirement. The casino helpfully placed a limousine at Ratzlaf's disposal, and assigned an employee to accompany him to banks in the vicinity. Informed that banks, too, are required to report cash transactions in excess of $10,000, Ratzlaf purchased cashier's checks, each for less than $10,000 and each from a different bank. He delivered these checks to the High Sierra Casino.

Based on this endeavor, Ratzlaf was charged with "structuring transactions" to evade the banks' obligation to report cash transactions exceeding $10,000; this conduct, the indictment alleged, violated 31 U.S.C. §§ 5322(a) and 5324(3). The trial judge instructed the jury that the Government had to prove defendant's knowledge of the banks' reporting obligation and his attempt to evade that obligation, but did not ***138** have to prove defendant knew the structuring was unlawful. Ratzlaf was convicted, fined, and sentenced to prison.[2]

Ratzlaf maintained on appeal that he could not be convicted of "willfully violating" the antistructuring law solely on the basis of his knowledge that a financial institution must report currency transactions in excess of $10,000 and his intention to avoid such reporting. To gain a conviction for "willful" conduct, he asserted, the Government must prove he was aware of the illegality of the "structuring" in which he engaged. The Ninth Circuit upheld the trial court's construction ****658** of the legislation and affirmed Ratzlaf's conviction. 976 F.2d 1280 (1992). We granted certiorari, 507 U.S. 1050, 113 S.Ct. 1942, 123 L.Ed.2d 648 (1993), and now conclude that, to give effect to the statutory "willfulness" specification, the Government had to prove Ratzlaf knew the structuring he undertook was unlawful. We therefore reverse the judgment of the Court of Appeals.

II

A

Congress enacted the Currency and Foreign Transactions Reporting Act (Bank Secrecy Act) in 1970, Pub.L. 91–508, Tit. II, 84 Stat. 1118, in response to increasing use of banks and other institutions as financial intermediaries by persons engaged in criminal activity. The Act imposes a variety of reporting requirements on individuals and institutions regarding foreign and domestic financial transactions. See 31 U.S.C. §§ 5311–5325. The reporting requirement relevant here, § 5313(a), applies to domestic financial transactions. Section 5313(a) reads:

> "When a domestic financial institution is involved in a transaction for the payment, receipt, or transfer of ***139** United States coins or currency (or other monetary instruments the Secretary of the Treasury prescribes), in an amount, denomination, or

> amount and denomination, or under circumstances the Secretary prescribes by regulation, the institution and any other participant in the transaction the Secretary may prescribe shall file a report on the transaction at the time and in the way the Secretary prescribes...." [3]

To deter circumvention of this reporting requirement, Congress enacted an antistructuring provision, 31 U.S.C. § 5324, as part of the Money Laundering Control Act of 1986, Pub.L. 99–570, Tit. I, Subtit. H, § 1354(a), 100 Stat. 3207–22. [4] Section 5324, [5] which Ratzlaf is charged with "willfully violating," reads:

> "No person shall for the purpose of evading the reporting requirements of section 5313(a) with respect to such transaction—

. . . . .

> ***140** "(3) structure or assist in structuring, or attempt to structure or assist in structuring, any transaction with one or more domestic financial institutions." [6]

The criminal enforcement provision at issue, 31 U.S.C. § 5322(a), sets out penalties for "[a] person willfully violating," *inter alia,* the antistructuring provision. Section 5322(a) reads:

> "A person willfully violating this subchapter [31 U.S.C. § 5311 *et seq.*] or a regulation prescribed under this subchapter (except section 5315 of this title or a ****659** regulation prescribed under section 5315) shall be fined not more than $250,000, or [imprisoned] for not more than five years, or both."

B

[2] Section 5324 forbids structuring transactions with a "purpose of evading the reporting requirements of section 5313(a)." Ratzlaf admits that he structured cash transactions, and that he did so with knowledge of, and a purpose to avoid, the banks' duty to report currency transactions in excess of $10,000. The statutory formulation (§ 5322) under which Ratzlaf was prosecuted, however, calls for proof of "willful[ness]" on the actor's part. The trial judge in Ratzlaf's case, with the Ninth Circuit's approbation, treated § 5322(a)'s "willfulness" requirement essentially as surplusage—as words of no consequence. [7] Judges should hesitate so to treat statutory terms in any setting, and resistance ***141** should be heightened when the words describe an element of a criminal offense. See *Pennsylvania Dept. of Public Welfare v. Davenport,* 495 U.S. 552, 562, 110 S.Ct. 2126, 2133, 109 L.Ed.2d 588 (1990) (expressing "deep reluctance" to interpret statutory provisions "so as to render superfluous other provisions in the same enactment") (citation omitted); cf. *Potter v. United States,* 155 U.S. 438, 446, 15 S.Ct. 144, 147, 39 L.Ed. 214 (1894) (word "wilful" used to describe certain offenses but not others in same statute "cannot be regarded as mere surplusage; it means something").

[3] "Willful," this Court has recognized, is a "word of many meanings," and "its construction [is] often ... influenced by its context." *Spies v. United States,* 317 U.S. 492, 497, 63 S.Ct. 364, 367, 87 L.Ed. 418 (1943). Accordingly, we view §§ 5322(a) and 5324(3) mindful of the complex of provisions in which they are embedded. In this light, we count it significant that § 5322(a)'s omnibus "willfulness" requirement, when applied to other provisions in the same subchapter, consistently has been read by the Courts of Appeals to require both "knowledge of the reporting requirement" *and* a "specific intent to commit the crime," *i.e.,* "a purpose to disobey the law." See *United States v. Bank of New England, N.A.,* 821 F.2d 844, 854–859 (CA1 1987) ("willful violation" of § 5313's reporting requirement for cash transactions over $10,000 requires "voluntary, intentional, and bad purpose to disobey the law"); *United States v. Eisenstein,* 731 F.2d 1540, 1543 (CA11 1984) ("willful violation" of § 5313's reporting requirement for cash transactions over $10,000 requires " 'proof of the defendant's knowledge of the reporting requirement and his specific intent to commit the crime' ") (quoting *United States v. Granda,* 565 F.2d 922, 926 (CA5 1978)).

Notable in this regard are 31 U.S.C. § 5314, [8] concerning records and reports on monetary transactions with foreign ***142** financial agencies, and § 5316, [9] concerning declaration of the transportation of more than $10,000 into, or out of, the United States. Decisions involving these provisions describe a "willful" actor as one who violates "a known legal duty." See, *e.g., United States v.*

Sturman, 951 F.2d 1466, 1476–1477 (CA6 1991) ("willful violation" of § 5314's ****660** reporting requirement for foreign financial transactions requires proof of " 'voluntary, intentional violation of a known legal duty' ") (quoting *Cheek v. United States,* 498 U.S. 192, 201, 111 S.Ct. 604, 610, 112 L.Ed.2d 617 (1991)); *United States v. Warren,* 612 F.2d 887, 890 (CA5 1980) ("willful violation" of § 5316's reporting requirement for transportation of currency across international boundaries requires that defendant "have *actually known* of the currency reporting requirement and have voluntarily and intentionally violated that known legal duty"); *United States v. Dichne,* 612 F.2d 632, 636 (CA2 1979) ("willful violation" of § 5316's reporting requirement for transportation of currency across international boundaries requires proof of defendant's " 'knowledge of the reporting requirement and his specific intent to commit the crime' ") (quoting *Granda,* 565 F.2d, at 926); *Granda,* 565 F.2d, at 924–926 (overturning conviction for "willful violation" of § 5316 because jury was not given "proper instruction [that] would include some discussion of defendant's ignorance of the law" and rejecting Government's contention that the statutory provisions "do not require that the defendant be aware of the fact that he is breaking the law").[10]

***143** **[4]** A term appearing in several places in a statutory text is generally read the same way each time it appears. See *Estate of Cowart v. Nicklos Drilling Co.,* 505 U.S. 469, 479, 112 S.Ct. 2589, 2596, 120 L.Ed.2d 379 (1992). We have even stronger cause to construe a *single* formulation, here § 5322(a), the same way each time it is called into play. See *United States v. Aversa,* 984 F.2d 493, 498 (CA1 1993) (en banc) ("Ascribing various meanings to a single iteration of [§ 5322(a)'s willfulness requirement]—reading the word differently for each code section to which it applies—would open Pandora's jar. If courts can render meaning so malleable, the usefulness of a single penalty provision for a group of related code sections will be eviscerated and ... almost any code section that references a group of other code sections would become susceptible to individuated interpretation.").

[5] The United States urges, however, that § 5324 violators, by their very conduct, exhibit a purpose to do wrong, which suffices to show "willfulness":

> "On occasion, criminal statutes—including some requiring proof of 'willfulness'—have been understood to require proof of an intentional violation of a known legal duty, *i.e.,* specific knowledge by the defendant that his conduct is unlawful. But where that construction has been adopted, it has been invoked only to ensure that the defendant acted with a wrongful purpose. See *Liparota v. United States,* 471 U.S. 419, 426, 105 S.Ct. 2084, 2088, 85 L.Ed.2d 434 (1985)....

. . . . .

> "The anti-structuring statute, 31 U.S.C. § 5324, satisfies the 'bad purpose' component of willfulness by explicitly defining the wrongful purpose necessary to violate the law: it requires proof that the defendant acted with the purpose to evade the reporting requirement of Section 5313(a)." Brief for United States 23–25.

***144** " '[S]tructuring is not the kind of activity that an ordinary person would engage in innocently,' " the United States asserts. *Id.,* at 29, 105 S.Ct. at 2090 (quoting *United States v. Hoyland,* 914 F.2d 1125, 1129 (CA9 1990)). It is therefore "reasonable," the Government concludes, "to hold a structurer responsible for evading the reporting requirements without the need to prove specific knowledge that such evasion is unlawful." Brief for United States 29.

Undoubtedly there are bad men who attempt to elude official reporting requirements in order to hide from Government inspectors such criminal activity as laundering drug money or tax evasion.[11] But currency ****661** structuring is not inevitably nefarious. Consider, for example, the small business operator who knows that reports filed under 31 U.S.C. § 5313(a) are available to the Internal Revenue Service. To reduce the risk of an IRS audit, she brings $9,500 in cash to the bank twice each week, in lieu of transporting over $10,000 once each week. That person, if the United States is right, has committed a criminal offense, because she structured cash transactions "for the specific purpose of depriving the Government of the information that Section 5313(a) is designed to obtain." Brief for United States 28–29. ***145** [12] Nor is a person who structures a currency transaction invariably motivated by a desire to keep the Government in the dark. But under the Government's construction an individual would commit a felony against the United States by making cash deposits in small doses, fearful that the bank's reports would increase the likelihood of burglary,[13] or in an endeavor to keep a former spouse unaware of his wealth.[14]

Courts have noted "many occasions" on which persons, without violating any law, may structure transactions "in order to avoid the impact of some regulation or tax." *United States v. Aversa,* 762 F.Supp. 441, 446 (NH 1991), aff'd in part, 984 F.2d 493 (CA1 1993). This Court, over a century ago, supplied an illustration:

> "The Stamp Act of 1862 imposed a duty of two cents upon a bank-check, when drawn for an amount not less than twenty dollars. A careful individual, having the amount of twenty dollars to pay, pays the same by handing to his creditor two checks of ten dollars each. He thus draws checks in payment of his debt to the amount ***146** of twenty dollars, and yet pays no stamp duty.... While his operations deprive the government of the duties it might reasonably expect to receive, it is not perceived that the practice is open to the charge of fraud. He resorts to devices to avoid the payment of duties, but they are not illegal. He has the legal right to split up his evidences of payment, and thus to avoid the tax." *United States v. Isham,* 84 U.S. (17 Wall.) 496, 506, 21 L.Ed. 728 (1873).

In current days, as an *amicus* noted, countless taxpayers each year give a gift of $10,000 on December 31 and an identical gift the next day, thereby legitimately avoiding the taxable gifts reporting required by 26 U.S.C. § 2503(b).[15] See Brief for National Association ****662** of Criminal Defense Lawyers as *Amicus Curiae* 16.

In light of these examples, we are unpersuaded by the argument that structuring is so obviously "evil" or inherently "bad" that the "willfulness" requirement is satisfied irrespective of the defendant's knowledge of the illegality of structuring. Had Congress wished to dispense with the requirement, it could have furnished the appropriate instruction.[16]

C

[6] **[7]** In § 5322, Congress subjected to criminal penalties only those "willfully violating" § 5324, signaling its intent to require for conviction proof that the defendant knew not only ***147** of the bank's duty to report cash transactions in excess of $10,000, but also of his duty not to avoid triggering such a report. There are, we recognize, contrary indications in the statute's legislative history.[17] But we do not resort to legislative ***148** history to cloud a statutory text that is clear.[18] ****663** Moreover, were we to find § 5322(a)'s "willfulness" requirement ambiguous as applied to § 5324, we would resolve any doubt in favor of the defendant. *Hughey v. United States,* 495 U.S. 411, 422, 110 S.Ct. 1979, 1985, 109 L.Ed.2d 408 (1990) (lenity principles "demand resolution of ambiguities in criminal statutes in favor of the defendant"); *Crandon v. United States,* 494 U.S. 152, 160, 110 S.Ct. 997, 1002–1003, 108 L.Ed.2d 132 (1990) ("Because construction of a criminal statute must be guided by the need for fair warning, it is rare that legislative history or statutory policies will support a construction of a statute broader than that clearly warranted by the text."); *United States v. Bass,* 404 U.S. 336, 347–350, 92 S.Ct. 515, 522–524, 30 L.Ed.2d 488 (1971) (rule of lenity premised on concepts that " 'fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed' " and that "legislatures and not courts should define ***149** criminal activity") (quoting *McBoyle v. United States,* 283 U.S. 25, 27, 51 S.Ct. 340, 341, 75 L.Ed. 816 (1931) (Holmes, J.)).

We do not dishonor the venerable principle that ignorance of the law generally is no defense to a criminal charge. See *Cheek v. United States,* 498 U.S. 192, 199, 111 S.Ct. 604, 609, 112 L.Ed.2d 617 (1991); *Barlow v. United States,* 32 U.S. (7 Pet.) 404, 410–412, 8 L.Ed. 728 (1833) (Story, J.). In particular contexts, however, Congress may decree otherwise. That, we hold, is what Congress has done with respect to 31 U.S.C. § 5322(a) and the provisions it controls. To convict Ratzlaf of the crime with which he was charged, violation of 31 U.S.C. §§ 5322(a) and 5324(3), the jury had to find he knew the structuring in which he engaged was unlawful.[19] Because the jury was not properly instructed in this regard, we reverse the judgment of the Ninth Circuit and remand this case for further proceedings consistent with this opinion.

It is so ordered.

***150** Justice BLACKMUN, with whom THE CHIEF JUSTICE, Justice O'CONNOR, and Justice THOMAS join, dissenting.

On October 27, 1988, petitioner Waldemar Ratzlaf[1] arrived at a Nevada casino with a shopping bag full of cash to pay off a $160,000 gambling debt. He told casino personnel he did not want any written report of the payment to be made. The casino vice president informed Ratzlaf that he could not accept a cash payment of more than $10,000 without filing a report.

Ratzlaf, along with his wife and a casino employee, then proceeded to visit several ****664** banks in and around Stateline, Nevada, and South Lake Tahoe, California, purchasing separate cashier's checks, each in the amount of $9,500. At some banks the Ratzlafs attempted to buy two checks—one for each of them—and were told that a report would have to be filed; on those occasions they canceled the transactions. Ratzlaf then returned to the casino and paid off $76,000 of his debt in cashier's checks. A few weeks later, Ratzlaf gave three persons cash to purchase additional cashier's checks in amounts less than $10,000. The Ratzlafs themselves also bought five more such checks in the course of a week.

A jury found beyond a reasonable doubt that Ratzlaf knew of the financial institutions' duty to report cash transactions in excess of $10,000 and that he structured transactions for the specific purpose of evading the reporting requirements.

The Court today, however, concludes that these findings are insufficient for a conviction under 31 U.S.C. §§ 5322(a) and 5324(3),[2] because a defendant also must have known that the structuring in which he engaged was illegal. Because this conclusion lacks support in the text of the statute, conflicts in my view with basic principles governing the interpretationof ***151** criminal statutes, and is squarely undermined by the evidence of congressional intent, I dissent.

I

"The general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system." *Cheek v. United States,* 498 U.S. 192, 199, 111 S.Ct. 604, 609, 112 L.Ed.2d 617 (1991). The Court has applied this common-law rule "in numerous cases construing criminal statutes." *Ibid.,* citing *United States v. International Minerals & Chemical Corp.,* 402 U.S. 558, 91 S.Ct. 1697, 29 L.Ed.2d 178 (1971); *Hamling v. United States,* 418 U.S. 87, 119–124, 94 S.Ct. 2887, 2908–2911, 41 L.Ed.2d 590 (1974); and *Boyce Motor Lines, Inc. v. United States,* 342 U.S. 337, 72 S.Ct. 329, 96 L.Ed. 367 (1952).

Thus, the term "willfully" in criminal law generally "refers to consciousness of the act but not to consciousness that the act is unlawful." *Cheek,* 498 U.S., at 209, 111 S.Ct., at 614 (SCALIA, J., concurring in judgment); see also *Browder v. United States,* 312 U.S. 335, 341, 61 S.Ct. 599, 603, 85 L.Ed. 862 (1941); *Potter v. United States,* 155 U.S. 438, 446, 15 S.Ct. 144, 147, 39 L.Ed. 214 (1894); *American Surety Co. of New York v. Sullivan,* 7 F.2d 605, 606 (CA2 1925) (L. Hand, J.) ("[T]he word 'willful' ... means no more than that the person charged with the duty knows what he is doing," not that "he must suppose that he is breaking the law"); American Law Institute, Model Penal Code § 2.02(8) (1985) ("A requirement that an offense be committed wilfully is satisfied if a person acts knowingly with respect to the material elements of the offense, unless a purpose to impose further requirements appears").

As the majority explains, 31 U.S.C. § 5322(a), originally enacted in 1970, imposes criminal penalties upon "person[s] willfully violating this subchapter." The subchapter (entitled "Records and Reports on Monetary Instruments Transactions") contains several different reporting requirements, including § 5313, which requires financial institutions to file reports for cash transactions over an amount prescribed by regulation; § 5314, which requires reports for transactions with foreign financial agencies; and § 5316, which requires ***152** reports for transportation of more than $10,000 into or out of the United States. In 1986, Congress added § 5324 to the subchapter to deter rampant evasion by customers of financial institutions' duty to report large cash transactions. See *infra,* at 669, and n. 13. The new section provides: "No person shall for the purpose of evading the reporting requirements of section 5313(a) ... (3) structure ... any transaction with one or more domestic financial institutions."

****665** Unlike other provisions of the subchapter, the antistructuring provision identifies the purpose that is required for a § 5324 violation: "evading the reporting requirements." The offense of structuring, therefore, requires (1) *knowledge* of a financial institution's reporting requirements, and (2) the structuring of a transaction for the *purpose* of evading those requirements. These elements define a violation that is "willful" as that term is commonly interpreted. The majority's additional requirement that an actor have actual knowledge *that structuring is prohibited* strays from the statutory text, as well as from our precedents interpreting criminal statutes generally and "willfulness" in particular.

The Court reasons that the interpretation of the Court of Appeals for the Ninth Circuit, and that of nine other Circuits,[3] renders § 5322(a)'s willfulness requirement superfluous. See *ante,* at 658–659. This argument ignores the generality ***153** of § 5322(a), which sets a single standard—willfulness—for the subchapter's various reporting provisions. Some of those provisions do not themselves define willful conduct, so the willfulness element cannot be deemed surplusage. Moreover, the fact that § 5322(a) requires willfulness for criminal liability to be imposed does not mean that each of the underlying offenses to which it applies must involve something less than willfulness. Thus, the fact that § 5324 *does* describe a "willful" offense, since it already requires "the purpose of evading the reporting requirements," provides no basis for imposing an artificially heightened scienter requirement.

The majority also contends that § 5322(a)'s willfulness element, when applied to the subchapter's other provisions, has been read by the Courts of Appeals to require knowledge of and a purpose to disobey the law. See *ante,* at 659–660. In fact, the cases to which the majority refers stand for the more subtle proposition that a willful violation requires knowledge of the pertinent reporting requirements and a purpose to avoid compliance with them.[4] Consistent ****666** with and in light ***154** of that construction, Congress' 1986 enactment prohibited structuring "for the purpose of evading the reporting requirements." The level of knowledge imposed by the term "willfully" as it applies to all the underlying offenses in the subchapter on reporting requirements is "knowledge of the reporting requirements."[5]

The Court next concludes that its interpretation of "willfully" is warranted because structuring is not inherently "nefarious." See *ante,* at 660–661. It is true that the Court, on occasion, has imposed a knowledge-of-illegality requirement upon criminal statutes to ensure that the defendant acted with a wrongful purpose. See, *e.g., Liparota v. United* ***155** *States,* 471 U.S. 419, 426, 105 S.Ct. 2084, 2088, 85 L.Ed.2d 434 (1985). I cannot agree, however, that the imposition of such a requirement is necessary here. First, the conduct at issue—splitting up transactions involving tens of thousands of dollars in cash for the specific purpose of circumventing a bank's reporting duty—is hardly the sort of innocuous activity involved in cases such as *Liparota,* in which the defendant had been convicted of fraud for purchasing food stamps for less than their face value. Further, an individual convicted of structuring is, by definition, aware that cash transactions are regulated, and he cannot seriously argue that he lacked notice of the law's intrusion into the particular sphere of activity. Cf. *Lambert v. California,* 355 U.S. 225, 229, 78 S.Ct. 240, 243, 2 L.Ed.2d 228 (1957). By requiring knowledge of a bank's reporting requirements as well as a "purpose of evading" those requirements, the antistructuring provision targets those who knowingly act to deprive the Government of information to which it is entitled. In my view, that is not so plainly innocent a purpose as to justify reading into the statute the additional element of knowledge of illegality.[6] In ***156** any event, Congress has determined that purposefully ****667** structuring transactions is not innocent conduct.[7]

In interpreting federal criminal tax statutes, this Court has defined the term "willfully" as requiring the " 'voluntary, intentional violation of a known legal duty.' " *Cheek v. United States,* 498 U.S., at 200, 111 S.Ct., at 610, quoting *United States v. Bishop,* 412 U.S. 346, 360, 93 S.Ct. 2008, 2017, 36 L.Ed.2d 941 (1973); see also *United States v. Murdock,* 290 U.S. 389, 394–396, 54 S.Ct. 223, 225–226, 78 L.Ed. 381 (1933). Our rule in the tax area, however, is an "exception to the traditional rule," applied "largely due to the complexity of the tax laws." *Cheek,* 498 U.S., at 200, 111 S.Ct., at 609; see also *Browder v. United States,* 312 U.S., at 341–342, 61 S.Ct., at 603. The rule is inapplicable here, where, far from being complex, the provisions involved are perhaps among the simplest in the United States Code.[8]

***157** II

Although I believe the statutory language is clear in light of our precedents, the legislative history confirms that Congress intended to require knowledge of (and a purpose to evade) the reporting requirements but not specific knowledge of the illegality of structuring.[9]

Before 1986, the reporting requirements included no provision explicitly prohibiting the structuring of transactions to evade the reporting requirements. The Government attempted to combat purposeful evasion of the reporting requirements through 18 U.S.C. § 1001, which applies to anyone who "knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact" within the jurisdiction of a federal agency, and 18 U.S.C. § 2(b), which applies to anyone who "willfully causes an act to be done which if directly performed by him or another would be an offense" under federal law. Some Courts of Appeals upheld application of those criminal statutes where a report would have been filed but for the defendant's purposeful structuring. See, *e.g., United States v. Tobon–Builes,* 706 F.2d 1092, 1096–1101 (CA11 1983); *United States v. Heyman,* 794 F.2d 788, 790–793 (CA2), cert. denied, 479 U.S. 989, 107 S.Ct. 585, 93 L.Ed.2d 587 (1986). As the leading case explained, a defendant's willfulness was established if he "knew about the currency reporting requirements and ... purposely sought to prevent the financial institutions from filing required reports ... by structuring his transactions as multiple smaller transactions under $10,000." *Tobon–Builes,* 706 F.2d, at 1101.

****668** Other courts rejected imposition of criminal liability for structuring under §§ 1001 and 2(b), concluding either that the ***158** law did not impose a duty not to structure or that criminal liability was confined to limited forms of structuring. See, *e.g., United States v. Varbel,* 780 F.2d 758, 760–763 (CA9 1986); *United States v. Denemark,* 779 F.2d 1559, 1561–1564 (CA11 1986); *United States v. Anzalone,* 766 F.2d 676, 679–683 (CA1 1985).

Congress enacted the antistructuring provision in 1986 "to fill a loophole in the Bank Secrecy Act caused by" the latter three decisions, which "refused to apply the sanctions of [the Act] to transactions 'structured' to evade the act's $10,000 cash reporting requirement." S.Rep. No. 99–433, p. 7 (1986). As explained by the Report of the Senate Judiciary Committee:

> "[The antistructuring provision] would codify *Tobon–Builes* and like cases and would negate the effect of *Anzalone, Varbel* and *Denemark.* It would expressly subject to potential liability a person who causes or attempts to cause a financial institution to fail to file a required report or who causes a financial institution to file a required report that contains material omissions or misstatements of fact. In addition, the proposed amendment would create the offense of structuring a transaction to evade the reporting requirements, without regard to whether an individual transaction is, itself, reportable under the Bank Secrecy Act." *Id.,* at 22.

See also H.R.Rep. No. 99–746, pp. 18–19, and n. 1 (1986). Congress' stated purpose to "codify *Tobon–Builes* " reveals its intent to incorporate *Tobon–Builes*' standard for a willful violation, which required knowledge of the reporting requirements and a purpose to evade them. Nothing in *Tobon–Builes* suggests that knowledge of the illegality of one's conduct is required.[10]

***159** The Senate Report proceeds to explain the intent required under the antistructuring provision:

> "For example, a person who converts $18,000 in currency to cashier's checks by purchasing two $9,000 cashier's checks at two different banks or on two different days ***160** *with the specific intent that the participating* ****669** *bank or banks not be required to file Currency Transaction Reports for those transactions,* would be subject to potential civil and criminal liability. A person conducting the same transactions for any other reasons or a person splitting up an amount of currency that would not be reportable if the full amount were involved in a single transaction (for example, splitting $2,000 in currency into four transactions of $500 each), would not be subject to liability under the proposed amendment." S.Rep. No. 99–433, at 22 (emphasis added).

The Committee's specification of the requisite intent as only the intent to prevent a bank from filing reports confirms that Congress did not contemplate a departure from the general rule that knowledge of illegality is not an essential element of a criminal offense.

A recent amendment to § 5324 further supports the interpretation of the court below. In 1992, Congress enacted the Annunzio–Wylie Anti–Money Laundering Act, creating a parallel antistructuring provision for the reporting requirements under 31 U.S.C. § 5316, which governs international monetary transportation. See Pub.L. 102–550, Tit. XV, § 1525(a), 106 Stat. 4064.[11] Like the provision at issue here, the new provision prohibits structuring "for the purpose of evading the reporting requirements" (in that case, the requirements of § 5316). At the time Congress amended the statute, every

Court of Appeals to consider the issue had held that a willful violation of the antistructuring provision requires knowledge of the bank's reporting requirements and an intent to evade them; none had held that knowledge of the illegality of structuring was required. See n. 3, *supra.* ***161** The House Report accompanying an earlier bill containing the pertinent provision explained:

> "Under the new provision, codified as subsection (b) of section 5324, it would be illegal to structure the importation or exportation of monetary instruments with the intent to evade the ... reporting requirement. As is the case presently for structuring cases involving currency transaction reports, the government would have to prove that the defendant knew of the ... reporting requirement, *but would not have to prove that the defendant knew that structuring itself had been made illegal. United States v. Hoyland,* 903 F.2d 1288 (9th Cir.1990)." H.R.Rep. No. 102–28, pt. 1, p. 45 (1991) (emphasis added).[12]

The 1992 amendment's replication of the original antistructuring provision's language strongly suggests that Congress intended to preserve the then-uniform interpretation of the scienter requirement of § 5324. See *Keene Corp. v. United States,* 508 U.S. 200, 212–213, 113 S.Ct. 2035, 2042–2043, 124 L.Ed.2d 118 (1993). At the very least, then, today's decision poses a dilemma for any attempt to reconcile the two parallel antistructuring provisions now codified in § 5324: Courts must either ignore clear evidence of legislative intent as to the newly added antistructuring provision or interpret its identical language differently from the antistructuring provision at issue in this case.

Finally, it cannot be ignored that the majority's interpretation of § 5324 as a practical matter largely nullifies the effect of that provision. In codifying the currency transaction reporting requirements in 1970, "Congress recognized the importance of reports of large and unusual currency transactions in ferreting out criminal activity." *California Bankers Assn. v. Shultz,* 416 U.S. 21, 38, 94 S.Ct. 1494, 1506, 39 L.Ed.2d 812 (1974). Congress enacted the antistructuring law to close what it perceived as ***162** a major loophole in the federal reporting scheme due to easy circumvention.[13] Because requiring proof of actual knowledge of illegality will make prosecution for structuring difficult or impossible ****670** in most cases,[14] the Court's decision reopens the loophole that Congress tried to close.

III

The petitioner in this case was informed by casino officials that a transaction involving more than $10,000 in cash must be reported, was informed by the various banks he visited that banks are required to report cash transactions in excess of $10,000, and then purchased $76,000 in cashier's checks, each for less than $10,000 and each from a different bank. Petitioner Ratzlaf, obviously not a person of limited intelligence, was anything but uncomprehending as he traveled from bank to bank converting his bag of cash to cashier's checks in $9,500 bundles. I am convinced that his actions constituted a "willful" violation of the antistructuring provision embodied in 31 U.S.C. § 5324. As a result of today's decision, Waldemar Ratzlaf—to use an old phrase—will be "laughing all the way to the bank."

The majority's interpretation of the antistructuring provision is at odds with the statutory text, the intent of Congress, and the fundamental principle that knowledge of illegality is not required for a criminal act. Now Congress must try again to fill a hole it rightly felt it had filled before. I dissent.

All Citations

510 U.S. 135, 114 S.Ct. 655, 126 L.Ed.2d 615, 62 USLW 4037, 94-1 USTC P 50,015

Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

[1] Compare, *e.g., United States v. Scanio,* 900 F.2d 485, 491 (CA2 1990) ("proof that the defendant knew that structuring is unlawful" is not required to satisfy § 5322's willfulness requirement), with *United States v. Aversa,* 984 F.2d 493, 502

(CA1 1993) (en banc) (a "willful action" within the meaning of § 5322(a) "is one committed in violation of a known legal duty or in consequence of a defendant's reckless disregard of such a duty").

2 Ratzlaf's wife and the casino employee who escorted Ratzlaf to area banks were codefendants. For convenience, we refer only to Waldemar Ratzlaf in this opinion.

3 By regulation, the Secretary ordered reporting of "transaction [s] in currency of more than $10,000." 31 CFR § 103.22(a) (1993). Although the Secretary could have imposed a report-filing requirement on "any ... participant in the transaction," 31 U.S.C. § 5313(a), the Secretary chose to require reporting by the financial institution but not by the customer. 31 CFR § 103.22(a) (1993).

4 Other portions of this Act make "money laundering" itself a crime. See Pub.L. 99–570, Tit. XIII, § 1352(a), 100 Stat. 3207–18, codified at 18 U.S.C. § 1956(a)(2)(B) (prohibiting various transactions involving the "proceeds of some form of unlawful activity"). The Government does not assert that Ratzlaf obtained the cash used in any of the transactions relevant here in other than a lawful manner.

5 Subsequent to Ratzlaf's conviction, Congress recodified § 5324(1)–(3) as § 5324(a)(1)–(3), without substantive change. In addition, Congress added subsection (b) to replicate the prohibitions of subsection (a) in the context of international currency transactions. See Annunzio–Wylie Anti–Money Laundering Act, Pub.L. 102–550, Tit. XV, § 1525(a), 106 Stat. 4064, 31 U.S.C. § 5324 (1988 ed., Supp. IV). For simplicity, we refer to the codification in effect at the time the Court of Appeals decided this case.

6 Regarding enforcement of § 5324, the Secretary considered, but did not promulgate, a regulation requiring banks to inform currency transaction customers of the section's proscription. See 53 Fed.Reg. 7948 (1988) (proposing "procedures to notify [bank] customers of the provisions to Section 5324" in order to "insure compliance" with those provisions); 54 Fed.Reg. 20398 (1989) (withdrawing proposal).

7 The United States confirmed at oral argument that, in its view, as in the view of the courts below, "the 5324 offense is just what it would be if you never had 5322." Tr. of Oral Arg. 23.

8 Section 5314 provides that "the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency."

9 Section 5316 requires the filing of reports prescribed by the Secretary of the Treasury when "a person or an agent or bailee of the person ... knowingly (1) transports, is about to transport, or has transported, monetary instruments of more than $10,000 at one time" into, or out of, the United States.

10 "[S]pecific intent to commit the crime[s]" described in 31 U.S.C. §§ 5313, 5314, and 5316 might be negated by, *e.g.,* proof that defendant relied in good faith on advice of counsel. See *United States v. Eisenstein,* 731 F.2d 1540, 1543–1544 (CA11 1984).

11 On brief, the United States attempted to link Ratzlaf to other bad conduct, describing at some length his repeated failure to report gambling income in his income tax returns. Brief for United States 5–7. Ratzlaf was not prosecuted, however, for these alleged misdeeds. Tr. of Oral Arg. 35–36. Nor has the Government ever asserted that Ratzlaf was engaged in other conduct Congress sought principally to check through the legislation in question—not gambling at licensed casinos, but laundering money proceeds from drug sales or other criminal ventures. See S.Rep. No. 99–433, pp. 1–2 (1986) (purpose of Act creating § 5324 is to "provide Federal law enforcement agencies with additional tools to investigate money laundering [and to] curb the spread of money laundering, by which criminals have successfully disguised the nature and source of funds from their illegal enterprises").

12 At oral argument, the United States recognized that, under its reading of the legislation, the entrepreneur in this example, absent special exemption, would be subject to prosecution. Tr. of Oral Arg. 32–34.

13 See *United States v. Dollar Bank Money Market Account No. 1591768456,* 980 F.2d 233, 241 (CA3 1992) (forfeiture action under 18 U.S.C. § 981(a)(1)(A) involving a cash gift deposited by the donee in several steps to avoid bank's reporting requirement; court overturned grant of summary judgment in Government's favor, noting that jury could believe donee's "legitimate explanations for organizing his deposits in amounts under $10,000," including respect for donor's privacy and fear that information regarding the donor—an "eccentric old woman [who] hid hundreds of thousands of dollars in her house"—might lead to burglary attempts).

14 See *Aversa,* 984 F.2d, at 495 (real estate partners feared that "paper trail" from currency transaction reports would obviate efforts to hide existence of cash from spouse of one of the partners).

15 The statute provides that "[i]n the case of gifts ... made to any person by [a] donor during [a] calendar year, the first $10,000 of such gifts to such person shall not ... be included in the total amount of gifts made during such year." 26 U.S.C. § 2503(b).

16 Congress did provide for civil forfeiture without any "willfulness" requirement in the Money Laundering Control Act of 1986. See 18 U.S.C. § 981(a) (subjecting to forfeiture "[a]ny property, real or personal, involved in a transaction ... in violation of section 5313(a) or 5324(a) of title 31 ..."); see also 31 U.S.C. § 5317(a) (subjecting to forfeiture any "monetary instrument ... being transported [when] a report on the instrument under section 5316 of this title has not been filed or contains a material omission or misstatement").

17 The United States points to one of the Senate Reports accompanying the Money Laundering Control Act of 1986, which stated that "a person who converts $18,000 in currency to cashier's checks by purchasing two $9,000 cashier's checks at two different banks or on two different days with the specific intent that the participating bank or banks not be required to file Currency Transaction Reports for those transactions, would be subject to potential civil and criminal liability." S.Rep. No. 99–433, p. 22 (1986), cited in Brief for United States 35. The same Report also indicated that § 5324 "would codify [*United States v.*] *Tobon–Builes* [, 706 F.2d 1092 (CA11 1983),] and like cases [by] expressly subject [ing] to potential liability a person who causes or attempts to cause a financial institution to fail to file a required report or who causes a financial institution to file a required report that contains material omissions or misstatements of fact." S.Rep. No. 99–433, at 22, cited in Brief for United States 33.

But the legislative history cited by the United States is hardly crystalline. The reference to *United States v. Tobon–Builes,* 706 F.2d 1092 (CA11 1983), is illustrative. In that case, the defendant was charged under 18 U.S.C. § 1001, the False Statements Act, with "conceal [ing] ... the existence, source, and transfer of approximately $185,200 in cash by purchasing approximately twenty-one cashier's checks in amounts less than $10,000 [and] using a variety of names, including false names...." 706 F.2d, at 1094. The defendant's "main contention," rejected by the Eleventh Circuit, was that he "could not have violated the concealment prohibition of § 1001 because he was under no legal duty to report any of his cash transactions." *Id.,* at 1096. No "ignorance of the law" defense was asserted. Congress may indeed have "codified" that decision in § 5324 by "expressly subject[ing] to potential liability a person who causes or attempts to cause a financial institution to fail to file a required report or who causes a financial institution to file a required report that contains material omissions or misstatements of fact," S.Rep. No. 99–433, at 22, but it appears that Congress did so in the *first* and *second* subsections of § 5324, which track the Senate Report language almost verbatim. See 31 U.S.C. § 5324(1) (no person shall "cause or attempt to cause a domestic financial institution to fail to file a report required under section 5313(a)"); 31 U.S.C. § 5324(2) (no person shall "cause or attempt to cause a domestic financial institution to file a report required under section 5313(a) that contains a material omission or misstatement of fact"). Indeed, the Senate Report stated that "*[i]n addition* " to codifying *Tobon–Builes,* § 5324 would also "create the offense of structuring a transaction to evade the reporting requirements." S.Rep. No. 99–433, at 22. The relevance of *Tobon–Builes* to the proper construction of § 5324(3), the subsection under which Ratzlaf was convicted, is not evident.

18 See *Barnhill v. Johnson,* 503 U.S. 393, 401, 112 S.Ct. 1386, 1391, 118 L.Ed.2d 39 (1992) (appeals to legislative history are well taken only to resolve statutory ambiguity). See also *United States v. Aversa,* 984 F.2d, at 499, n. 8 (commenting that legislative history of provisions here at issue " 'is more conflicting than the [statutory] text is ambiguous' ") (quoting *Wong Yang Sung v. McGrath,* 339 U.S. 33, 49, 70 S.Ct. 445, 454, 94 L.Ed. 616 (1950)). As the First Circuit noted, no House, Senate, or Conference Report accompanied the final version of the Anti–Drug Abuse Act of 1986; instead, over 20 separate reports accompanied various proposed bills, portions of which were incorporated into that Act. See 1986 U.S.C.C.A.N. 5393 (listing reports).

The dissent, see *post,* at 669, features a House Report issued in 1991 in connection with an unenacted version of the Annunzio–Wylie Anti–Money Laundering Act. We do not find that Report, commenting on a bill that did not pass, a secure indicator of congressional intent at any time, and it surely affords no reliable guide to Congress' intent in 1986. See *Oscar Mayer & Co. v. Evans,* 441 U.S. 750, 758, 99 S.Ct. 2066, 2072, 60 L.Ed.2d 609 (1979) (cautioning against giving weight to "history" written years after the passage of a statute).

19 The dissent asserts that our holding "largely nullifies the effect" of § 5324 by "mak[ing] prosecution for structuring difficult or impossible in most cases." See *post,* at 669–670. Even under the dissent's reading of the statute, proof that the defendant knew of the bank's duty to report is required for conviction; we fail to see why proof that the defendant knew of his duty to refrain from structuring is so qualitatively different that it renders prosecution "impossible." A jury may, of course, find the requisite knowledge on defendant's part by drawing reasonable inferences from the evidence of defendant's conduct, see *Spies v. United States,* 317 U.S. 492, 499–500, 63 S.Ct. 364, 368–369, 87 L.Ed. 418 (1943) (illustrating conduct that can support permissible inference of an "affirmative willful attempt" to evade a tax); *United States v. Bank of New England, N.A.,* 821 F.2d 844, 854 (CA1 1987) (willfulness "is usually established by drawing reasonable inferences from the available facts"), and the Government has not found it "impossible" to persuade a jury to make such inferences in prosecutions for willful violations of §§ 5313, 5314, or 5316. See, *e.g., United States v. Dichne,* 612 F.2d 632, 636–

638 (CA2 1979) (evidence that Government took "affirmative steps" to bring the reporting requirement to the defendant's attention by means of visual notices supports inference that defendant "willfully violated" § 5316).

[1] For convenience, I follow the majority, see *ante,* at 657, n. 2, and refer only to Waldemar Ratzlaf in this opinion.

[2] As does the majority, I refer to the codification in effect at the time the Court of Appeals decided this case. See *ante,* at 658, n. 5.

[3] See *United States v. Scanio,* 900 F.2d 485, 489–492 (CA2 1990); *United States v. Shirk,* 981 F.2d 1382, 1389–1392 (CA3 1993); *United States v. Rogers,* 962 F.2d 342, 343–345 (CA4 1992); *United States v. Beaumont,* 972 F.2d 91, 93–95 (CA5 1992); *United States v. Baydoun,* 984 F.2d 175, 180 (CA6 1993); *United States v. Jackson,* 983 F.2d 757, 767 (CA7 1993); *United States v. Gibbons,* 968 F.2d 639, 643–645 (CA8 1992); *United States v. Dashney,* 937 F.2d 532, 537–540 (CA10), cert. denied, 502 U.S. 951, 112 S.Ct. 402, 116 L.Ed.2d 351 (1991); *United States v. Brown,* 954 F.2d 1563, 1567–1569 (CA11), cert. denied, 506 U.S. 900, 113 S.Ct. 284, 121 L.Ed.2d 210 (1992).

The only Court of Appeals to adopt a contrary interpretation is the First Circuit, and even that court allows "reckless disregard" of one's legal duty to support a conviction for structuring. See *United States v. Aversa,* 984 F.2d 493, 502 (1993) (en banc).

[4] The dominant formulation of the standard for a willful violation of the related provisions demands "proof of the defendant's knowledge of the reporting requirement and his specific intent to commit the crime." *United States v. Granda,* 565 F.2d 922, 926 (CA5 1978); see also *United States v. Bank of New England, N.A.,* 821 F.2d 844, 854 (CA1) ("willful" violation of § 5313 requires " 'knowledge of the reporting requirements and [defendant's] specific intent to commit the crime' "), cert. denied, 484 U.S. 943, 108 S.Ct. 328, 98 L.Ed.2d 356 (1987); *United States v. Eisenstein,* 731 F.2d 1540, 1543 (CA11 1984) (same); *United States v. Dichne,* 612 F.2d 632, 636 (CA2 1979) (same standard under predecessor to § 5316), cert. denied, 445 U.S. 928, 100 S.Ct. 1314, 63 L.Ed.2d 760 (1980); *United States v. Schnaiderman,* 568 F.2d 1208, 1211 (CA5 1978) (same). The term "specific intent" does not, as the majority appears to assume, import the notion of knowledge of illegality. Rather, that term generally corresponds to the concept of "purpose," see *United States v. Bailey,* 444 U.S. 394, 405, 100 S.Ct. 624, 632, 62 L.Ed.2d 575 (1980), and it does not add to the requisite *knowledge,* which is specified in the first prong of the standard. The majority correctly notes that courts in a few instances have referred to a willful violation of the reporting provisions as involving violation of a "known legal duty." Those courts, however, either applied the standard from *Cheek v. United States,* 498 U.S. 192, 200, 111 S.Ct. 604, 609, 112 L.Ed.2d 617 (1991), despite this Court's restriction of that standard's application to the tax context, see *United States v. Sturman,* 951 F.2d 1466, 1476 (CA6 1991), or were referring simply to the reporting requirements as the "law" that one must know and actually applied the dominant standard from *Granda,* see *Bank of New England,* 821 F.2d, at 854; *United States v. Warren,* 612 F.2d 887, 890 (CA5 1980). This understanding is supported by *Granda*'s statement that "the proper instruction would include some discussion of the defendant's ignorance of the law since the defendant's alleged *ignorance of the reporting requirements* goes to the heart of his or her denial of the specific intent necessary to commit the crime." 565 F.2d, at 926 (emphasis added).

[5] "Knowledge of the reporting requirements" is easily confused with "knowledge of illegality" because, in the context of the other reporting provisions—§§ 5313, 5314, and 5316—the entity that can "willfully violate" each provision is also the entity charged with the reporting duty; as a result, a violation with "knowledge of the reporting requirements" necessarily entails the entity's knowledge of the illegality of its conduct (that is, its failure to file a required report). In contrast, § 5324 prohibits a customer from purposefully evading a *bank's* reporting requirements, so knowledge of the reporting requirements does not collapse into actual knowledge that the customer's own conduct is prohibited. Under the cases interpreting the statute as well as fundamental principles of criminal law, it is one's knowledge of the reporting requirements, not "knowledge of the illegality of one's conduct," that makes a violation "willful." Moreover, as explained below, Congress in 1992 rejected the majority's construction when it enacted a parallel antistructuring provision for attempts to evade § 5316's reporting requirements. See *infra,* at 669–670.

[6] The question is not whether structuring is "so obviously 'evil' or inherently 'bad' that the 'willfulness' requirement is satisfied irrespective of the defendant's knowledge of the illegality of structuring." *Ante,* at 662. The general rule is that "willfulness" does *not* require knowledge of illegality; the inquiry under exceptional cases such as *Liparota v. United States,* 471 U.S. 419, 105 S.Ct. 2084, 85 L.Ed.2d 434 (1985), is whether the statute criminalizes "a broad range of apparently innocent conduct," *id.,* at 426, 105 S.Ct., at 2088, such that it requires no element of wrongfulness.

The majority expresses concern about the potential application of the antistructuring law to a business operator who deposits cash twice each week to reduce the risk of an IRS audit. See *ante,* at 660–661. First, it is not at all clear that the statute would apply in this situation. If a person has legitimate business reasons for conducting frequent cash transactions, or if the transactions genuinely can be characterized as separate, rather than artificially structured, then the person is not engaged in "structuring" for the purpose of "evasion." See *United States v. Brown,* 954 F.2d, at 1571; S.Rep. No. 99–433, p. 22 (1986). Even if application of § 5324 were theoretically possible in this extreme situation, the example would not establish prohibition of a "broad range of apparently innocent conduct" as in *Liparota,* 471 U.S., at 426, 105 S.Ct., at 2088, and it would not justify reading into the statute a knowledge-of-illegality requirement.

7 "[The antistructuring provision] requires proof beyond a reasonable doubt that the purpose of the 'structured' aspect of a currency exchange was to evade the reporting requirements of the Bank Secrecy Act. It is this requirement which shields innocent conduct from prosecution." Hearing on S. 571 and S. 2306 before the Senate Committee on Banking, Housing, and Urban Affairs, 99th Cong., 2d Sess., 136–137 (1986) (response of Deputy Asst. Atty. Gen. Knapp and Asst. U.S. Atty. Sun to written question of Sen. D'Amato).

8 The majority offers examples of tax "avoidance" as further evidence of the apparent "innocence" of structuring transactions to evade the reporting requirements. See *ante,* at 661–662. These examples are inapposite because Congress specifically has prohibited the structuring of transactions to evade the reporting requirements. Indeed, its use of the word "evading" in § 5324 reveals that Congress deemed the intent to circumvent those requirements a "bad purpose." Moreover, the analogy to the tax field is flawed. Tax law involves a unique scheme consisting of myriad categories and thresholds, applied in yearly segments, designed to generate appropriate levels of taxation while also influencing behavior in various ways. Innocent "avoidance" is an established part of this scheme, and it does not operate to undermine the purposes of the tax law. In sharp contrast, evasion of the currency transaction reporting requirements completely deprives the Government of the information that those requirements are designed to obtain, and thus wholly undermines the purpose of the statute.

9 Because the statutory language unambiguously imposes no requirement of knowledge of the illegality of structuring, I would not apply the rule of lenity. Moreover, I am not persuaded that that rule should be applied to defeat a congressional purpose that is as clear as that evidenced here. See *Liparota,* 471 U.S., at 427, 105 S.Ct., at 2089; *United States v. Bramblett,* 348 U.S. 503, 509–510, 75 S.Ct. 504, 508, 99 L.Ed. 594 (1955).

10 Contrary to the majority's suggestion, *ante,* at 662, n. 17, Congress did sanction *Tobon–Builes'* scienter standard. In that case, which Congress intended to "codify," the Eleventh Circuit clearly addressed the level of knowledge required for a willful violation. See *United States v. Tobon–Builes,* 706 F.2d 1092, 1101 (CA11 1983). Moreover, Congress was aware of the standard that the court had adopted, explicitly characterizing *Tobon–Builes* as imposing criminal liability upon individuals who structure transactions "to evade the reporting requirements." S.Rep. No. 99–433, at 21.

The majority misreads the Senate Report as stating that § 5324 creates the structuring offense " '*[i]n addition*' to codifying *Tobon–Builes.*" *Ante,* at 662, n. 17. The phrase "in addition" plainly refers to the previous sentence in the Report, which states that § 5324 "would expressly subject to potential liability a person who causes or attempts to cause a financial institution to fail to file a required report or who causes a financial institution to file a required report that contains material omissions or misstatements of fact." S.Rep. No. 99–433, at 22. The "codification" of *Tobon–Builes* encompasses both sentences, and thus all three subsections of the original § 5324. In any event, there is no doubt that the Report's reference to "codifying *Tobon–Builes* " is a reference to the creation of the antistructuring offense, particularly given that *Tobon–Builes* expressly imposed criminal liability for "structuring" transactions. 706 F.2d, at 1101. Even more direct evidence of Congress' intent to incorporate the *Tobon–Builes* scienter standard is found in the response to a question from Senator D'Amato, the Senate sponsor of the antistructuring provision. He asked Deputy Assistant Attorney General Knapp and Assistant United States Attorney Sun: "Assuming that [the antistructuring] provision had been on the books, could you have demonstrated a willful violation in the *Anzalone, Varbel* and *Denemark* cases?" The written response stated: "Assuming that the terms of [the antistructuring provision] were in effect at the time of the conduct described in *Anzalone, Varbel,* and *Denemark,* the result would, or should have been markedly different. Statements from defendants in those cases indicated that the structuring conduct was purposely undertaken to evade the reporting requirements of Title 31. As this is expressly what is prohibited under [the antistructuring provision], a willful violation ... would have been demonstrated." Hearing on S. 571 and S. 2306 before the Senate Committee on Banking, Housing, and Urban Affairs, 99th Cong., 2d Sess., at 141–142.

11 The new law moved the antistructuring provision at issue here into a new subsection (a) of § 5324 and created subsection (b) for the new antistructuring provision.

12 The Court of Appeals for the Ninth Circuit relied on *Hoyland* in affirming the conviction in this case.

13 See, *e.g.,* S.Rep. No. 99–433, at 2–3, 7.

14 See Welling, Smurfs, Money Laundering, and the Federal Criminal Law: The Crime of Structuring Transactions, 41 Fla.L.Rev. 287, 320 (1989).

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45 F.Supp.3d 1175
United States District Court,
N.D. California.

United States of America, Plaintiff,
v.
John C. Hom, Defendant.

No. C 13–03721 WHA
|
Signed June 04, 2014

Synopsis
Background: Federal government sought to hold United States taxpayer liable for failing to file Foreign Bank and Financial Accounts Reports (FBARs) as allegedly required by the Bank Secrecy Act. Government moved for summary judgment.

Holdings: The District Court, William Alsup, J., held that:

[1] online accounts through which a United States citizen carried on his gambling activities, and which allowed him to carry balances and to withdraw and transfer funds to other entities, qualified as "bank or other financial accounts";

[2] online financial accounts through which a United States citizen carried on his gambling activity were located in foreign countries in which financial institutions that created and managed these accounts were located; and

[3] Internal Revenue Manual did not have force of law and did not confer any right on taxpayer with regard to penalties assessed for his failure to file FBARs.

Motion granted.

Attorneys and Law Firms

***1177** Jeremy N. Hendon, United States Department of Justice, Washington, DC, Thomas Moore, Thomas M. Newman, U.S. Attorney's Office, San Francisco, CA, for Plaintiff.

John C. Hom, San Rafael, CA, pro se.

ORDER GRANTING SUMMARY JUDGMENT

WILLIAM ALSUP, UNITED STATES DISTRICT JUDGE

INTRODUCTION

In this action involving the Bank Secrecy Act, the government moves for summary judgment. The motion is **GRANTED.**

STATEMENT

The following facts are uncontested. During 2006, *pro se* defendant John Hom gambled online through internet accounts with PokerStars.com and PartyPoker.com (Hendon Decl., Exh. 5 at 1–2). In 2007, defendant continued to gamble online through his PokerStars account (Hendon Decl., Exh. 5 at 2). Both poker websites allowed defendant to deposit money or make withdrawals.

Defendant used his account at FirePay.com, an online financial organization that receives, holds, and pays funds on behalf of its customers, to fund his online PokerStars and PartyPoker accounts. He deposited money into his FirePay account via his domestic Wells Fargo bank account or other online financial institutions, such as Western Union. In 2006, FirePay ceased allowing United States customers to transfer funds from their FirePay accounts to offshore internet gambling sites, so defendant used Western Union and other online financial institutions to transfer money from his Wells Fargo bank account to his online poker accounts (Hom Dep. at 38, 40, 45–46, 75, 110, 116, 121–24). Defendant admits that at some points in both 2006 and 2007, the aggregate amount of funds in his FirePay, PokerStars, and PartyPoker accounts exceeded $10,000 in United States currency (Hendon Decl., Exh. 5 at 4).

After the Internal Revenue Service detected discrepancies in defendant's federal income tax returns for 2006 and 2007, it opened a Foreign Bank and Financial Accounts Report ("FBAR") examination (Hendon Decl., Exh. 15). Individuals must file an FBAR with respect to foreign financial accounts exceeding $10,000 maintained during the previous year by June 30. 31 C.F.R. 103.27(c). Defendant did not file his 2006 or 2007 FBARs until

June 26, 2010 (Hendon Decl., Exh. 5, at 4). Moreover, his submitted FBAR for 2006 did not include his FirePay account (Hom Dep. at 138).

On September 20, 2011, the IRS assessed defendant with civil penalties under 31 U.S.C. 5321(a)(5) for his non-willful failure to submit FBARs, as required by 31 U.S.C. 5314, regarding his interest in his FirePay, PokerStars, and PartyPoker accounts. The IRS assessed a $30,000 penalty for 2006, which included a $10,000 penalty for each of the three accounts, and a $10,000 penalty for 2007 based solely on defendant's PokerStars account (Hendon Decl., Exh. 5, at 5). Interest and penalties continue to accrue until paid in full pursuant to 31 U.S.C. 3717. This order follows full briefing and oral argument. The Court has tried to appoint a free lawyer for defendant—but no one would take the case.

*1178 ANALYSIS

The Bank Secrecy Act of 1970 was enacted "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." *United States v. Clines,* 958 F.2d 578, 581 (4th Cir.1992) (citations omitted), *cert. denied,* 505 U.S. 1205, 112 S.Ct. 2994, 120 L.Ed.2d 871 (1992). To accomplish this end, the Act established reporting requirements for transactions involving foreign financial agencies. 31 U.S.C. 5314. The provisions of the Act relating to foreign financial transactions resulted from the concern of Congress that foreign financial institutions located in jurisdictions having laws of secrecy with respect to bank activity were being used extensively to violate or evade domestic criminal, tax, and regulatory requirements. *California Bankers Ass'n v. Shultz,* 416 U.S. 21, 27, 94 S.Ct. 1494, 39 L.Ed.2d 812 (1974). The Act explicitly empowers the Secretary of the Treasury to determine the method in which covered persons should disclose their relationships or accounts with a foreign financial agency. 31 U.S.C. 5314.

According to the pertinent regulations, each person who is subject to the jurisdiction of the United States and has a "financial interest in, or signature authority over, a bank, securities, or other financial account in a foreign country" is required to report such relationship to the Commissioner for each year in which such relationship exists and provide this information in a reporting form prescribed by the Secretary to be filed by such persons. 31 C.F.R. 103.24. "Reports required to be filed by [Section] 103.24 shall be filed with the Commissioner of Internal Revenue on or before June 30 of each calendar year with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year." 31 C.F.R. 103.27(c). If a person subject to the jurisdiction of the United States fails to submit an FBAR to the IRS when required to do so under 31 U.S.C. 5314, the Secretary of the Treasury may impose civil penalties. 31 U.S.C. 5321. In 2011, 31 C.F.R. 103.24 was amended and renumbered 31 C.F.R 1010.350. Section 103.24 was the version of the regulation in effect in 2006 and 2007, and the 2011 amendments did not fundamentally alter any of the reporting obligations.

For non-willful violations occurring after October 22, 2004, the amount of the civil penalty shall not exceed $10,000. 31 U.S.C. 5321(a)(5)(B). No penalty shall be imposed, however, if the violation was due to reasonable cause *and* the amount of the transaction or the balance in the account at the time of the transaction was properly reported. *Ibid.*

[1] In sum, an individual must file an FBAR for a reporting year if: (1) he or she is a United States person; (2) he or she has a financial interest in, or signature or other authority over, a bank, securities, or other financial account; (3) the bank, securities, or other financial account is in a foreign country; and (4) the aggregate amount in the accounts exceeds $10,000 in U.S. currency at any time during the year.

1. UNITED STATES PERSON.

The first element is whether the individual is a "United States person." As both sides agree that defendant is a United States citizen "subject to the jurisdiction of the United States," this element is met (Opp. at 1). 31 C.F.R. 103.24.

2. INTEREST IN "A BANK, SECURITIES, OR OTHER FINANCIAL ACCOUNT."

[2] The second element is whether defendant had a financial interest in, or authority over, a bank, securities, or other financial account in 2006 or 2007. Defendant ***1179** does not contest in his opposition that he had a financial interest in his online FirePay, PokerStars, and PartyPoker accounts in 2006 and his online PokerStars account in 2007. Rather, defendant argues that those accounts are not a "bank or other financial accounts" for purposes of the applicable statute and regulations.

While our court of appeals has not yet answered what constitutes "other financial account[s]" under 31 C.F.R. 103.24, the Court of Appeals for the Fourth Circuit found that an account with a financial agency is a financial account under Section 5314. *Clines,* 958 F.2d at 582. Under Section 5312(a)(1), a "person acting for a person" as a "financial institution" or a person who is "acting in a similar way related to money" is considered a "financial agency." Section 5312(a)(2) lists 26 different types of entities that may qualify as a "financial institution." Based on the breadth of the definition, our court of appeals has held that "the term 'financial institution' is to be given a broad definition." *United States v. Dela Espriella,* 781 F.2d 1432, 1436 (9th Cir.1986). The government claims that FirePay, PokerStars, and PartyPoker are all financial institutions because they function as "commercial bank[s]." Section 5312(a)(2)(B). The Fourth Circuit in *Clines* found that "[b]y holding funds for third parties and disbursing them at their direction, [the organization at issue] *functioned as a bank* [under Section 5314]." *Clines,* 958 F.2d at 582 (emphasis added).

So too here. Defendant admits that he opened up all three accounts in his name, controlled access to the accounts, deposited money into the accounts, withdrew or transferred money from the accounts to other entities at will, and could carry a balance on the accounts (Hom Dep. at 38, 40, 45–46, 110, 116). As FirePay, PokerStars, and PartyPoker functioned as banks, defendant's online accounts with them are reportable.

Defendant alternatively argues that his online accounts are not "other accounts" according to the current regulations. The current regulations define a reportable account as including "bank account[s] ... [which means] a savings deposit, demand deposit, checking, or any other account maintained with a person engaged in the business of banking." 31 C.F.R. 1010.350. As explained above, FirePay, PokerStars, and PartyPoker function as institutions engaged in the business of banking. Accordingly, defendant's accounts are reportable even under the current regulations.

3. THE FINANCIAL ACCOUNT IS IN A FOREIGN COUNTRY.

[3] The third element is whether defendant's three financial accounts are located in foreign countries. The government argues that "located in" refers to where the financial institution that created and managed the account is located, whereas defendant argues that "located in" refers to the geographic location of the funds. As defendant has provided some evidence to suggest that PokerStars has several dozen bank accounts located in the United States, he asserts that "there is a real possibility that Defendant's funds are in an American bank" (Opp. at 2–3).

This order agrees with the government. It is irrelevant where PokerStars, FirePay, or PartyPoker opened *their* bank accounts. Those accounts belong to *them,* not defendant. Rather, *his* accounts are digital constructs that these financial institutions, all located outside of the United States, created and maintained on his behalf. FirePay is located in and regulated by the United Kingdom (Hendon Supp. Decl., Exh 19). PokerStars and its parent company, Rational Entertainment Enterprises Ltd., are licensed and regulated by ***1180** the government of the Isle of Man (Hendon Supp. Decl., Exh. 20). PartyPoker and its parent company, PartyGaming, are licenced, regulated, and headquartered in Gibraltar (Hendon Supp. Decl., Exh. 26). These are the locations of his digital accounts, regardless of where the three companies place their own funds.

The Financial Crimes Enforcement Network of the Department of the Treasury has recently provided more guidance in its response to comments on its notice of proposed 2011 amendments to the Bank Secrecy Act, stating, "an account is not a foreign account under the FBAR if it is maintained with a financial institution *located in the United States.*" Final Regulations, 76 Fed.Reg. 10,235 (Feb. 24, 2011) (to be codified at 31 C.F.R. pt. 1010) (emphasis added); *see also* Michael I. Saltzman & Leslie Book, IRS Prac. & Proc. S7A–19 (Thompson Reuters ed., rev.2d ed. Supp.2014). The Department of Treasury's determination merits *Chevron* deference. Although the above statement is less than formal, Congress clearly delegated to the Department of the Treasury broad regulatory authority under 31 U.S.C. 5314 and its interpretation was issued with a "lawmaking pretense" via its notice of rulemaking. *Marmolejo–Campos v. Holder,* 558 F.3d 903, 908–10 (9th

Cir.2009). Here, Congress did not directly address the precise question at issue on the face of the statute and the Department of Treasury reasonably interpreted the statute in finding that an account's location is determined by the location of its host institution, not where the physical money might be stored after it is sent to financial institution. *Chevron v. NRDC,* 467 U.S. 837, 843, 865, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).

In support of his position, defendant cites to the general instructions from the 2010 FBAR form he tardily filed, which stated, "[t]he geographic location of the account, not the nationality of the financial institution in which the account is found determines whether it is an account in a foreign country." (Hendon Decl., Exh. 17 at HOM000404). That argument is unconvincing. The instructions contained within the FBAR form, as interpreted by defendant, have no legal weight because " interpretation by taxpayers of the language used in government pamphlets [cannot] act as an estoppel on the government, nor change the meaning of taxing statutes." *Adler v. Commissioner,* 330 F.2d 91, 93 (9th Cir.1964). And even if the instructions had legal weight—even if they were determinative—there is no suggestion here that FirePay, PokerStars, and PartyPoker opened and maintained the defendant's *accounts* in the United States.

As defendant concedes, PokerStars, FirePay, and PartyPoker are all licensed and operated in foreign countries (Br. at 2, Dkt. No. 41). These foreign countries are where the companies created and maintained defendant's online accounts. Accordingly, this order finds that defendant's accounts are all located in foreign countries.

4. $10,000 REQUIREMENT.

The fourth element is that the aggregate amount in the accounts exceeds $10,000 in U.S. currency at any time during the reporting year. Here, defendant admits that there was, in aggregate, at least $10,000 at some time during both 2006 and 2007 in his online PokerStars, FirePay, or PartyPoker accounts (Hendon Decl., Exh. 5 at 4). Accordingly, this element is met.

5. AFFIRMATIVE DEFENSES.

[4] Defendant argues that even if he is liable, the amount of penalty assessed was too high because it *might* contravene the "Internal Revenue Manual" (Opp. at 3). ***1181** Our court of appeals, however, has foreclosed that argument by holding that "[t]he Internal Revenue Manual does not have the force of law and does not confer rights on taxpayers." *Fargo v. Comm'r of Internal Revenue,* 447 F.3d 706, 713 (9th Cir.2006). Thus, defendant's argument fails.

[5] Defendant also requests that ruling on the government's summary judgment motion be delayed to allow further discovery. Yet, defendant has not identified any additional discovery or facts that might preclude summary judgment. *Panatronic USA v. AT & T Corp.,* 287 F.3d 840, 846 (9th Cir.2002). Accordingly, defendant's request is **DENIED.**

6. JUDICIAL NOTICE.

[6] The government seeks judicial notice of factual documents found on the internet. Defendant opposes. While our court of appeals has not yet ruled on whether information found on the internet may be judicially noticed, other circuit courts have judicially noticed reliable internet sources, such as government websites. *O'Toole v. Northrop Grumman Corp.,* 499 F.3d 1218, 1225 (10th Cir.2007); *Coleman v. Dretke,* 409 F.3d 665, 667 (5th Cir.2005) (*per curiam*); *Denius v. Dunlap,* 330 F.3d 919, 926–27 (7th Cir.2003). While parties are certainly not entitled to judicial notice of all internet sources, several judges in this district have judicially noticed information found on official government webpages or other reliable internet sources. *See, e.g., Paralyzed Veterans of Am. v. McPherson,* 2008 WL 4183981, at *5–6, 2008 U.S. Dist. LEXIS 69542, at *17–18 (N.D.Cal. Sept. 8, 2008) (Judge Saundra Brown Armstrong); *Sears v. County of Monterey,* 2013 WL 4510672, at *4–5, 2013 U.S. Dist. LEXIS 120401, at *12–13 (N.D.Cal. Aug. 22, 2013) (Judge Lucy Koh); *Gaudin v. Saxon Mortg. Servs.,* 297 F.R.D. 417, 419–421 (N.D.Cal.2013) (Judge Jon Tigar). Accordingly, the government's request for judicial notice that FirePay, PokerStars, and PartyPoker are all foreign entities is **GRANTED.**

CONCLUSION

For the reasons stated above, the government's motion for summary judgment is **GRANTED.**

The government shall file a brief by June 10, 2014, no longer than five pages, detailing the amount of money owned by defendant up to June 10. Final judgment will be entered afterwards.

IT IS SO ORDERED.

All Citations

45 F.Supp.3d 1175, 113 A.F.T.R.2d 2014-2325, 2014-1 USTC P 50,307

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595 Fed.Appx. 692
This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 9th Cir. Rule 36-3.
United States Court of Appeals,
Ninth Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
Michael QUIEL, Defendant–Appellant.
United States of America, Plaintiff–Appellee,
v.
Stephen Kerr, Defendant–Appellant.

Nos. 13–10503, 13–10504.
|
Argued and Submitted Dec. 10, 2014.
|
Filed Dec. 19, 2014.

Synopsis

Background: Defendants were convicted in the United States District Court for the District of Arizona, James A. Teilborg, of willfully making and subscribing false tax returns, and one of defendants was also convicted of willfully failing to file foreign bank account reports (FBARs).

Holdings: The Court of Appeals held that:

[1] evidence supported defendants' convictions;

[2] District Court did not violate defendants' right to confrontation;

[3] District Court properly allowed evidence of defendants' business activities and allowed government to argue those activities were fraudulent; and

[4] District Court did not abuse its discretion by admitting evidence defendant filed FBARs in later years.

Affirmed.

Attorneys and Law Firms

***693** Monica N. Edelstein, Assistant U.S., Office of the U.S. Attorney, Phoenix, AZ, Timothy Stockwell, Special Assistant U.S., Office of the U.S. Attorney, San Diego, CA, Frank Phillip Cihlar, Esquire, Senior Counsel, Gregory Victor Davis, Alexander Patrick Robbins, U.S. Department of Justice, Washington, DC, for Plaintiff–Appellee.

***694** Ashley Arnett, Michael Louis Minns, Law Office Of Michael Louis Minns PLC, Houston, TX, for Defendant–Appellant.

Appeal from the United States District Court for the District of Arizona, James A. Teilborg, Senior District Judge, Presiding. D.C. Nos. 2:11–cr–02385–JAT–2, 2:11–cr–02385–JAT–1.

Before: O'SCANNLAIN, N.R. SMITH, and HURWITZ, Circuit Judges.

MEMORANDUM [*]

Michael Quiel and Stephen Kerr appeal their convictions for willfully making and subscribing false tax returns, in violation of 26 U.S.C. § 7206(1). Kerr also appeals his conviction for willfully failing to file foreign bank account reports ("FBARs"), in violation of 31 U.S.C. §§ 5314, 5322(a) and 31 C.F.R. §§ 1010.350, 1010.306(c)-(d). We affirm.

[1] 1. "We review de novo claims of insufficient evidence." *United States v. Chhun,* 744 F.3d 1110, 1117 (9th Cir.), *cert. denied,* ––– U.S. ––––, 135 S.Ct. 131, 190 L.Ed.2d 100 (2014). We will uphold a conviction if, "viewing the evidence in the light most favorable to the prosecution, *any* rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *Jackson v. Virginia,* 443 U.S. 307, 319, 99 S.Ct. 2781, 61 L.Ed.2d 560 (1979). The question of whether Defendants willfully failed to report income and file FBARs is one of fact for the jury. *See Rykoff v. United States,* 40 F.3d 305, 307–08 (9th Cir.1994). The jury could have concluded that Kerr and Quiel knew they had a duty to report the income from their foreign accounts, because Christopher Rusch, their attorney and business partner, testified that the accounts were set up using nominees under Kerr's and Quiel's control in order to evade reporting requirements. Even without Rusch's testimony, the jury could have inferred control because (a) the accounts were traded in Kerr's and Quiel's stock for their benefit; (b) the foreign firms never served their stated purpose of finding investors; and (c) these firms were not actual, functioning businesses. Additionally, even without Rusch's testimony, the jury could infer motive from Kerr's having recently paid high tax rates and Quiel's recent payment of a large tax penalty before either engaged in these transactions. With regard to Kerr's conviction for willful failure to file FBARs, the evidence was sufficient to convict him given the jury instructions, to which Kerr did not object.

[2] 2. The district court did not err by admitting Rusch's testimony. "The district court's conclusion concerning whether statements are protected by an individual attorney-client privilege is a mixed question of law and fact which this court reviews independently and without deference to the district court." *United States v. Richey,* 632 F.3d 559, 563 (9th Cir.2011) (internal quotation marks omitted). Defendants waived the protection of the privilege by relying on an advice-of-counsel defense. *Rock River Commc'ns, Inc. v. Universal Music Grp., Inc.,* 745 F.3d 343, 353 (9th Cir.2014) ("A party who affirmatively places its attorney-client communications at issue in a litigation implicitly waives the privilege.").

[3] 3. The district court did not violate Kerr's and Quiel's constitutional right to confront Rusch by imposing a blanket ban on recross examination. We review ***695** "[w]hether limitations on the scope of questioning at trial constitute a violation of the confrontation clause ... de novo." *United States v. Jones,* 982 F.2d 380, 383 (9th Cir.1992). "Allowing recross is within the sound discretion of the trial court except where new matter is elicited on redirect examination, in which case denial of recross as to that new matter violates the Confrontation Clause." *United States v. Baker,* 10 F.3d 1374, 1404 (9th Cir.1993), *overruled on other grounds by United States v. Nordby,* 225 F.3d 1053 (9th Cir.2000). Although the district court may have imposed a blanket ban on recross examination, this ban did not violate Kerr's and Quiel's constitutional right to recross Rusch regarding three new exhibits admitted on redirect, because the exhibits were not "new matter." The exhibits merely bolstered Rusch's prior testimony. *See United States v. Croft,* 124 F.3d 1109, 1121 (9th Cir.1997). In any event, at Defendants' request, Rusch remained subject to the Government's subpoena after his testimony and the Defendants declined to recall him. *See United States v. Ross,* 33 F.3d 1507, 1518 (11th Cir.1994).

We reject the Defendants' separate Confrontation Clause argument that the exhibits constituted testimonial hearsay from a declarant not subject to cross-examination. Defendants failed to object to the exhibits on the basis of the Confrontation Clause, and we find that the district court did not plainly err. *See United States v. Olano,* 507 U.S. 725, 731–32, 113 S.Ct. 1770, 123 L.Ed.2d 508 (1993). The exhibits did not contain testimonial statements. *See Crawford v. Washington,* 541 U.S. 36, 51–53, 124 S.Ct. 1354, 158 L.Ed.2d 177 (2004).

[4] 4. We review the district court's decision to allow extensive evidence of Defendants' business activities and to allow the Government to argue that Defendants' activities were fraudulent for plain error, because, although Kerr and Quiel contend that admission of this evidence violated Fed.R.Evid. 403 and 404(b), they failed to make contemporaneous objections to this evidence. *United States v. Archdale,* 229 F.3d 861, 864–65 (9th Cir.2000). The district court did not plainly err, because the evidence was (a) intrinsic to the charged offenses; (b) more cumulative than prejudicial; and (c) addressed by a limiting instruction. Additionally, we conclude that the district court did not abuse its discretion by refusing to order a mistrial. *See United States v. Guerrero,* 756 F.2d 1342, 1347–48 (9th Cir.1984).

[5] 5. To the extent Defendants challenge the Government's characterization of their business activities as fraud during closing, they have not shown that the prosecutor's statements "so infected the trial with unfairness as to make the resulting conviction a denial of due process." *Towery v. Schriro,* 641 F.3d 300, 310 (9th Cir.2010) (internal quotation marks omitted).

[6] 6. On de novo review, we find that the district court did not err by refusing to order the Government to turn over a special agent's report or to disclose Quiel's individual tax master file. *See United States v. Si,* 343 F.3d 1116, 1122 (9th Cir.2003). To warrant disclosure (1) "the evidence at issue must be favorable to the accused"; (2) "the evidence must have been suppressed by the State, either willfully or inadvertently"; and (3) "prejudice must result from the failure to disclose the evidence." *Benn v. Lambert,* 283 F.3d 1040, 1052–53 (9th Cir.2002).

Defendants failed to show that the evidence was clearly exculpatory and did not make the plausible showing of that fact required to warrant in camera inspection. *See Pennsylvania v. Ritchie,* 480 U.S. 39, 58 n. 15, 107 S.Ct. 989, 94 L.Ed.2d 40 (1987).

***696** **[7]** 7. The district court did not abuse its discretion by admitting evidence that Kerr filed FBARs in later years. Kerr stipulated to the admission of the FBARs and does not now claim that his stipulation was involuntary. *See United States v. Molina,* 596 F.3d 1166, 1169 (9th Cir.2010). Further, the FBARs were not remedial measures under Fed.R.Evid. 407.

[8] 8. The district court did not abuse its discretion by refusing to order a new trial after Defendants were acquitted of conspiracy, *see United States v. King,* 660 F.3d 1071, 1076 (9th Cir.2011), because Defendants cannot identify evidence that was admitted against them solely because of the conspiracy charge.

AFFIRMED.

All Citations

595 Fed.Appx. 692, 114 A.F.T.R.2d 2014-6984

Footnotes

[*] This disposition is not appropriate for publication and is not precedent except as provided by 9th Cir. R. 36–3.

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2017 WL 3887520
United States District Court,
E.D. Pennsylvania.

Arthur BEDROSIAN
v.
The UNITED STATES of America, Department of the Treasury, Internal Revenue Service

CIVIL ACTION NO. 15-5853
|
Filed 09/05/2017

Attorneys and Law Firms

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MEMORANDUM RE: MOTION IN LIMINE

Baylson, District Judge

***1** Presently before the Court in this tax penalty action is Defendant the United States' motion in limine to preclude evidence concerning the "procedures, actions, analyses, or viewpoints of the Internal Revenue Service and its personnel at the administrative level regarding willfulness." (ECF 43, Gov't Mot. at 1.) Plaintiff Arthur Bedrosian opposes the motion on the grounds that the IRS administrative findings and related testimony are relevant to the Court's determination of whether his failure to file an accurate Report of Foreign Bank and Financial Accounts ("FBAR") in 2007 was willful. (ECF 46, Bedrosian Opp'n.) For the reasons discussed below, Defendant's motion is granted.

I. Legal Framework

Although the Third Circuit has not ruled on what standard of review applies to a determination of the validity of an IRS penalty under 31 U.S.C. § 5321, those courts that have considered the question have found the correct standard to be *de novo.* See United States v. Williams, No. 09-437, 2010 WL 3473311, at *1 (E.D. Va. Sept. 1, 2010), rev'd on other grounds, United States v. Williams, 489 Fed.Appx. 655 (4th Cir. 2012) (looking to enforcement actions brought by the government in other contexts which require a *de novo* review, as well as the fact that Section 5321 provides for no adjudicatory hearing before an FBAR penalty is assessed, to conclude that *de novo* review is appropriate); United States v. McBride, 908 F. Supp. 2d 1186, 1201 (D. Utah 2012) (applying *de novo* standard to whether underlying penalty was valid).

The government bears the burden of proving each element of its claim for a civil FBAR penalty by a preponderance of the evidence, including the key question here of whether an individual's failure to report was "willful." Williams, 2010 WL 3473311, at *1; McBride, 908 F. Supp. 2d at 1201-02 (explaining that "[a]s with [g]overnment penalty enforcement and collection cases generally, absent a statute that prescribes the burden of proof, imposition of a higher burden of proof is warranted only where 'particularly important individual interests or rights,' are at stake") (quoting Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983)); United States v. Bohanec, No. 15-4347, ––– F. Supp. 3d. ––––, 2016 WL 7167860, at *6 (C.D. Cal. Dec. 8, 2016) (holding that because "[t]he monetary sanctions at issue [in an FBAR civil penalty action] do not rise to the level of 'particularly important individual interest or rights,' ... the preponderance of the evidence standard applies").

II. Analysis

The government cites significant case law supporting its position that "[e]vidence regarding the thoughts, analysis, application of facts to law, and determinations at the administrative level with respect to willfulness have no place in the Court's *de novo* review of whether Bedrosian willfully failed to comply with the FBAR requirements." (Gov't Mot. at 6.) One especially compelling case is United States v. Farley, 11 F.3d 1385 (7th Cir. 1993), in which the court reviewed the district court's dismissal of a government action against an individual for violation of one of the Clayton Act's reporting requirements. The government had refused to produce certain internal Federal Trade Commission ("FTC") documents from the underlying administrative investigation in contravention to the district court's order, citing work product and deliberative process privileges. Id. at 1387. The district court dismissed the case with prejudice due to the government's failure to abide the court's order.

***2** The Seventh Circuit first found that the documents were within the scope of both privileges and that the district court had therefore erred in ordering the documents' disclosure without assessing the defendant's need for them. Id. at 1389-90. Second, and pertinent to this case, the court declined to remand for such a balancing analysis because the documents were legally irrelevant to the issue presented by the government's complaint. Specifically, the court held that the FTC documents were not relevant to the defendant's claim that his stock purchase fell within a given exemption to the federal reporting requirement because "[t]his defense requires only that the district court interpret the statutory exemption and determine whether [the defendant's] purchases were within the scope of that exemption." Id. at 1390.

Similarly, here Bedrosian cannot show that documents relating to the underlying IRS investigation and penalty assessment are relevant to the only question that remains in this case—whether he acted willfully when he failed to report one of his foreign accounts on his 2007 FBAR. As in Farley, that determination solely requires our consideration of Section 5321 and evidence pertaining to Bedrosian's state of mind in failing to accurately file his 2007 FBAR.

We further find instructive cases in which courts conduct *de novo* reviews of tax assessments. In Katz v. United States, No. 91-5623, 1992 WL 103006 (E.D. Pa. May 6, 1992), the court granted the government's motion to preclude the defendant from introducing evidence at trial pertaining to the IRS's investigation because "[i]t is not for [the] court to look behind an assessment to evaluate the procedure and evidence used in making the assessment." Id. at *1 (explaining that the *de novo* standard of review meant that there was no need for "any ancillary determination as to the procedures employed by the government in levying their assessment"); see also Rupert v. United States, 225 F.R.D. 154, 157 (M.D. Pa. 2004) (stating that where the court must determine the propriety of a tax refund, it "must independently evaluate the [p]laintiffs' claim, [rendering] the recommendations of the [IRS] Appeals Officer ... not relevant to [the] review").

Bedrosian, on the other hand, fails to proffer any case law that compels a contrary conclusion. He first cites S.H. v. State-Operated School District of City of Newark, 336 F.3d 260 (3d Cir. 2003) and Wilkins v. District of Columbia., 571 F. Supp. 2d 163 (D.D.C. 2008) for the proposition that we must give "due weight" to the underlying administrative proceedings. (Bedrosian Opp'n at 8.) But those cases deal with the particular circumstance of judicial review over cases arising under the Individuals with Disabilities Education Act ("IDEA"), which standard of review has developed in a line of cases specific to that statute. See Bd. of Educ. of Hendrick Hudson Ctrl. Sch. Dist., Westchester Cty. v. Rowley, 458 U.S. 176, 206 (1982) ("The fact that § 1415(e) requires that the reviewing court 'receive the records of the [state] administrative proceedings' carries with it the implied requirement that due weight shall be given to these proceedings."); Shore Reg'l High Sch. Bd. of Educ. v. P.S., 381 F.3d 194, 199 (3d Cir. 2004). Indeed, Bedrosian points us to no precedent for the application of such a standard outside of the IDEA context. Because neither the Supreme Court nor any other court discovered by the undersigned has limited the district court's *de novo* review of the imposition of an FBAR civil penalty in such a way, these cases are inapposite to the instant inquiry.

Bedrosian additionally argues that the fact that Section 5321 did not afford him an adjudicatory hearing sways in favor of admitting evidence relating to the IRS's administrative findings because he did not have "an adequate opportunity to be heard at the administrative level before the willful FBAR penalty was imposed." (Bedrosian Opp'n at 9.) We disagree. Bedrosian has the chance before this Court to put forth any relevant, admissible evidence of the only issue left to be adjudicated—his state of mind in not filing an accurate 2007 FBAR. The IRS's analysis of Bedrosian's case, its preliminary conclusions regarding his FBAR violation, and the viewpoints of its personnel plainly do not go to Bedrosian's willfulness in failing to list one of his foreign accounts on his 2007 FBAR.

***3** For the aforementioned reasons, we find that the government is correct in its contention that evidence concerning the "procedures, actions, analyses, or viewpoints of the Internal Revenue Service and its personnel at the administrative level regarding willfulness" is not relevant under FRE 401. (Gov't Mot. at 1.) Because evidence must be admissible in order to be relevant under FRE 402, the inquiry ends here and Bedrosian will not be permitted to introduce such evidence at trial.

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552 B.R. 338
United States Bankruptcy Court,
N.D. Texas, Dallas Division.

In re: Samuel Evans Wyly, et al., Debtors.

CASE NO. 14–35043–BJH
JOINTLY ADMINISTERED
|
Signed May 10, 2016

Synopsis

Background: Chapter 11 debtors moved to determine federal tax liability and objected to proofs of claim filed by the Internal Revenue Service (IRS). United States filed motion to exclude expert report.

Holdings: The Bankruptcy Court, Barbara J. Houser, J., held that:

[1] testimony of debtors' expert regarding fact that there was uncertainty as to the law among the relevant bars concerning, inter alia, the establishment and administration of foreign trusts during certain period was relevant and admissible;

[2] failure by the IRS to supply a fully itemized statement of interest, fees, expenses, or other charges as required by Bankruptcy Rules was harmless, and did not affect the proofs of claim's prima facie validity;

[3] debtor acted with fraudulent intent in underpaying his income taxes, and thus was liable for fraudulent underpayment penalties;

[4] debtor was not willfully blind to high probability of deceased husband's understated income or underpaid taxes, as would warrant imposition of fraud penalty;

[5] debtor was entitled to innocent spouse relief from fraudulent underpayment penalties, although deceased husband had been charged with concealing income and assets with his brother through complex offshore system of trusts and corporations;

[6] debtor did not reasonably rely in good faith on the advice he received from various lawyers as to the income tax treatment of his offshore system of trusts and corporations and the transactions undertaken through that system, and therefore failed to establish "reasonable cause and good faith" defense to imposition of fraud penalties; and

[7] offshore funds used by debtor for purchase, maintenance, improvement, and upkeep of certain properties was not a gift to his children.

Ordered accordingly.

Attorneys and Law Firms

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Related to ECF Nos. 4, 75, 516, 923, & 938

MEMORANDUM OPINION

BARBARA J. HOUSER, United States Bankruptcy Judge

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Before the Court are the Motion Pursuant to Bankruptcy Code § 505 to Determine Tax Liability, If Any [ECF No. 4] and the Amended Motion Under Bankruptcy Code Section 505 to Determine Tax Liability, If Any [ECF No. 516] (together, the "**Motions**") filed by Samuel Evans Wyly ("**Sam**") and Carolyn Dee Wyly ("**Dee,**" and together with Sam, the "**Debtors**"), respectively, in which the Debtors seek to have this Court determine the allowed claim of the Internal Revenue Service ("**IRS**") against them. The Debtors have also objected to the proofs of claim [1] filed by the IRS against them (together, the "**Claim Objections**"). [2] By agreement of the parties, the Motions and the Claim Objections were heard concurrently, as each seeks to have the Court determine the IRS' allowed claims against the Debtors' respective estates. Pursuant to a Scheduling Order agreed to by the parties and entered by the Court [ECF No. 564], trial commenced on January 6, 2016 and concluded on January 21, 2016. Closing arguments were heard on January 27 and 28, 2016. At the Court's direction, the Debtors and the IRS filed post-trial briefs on certain issues on February 5, 2016 and reply briefs to each other's post-trial brief on February 10, 2016. The Motions and Claim Objections are now ripe for ruling.

After carefully considering the arguments of the parties (as advanced orally and in writing both pre and post-trial), the evidence admitted at trial, and its own research of the legal issues raised, this Memorandum Opinion contains the Court's findings of fact and conclusions of law pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014. [3]

I. JURISDICTION, AUTHORITY, AND VENUE

The district court of the Northern District of Texas has subject matter jurisdiction ***356** over the Debtors' bankruptcy cases (the "**Cases**") pursuant to 28 U.S.C. § 1334, and this Court has authority to determine the amount or legality of tax and the allowance or disallowance of claims against the bankruptcy estates pursuant to 28 U.S.C. § 157(a), (b)(1), (b)(2)(B), and (b)(2)(*O*), 11 U.S.C. § 505(a), [4] and the Order of Reference of Bankruptcy Cases and Proceedings Nunc Pro Tunc adopted in the Northern District of Texas on August 3, 1984. As explained by the Fifth Circuit, § 505(a)(1) is a "broad grant of jurisdiction" authorizing the bankruptcy court to determine certain tax issues, subject to statutory exceptions that are not applicable to the Cases. [5] Venue is proper in this district pursuant to 28 U.S.C. § 1408.

II. PRELIMINARY MATTERS

A. Factual and Computation Stipulations of the Parties

At the Court's urging, the parties stipulated to a large number of undisputed facts, which are contained in the Joint Stipulations of Fact [ECF No. 1040] (the "**Joint Stipulations**") filed December 30, 2015. While the Court will not repeat those factual stipulations verbatim in this Memorandum Opinion, it adopts them as if they were set forth herein.

In addition, the parties were able to stipulate to the facts that will be necessary for them to compute the amount of tax, interest, and penalties that may result from this Court's determination of the factual and legal issues in dispute among them, which are included in the parties' Computation Stipulations [ECF No. 1106] (the "**Computation Stipulations**") filed January 26, 2016. The Computation Stipulations, like everything else in the Cases, is complicated and detailed, so suffice it to say that the Court is not going to repeat those stipulations here, but it adopts them as if they were set forth herein. [6]

B. Facts Found Due to this Court's Application of Collateral Estoppel

On May 29, 2015 the IRS filed its Motion for Partial Summary Judgment on the Application of Collateral Estoppel to Facts and Conclusions Established in the Securities and Exchange Commission v. Sam Wyly et al. Litigation [ECF No. 611] (the "**Motion for Partial Summary Judgment**"), seeking this Court's determination that certain findings of fact and conclusions of law made in connection with a civil action pending in federal district court in the Southern District of New York (the "**SDNY Court**") were binding on the Debtors in connection with this Court's resolution ***357** of the Motions and the Claim Objections. In summary, the Securities and Exchange Commission (the "**SEC**") sued Sam and his brother, Charles Wyly ("**Charles**"), [7] among others, for securities fraud in connection with certain securities transactions undertaken by various offshore trusts and other offshore corporations that Sam and Charles were associated with in a case styled *SEC v. Wyly et al.,* Case No. 10–5760–SAS (S.D.N.Y.) (the "**SEC Action**"). Following a jury trial on the liability phase and a bench trial on the remedies phase of the SEC Action, the SDNY Court entered judgment against Sam and the probate estate of Charles, who died in 2011, for $123,836,958.75 and $63,881,743.97, respectively, plus prejudgment interest. [8] The SDNY Court's decision contained numerous findings of fact that either the jury or it had made, along with its conclusions of law, which the IRS sought to have this Court give collateral estoppel effect to here, as these same offshore trusts and other offshore corporations and the transactions that they engaged in for a number of years are at the heart of the IRS' tax claims against the Debtors here.

For the reasons stated in its Memorandum Opinion and Order [ECF No. 789] entered on August 24, 2015, this Court granted the IRS' Motion for Partial Summary Judgment, thereby giving collateral estoppel effect to sixty-four (64) specific facts and/or legal conclusions established in the SEC Action. [9] While the Court will not repeat them here, it adopts them and will quote them and/or discuss them when relevant to this Court's specific determinations here. [10]

As will be explained more fully below, of particular significance here is the SDNY Court's determination that certain of the offshore trusts at issue in the SEC Action and here are foreign grantor trusts of Sam and Charles. Because of this determination by the SDNY Court, and because this Court has given collateral estoppel effect to the SDNY Court's determination, the Debtors and the IRS agree that there were substantial underpayments of income ***358** taxes by the Debtors, [11] including (i) for Sam tax years 1992 through 2003, 2005 through 2006, and 2010, and (ii) for Dee tax years 1992, 1994 through 2003, 2006, 2008, 2011, and 2013. [12]

The reference above is the first time that the Court has used the phrase "foreign grantor trust" in this opinion and it will use it and other related terms throughout this opinion. Of course, it is important to understand what the Court is referring to when using these terms. A foreign trust is defined in 26 U.S.C. § 7701 as "any trust other than a trust described in subparagraph (E) of paragraph (30)." [13] Subparagraph (E) of paragraph (30) in turn defines when a trust can be considered a "United States person," which is if "(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and (ii) one or more United States persons have the authority to control all substantial decisions of the trust." [14] In other words, if the trust is not subject to primary supervision by a court within the U.S. and control over the trust is exercised by a non-U.S. person, it is a foreign trust. The difference between grantor and non-grantor trusts is explained as follows:

> Although trusts are usually separate taxable entities, the grantor trust rules may require that a portion or all of a trust be ignored for income tax purposes. When this occurs, the grantor (or in some cases a beneficiary or trust powerholder) is deemed to own the trust assets. When the assets of a trust are deemed owned by its grantor under Sections 671 through 677 or Section 679 of the Internal Revenue Code

> (the Code), the trust is called a "grantor trust."[15]

The "grantor trust rules" referred to above are contained in 26 U.S.C. §§ 671 through 679.[16] By implication, a trust that is not a "grantor trust" is a "non-grantor trust," and is treated as its own taxable entity under the Internal Revenue Code.

C. United States' Motion to Exclude the Expert Report, Opinions, and Testimony of Joshua S. Rubenstein

The IRS filed a Motion to Exclude the Expert Opinions of Joshua S. Rubenstein [ECF No. 923] (the "**Rubenstein Motion**") prior to trial. Because the Rubenstein Motion was heard the day before trial was scheduled to commence, and because the Court did not have sufficient time to rule on the Rubenstein Motion before the Debtors called Mr. Rubenstein ("**Rubenstein**") to testify at trial, the Court allowed Rubenstein to testify, subject ***359** to his testimony being stricken if the Court decided to grant the Rubenstein Motion. For the reasons explained below, the Rubenstein Motion is granted in part and denied in part. Those portions of Rubenstein's testimony that are excluded are stricken from the record.

Rubenstein is a lawyer and partner at the firm of Katten Muchin Rosenman, LLP. The Debtors offered Rubenstein as an expert in "trust and estate law and taxation of trusts, with specific experience and knowledge regarding these areas during the 1990s, and also as an expert regarding practices concerning the establishment and administration of foreign trusts during the 1990s."[17] Rubenstein was to provide "an opinion as to how practitioners advised clients with respect to the application of the grantor trust rules to foreign trusts during the 1990's (the 'relevant time period') and how foreign trusts, as opposed to domestic trusts were drafted and administered at the time."[18] The purported purpose of Rubenstein's opinion is to assist the Court in the evaluation of the Debtors' reasonable cause defense to their failure to file Forms 3520, 3520–A, and 5471, as well as to assist the Court in its evaluation of the Debtors' alleged fraudulent intent for purposes of the IRS' recovery of fraud penalties under 26 U.S.C. § 6663.[19]

In the Rubenstein Motion, the IRS objected to Rubenstein's proposed testimony on multiple grounds. First, the IRS contended that Rubenstein's opinions would consist of statements of the law and legal analysis that would usurp this Court's role as both fact finder and the "one spokesman of the law."[20] Second, the IRS argued that Rubenstein's failure to apply his expert knowledge to the specific facts of these Cases made his opinions both irrelevant and unreliable under *Daubert* and Federal Rule of Evidence 702.[21] Finally, the IRS argued that Rubenstein's lack of experience with private annuity transactions in a foreign trust context rendered him unqualified under Federal Rule of Evidence 702 to give any opinion related to the private annuity transactions at issue here.[22]

[1] **[2]** We turn first to the IRS' argument that Rubenstein's opinion consisted of impermissible recitations of the law and legal conclusions. It is all but axiomatic that the judge should be the sole source of the applicable legal standard in any case, and that expert testimony that attempts to tell the fact finder what law to apply is improper.[23] Likewise, expert testimony that states a legal opinion that tells the fact finder what result to reach is improper.[24]

Much of Rubenstein's expert opinion consisted of explanations of what Internal Revenue Code provisions and IRS regulations did or do not allow during the relevant ***360** time period or today. For example, at one point Rubenstein testified that, until 2010, it was permissible under the law for a beneficiary of a foreign non-grantor trust to engage in uncompensated use of trust property without paying tax on the fair rental value of that use.[25] Testimony such as this—which explained black letter law as it stands today or as it stood in years past—consisted of legal conclusions and was therefore inadmissible. This Court is capable of determining the law applicable to the Cases on its own, without Rubenstein's assistance. All of Rubenstein's testimony that simply told the Court what the law was or is will be stricken.

However, not all of Rubenstein's testimony consisted of statements that were simply impermissible legal analysis, opinions, and conclusions. In addition to giving general statements of both past and present law, Rubenstein also made statements that the law that governed offshore trusts and the tax treatment of such trusts during the relevant time period was, in the eyes of many practitioners, including him, uncertain.[26] The purported purpose of this testimony was, again, to assist the Court in assessing the Debtors' reasonable cause defense and the presence or absence of fraudulent intent [27] —*i.e.,* according to the Debtors, given the fact of uncertainty among experienced tax professionals, how could the Debtors possibly have acted with fraudulent intent here? More specifically, the Debtors argue that if lawyers practicing in the area of cross-border trust and estate taxation felt that the law governing the taxation of offshore trusts like the ones at issue here was uncertain, then this in turn would tend to corroborate that the Debtors were uncertain about the state of the law, and any missteps that the Debtors made in following that law would be more reasonable and less likely to be fraudulent.

[3] The admissibility of this testimony regarding the fact of alleged uncertainty among members of the cross border trust and estate and tax bars as to how to interpret and apply the law during the relevant time period was a close call. As the Fifth Circuit has noted, "the task of separating impermissible questions which call for overbroad or legal responses from permissible questions is not a facile one." [28] In general, a fact finder is "qualified to determine intelligently and to the best degree possible both the reasonableness of a client relying upon the advice of an attorney ... retained to render such advice and whether the client did so in good faith after making full disclosure" on its own, and that "expert testimony as to the legal basis underlying the advice" does not assist the fact finder. [29] However, *in U.S. v. Burton,* [30] the Fifth Circuit also stated that:

> Evidence of legal uncertainty, *except as it relates to defendant's effort to show* ***361** *the source of his state of mind,* need not be received, at least where, as here, the claimed uncertainty does not approach vagueness and is neither widely recognized nor related to a novel or unusual application of the law.

The Debtors have not introduced any evidence that the purported uncertainty in the law at issue here approached vagueness, a phrase that harkens back to the Fifth Circuit's decision in *U.S. v. Garber,* [31] which in turn seems to have been limited to its "unique, indeed near bizarre, facts." [32] However, even if they did, the Court concludes that Rubenstein's testimony regarding the fact of uncertainty as to the law among the relevant bars during the relevant time period need only be admitted if the Debtors *knew of* this legal uncertainty, as this is the only way this legal uncertainty could have affected their states of mind.

[4] As explained below, knowledge that there was uncertainty regarding the proper legal characterization of the various offshore trusts at issue here can be imputed to Sam and Charles back to 1993. [33] Moreover, the evidence shows that by 2003 at the latest, Sam and Charles had actual knowledge of this uncertainty. [34] Thus knowledge of this legal uncertainty may have had some influence on Sam's and Charles' states of mind. On this basis, Rubenstein's testimony regarding the fact that there was uncertainty as to the law among the bar is relevant and admissible, and is not an impermissible legal conclusion. However, for the reasons more fully explained below, the Court gives this testimony little weight.

As the IRS pointed out in its cross-examination of Rubenstein, Rubenstein offered no opinion as to (and was unaware of) whether Sam, Charles, or any Wyly advisor felt that there was any uncertainty in the applicable law during the relevant time period. [35] Rubenstein's failure to connect his testimony to the specific facts of the Cases makes his testimony of less use in evaluating Sam's and Charles' actions or intent, [36] and thus the Court gives this testimony little weight.

In closing out the analysis of the IRS' first argument—that Rubenstein's testimony consisted of impermissible legal conclusions—the Court will identify other testimony that Rubenstein gave that did not consist of impermissible legal conclusions. Although Rubenstein is a lawyer, this does not automatically mean that all of his testimony must therefore consist of statements of the law or legal conclusions. Rubenstein is permitted to "testify as to legal matters when those matters involve questions of fact." [37] Here, Rubenstein offered ***362** testimony as to whether certain practices—such as the settlement of trusts with nominal amounts of money, the use of protectors [38] with expansive powers, or the use of "accommodation grantors" [39] —were viewed as normal or proper by the cross-border trust and estate and tax bars during the relevant time period. The question of what members of the bar thought, as opposed to what the actual state of the law was, is a factual one. Although counsel for the Debtors or the IRS can explain what the true state of the law during the relevant time period was or is today via briefing or oral argument, proving what the cross-border trust and estate and tax bars *thought* the law was or how they *viewed* the law is a factual inquiry that requires resort to expert testimony as opposed to argument. Rubenstein's testimony regarding the views of the bar during the relevant time period—like his testimony regarding the fact of uncertainty in the law during the relevant time period—is admissible. However, the Court must still analyze the relevance and reliability of such testimony under *Daubert.*

[5] Thus, we turn to the IRS' second argument, that Rubenstein's testimony is inadmissible because it is irrelevant and unreliable under *Daubert* and Federal Rule of Evidence 702. Two Supreme Court cases guide our analysis of the admissibility of expert opinion evidence on the basis of whether it is both relevant and reliable: *Daubert v. Merrell Dow Pharm., Inc.* [40] and *Kumho Tire Co., Ltd. v. Carmichael.* [41] At the outset, we note that this is a bench trial and that "[m]ost of the safeguards provided for in *Daubert* are not as essential in a case ... where ... a ... judge sits as the trier of fact in place of a jury." [42] This makes perfect sense, as this Court's "chief role when determining the admissibility of expert testimony under *Daubert* is that of a 'gate-keeper,' " [43] and there is little need for the Court to serve as a gate-keeper for itself.

[6] Nevertheless, the basic holding of *Daubert,* as expanded upon by *Kumho Tire Co., Ltd.,* is very simple—in order to be admissible, expert testimony must be both (i) relevant, and (ii) reliable. [44] *Daubert* defined the standards for admissibility of expert opinion evidence under Federal Rule of Evidence 702, and was decided within the specific context of a scientific expert. [45] In *Kumho Tire Co., Ltd.* [46] the ***363** Supreme Court explained how to apply *Daubert's* holding and its specific indicia of reliability to non-scientific testimony:

> We conclude that *Daubert's* general holding—setting forth the trial judge's general "gatekeeping" obligation—applies not only to testimony based on "scientific" knowledge, but also to testimony based on "technical" and "other specialized" knowledge. *See* Fed. Rule Evid. 702. We also conclude that a trial court may consider one or more of the more specific factors that *Daubert* mentioned when doing so will help determine that testimony's reliability. But, as the Court stated in *Daubert,* the test of reliability is "flexible," and *Daubert's* list of specific factors neither necessarily nor exclusively applies to all experts or in every case. Rather, the law grants a district court the same broad latitude when it decides how to determine reliability as it enjoys in respect to its ultimate reliability determination. *See General Electric Co. v. Joiner,* 522 U.S. 136, 143, 118 S.Ct. 512, 139 L.Ed.2d 508 (1997) (courts of appeals are to apply "abuse of discretion" standard when reviewing district court's reliability determination).

[7] **[8]** **[9]** As indicated by the Supreme Court in *Kumho Tire Co., Ltd.,* [47] the relevance and reliability inquiry under *Daubert* is necessarily very fact specific. [48] Furthermore, a trial court's decision whether to admit expert testimony, and how to determine the reliability of such testimony, is subject to an abuse of discretion review. [49] According to the Fifth Circuit, "[d]istrict courts enjoy wide latitude in determining the admissibility of expert testimony, and the discretion of the trial judge and his or her decision will not be disturbed on appeal unless manifestly erroneous." [50]

The IRS' main argument as to why Rubenstein's testimony does not pass muster under *Daubert* is that Rubenstein did not opine on anything the Wylys did or any facts specific to the Cases. Instead, Rubenstein gave a general assessment of what the bar thought was normal or proper practice regarding offshore trusts during the relevant time period and opined as to areas where the bar thought that the law was uncertain. At the outset, the Court notes that the language of Federal Rule of Evidence

702(d) requiring an expert to apply their principles and methods "to the facts of the case" does not per se exclude expert testimony that does not refer to the facts of the particular case before the fact finder. [51] However, despite the permissibility of "general principles" expert testimony, such expert testimony is not automatically relevant.

***364** As the IRS pointed out during its cross-examination of Rubenstein, Rubenstein does not apply his concept of normal or proper practice to the facts of the Cases or to anything that the Wylys did. [52] Nor does he know whether the Wylys or their advisors viewed the law governing their offshore transactions as uncertain. [53] Thus, this Court has no way of knowing whether the scope of normal or proper practice that Rubenstein describes encompasses anything that the Wylys did. Nor is this Court able to say for certain whether the legal uncertainties that Rubenstein described influenced the Wylys or their advisors. The lack of connection between Rubenstein's testimony and the Wylys' actions raises relevance concerns.

Despite these concerns, Rubenstein's testimony that, during the relevant time periods: (i) the use of protectors in the context of foreign trusts was permissible and even common, (ii) de facto control of trustees by grantors was not out of the ordinary, and (iii) the use of "accommodation grantors" was thought to be legitimate is admittedly of some relevance here. It is helpful for the Court to understand that these practices—in and of themselves—were not considered to be inappropriate by the cross-border trust and estate and tax bars during the relevant time period. [54] However, without any opinion as to whether the manner in which the Wylys themselves implemented their offshore system falls within the scope of the "usual" practices that Rubenstein describes, the Court can draw few useful conclusions from Rubenstein's testimony. While the Court can conclude that, in at least some situations, the use of protectors, accommodation grantors, and other devices that Rubenstein described was seen by the trust and estate and tax bars during the relevant time period as appropriate, the Court has no way of knowing how these same bars would have viewed the Wylys' particular uses of these same devices. Though there is admittedly some relevance to Rubenstein's testimony, it is limited.

Despite its limited relevance, Rubenstein's opinions are reliable for what they are as shown by his curriculum vitae (CV), testimony at the *Daubert* hearing, and testimony at trial—his recollections based on his experience as an admittedly prominent and accomplished cross-border trust and estate and tax lawyer who practiced during the relevant time period, coupled with some confirmatory research. [55] Rubenstein's opinions were testable both by exploring the research that was cited in his expert report and by probing the accuracy of his own recollections. Indeed, the IRS did this at trial by pointing out that Rubenstein did not speak to any practitioners specifically to confirm his recollection of the cross-border trust and estate and tax bars' views during the relevant time period. Nevertheless, Rubenstein did engage in substantial research and pointed out ***365** that he spoke to practitioners "every day of every week" in the course of his work. [56]

[10] As the Supreme Court counseled in *Daubert,* [57] "[v]igorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence." Despite the various issues with Rubenstein's testimony, this Court finds that Rubenstein's opinions that are not impermissible legal conclusions are somewhat relevant and reliable, and therefore admissible under the principles of *Daubert.* [58] As this is a bench trial, the Court need not be concerned with any possible undue prejudice outweighing the probative value of Rubenstein's testimony under Federal Rule of Evidence 403. [59] The Court is capable of giving Rubenstein's testimony its proper weight, which it views as limited in light of the concerns outlined above.

[11] Finally, we address the IRS' third argument—that Rubenstein was not qualified to give an opinion on the private annuity transactions at issue here. The IRS argued that Rubenstein's lack of experience with private annuity transactions in a foreign trust context rendered him unqualified under Federal Rule of Evidence 702 to give any opinion related to the private annuity transactions at issue here. [60] According to the Fifth Circuit, qualification of experts should not become a battle of labels, where the expert's expertise is labeled broadly and the needed expertise is labeled narrowly in an attempt to disqualify experts. [61] Furthermore, the Fifth Circuit has stated that "it is well established that an expert's qualifications depend upon his knowledge, skill, experience, training, or education, and the trial court is afforded the widest possible discretion in deciding whether a witness qualifies as an expert" [62] and that those challenging a trial court's determination that an expert is qualified or not face a "heavy burden." [63]

Rubenstein is an experienced cross-border trust and estate and tax lawyer, as his CV amply demonstrates. [64] Furthermore, Rubenstein's uncontradicted testimony was that utilizing a foreign trust, as opposed to a domestic trust, does not change the character of the private annuity transaction itself. [65] Thus, Rubenstein's experience advising taxpayers as to annuities issued by domestic trusts makes him qualified to testify here. For these reasons, the Court rejects the IRS' argument and will permit Rubenstein's testimony to the extent set forth above.

*366 D. Dee's Motion for Partial Summary Judgment

Dee filed a Motion for Partial Summary Judgment [ECF No. 879] on November 16, 2015, seeking to have this Court determine that there was no evidence in the record to support the IRS' claim for fraud penalties under 26 U.S.C. § 6663. The IRS opposed Dee's motion, which motion was heard on December 21, 2015, shortly before trial was scheduled to commence. Given (i) other more pressing matters in preparing for trial, and (ii) the timing of when the parties filed briefs on Dee's innocent spouse defense, which the Court wanted to read and understand before ruling on her motion for partial summary judgment, the Court simply ran out of time to rule on her motion before trial. The motion is now moot, as the issues were fully tried by the parties.

III. FACTUAL AND PROCEDURAL HISTORY

While the parties stipulated to many facts as noted previously, the Court will briefly summarize certain facts in order to put its legal analysis into context. This summary is, by definition, incomplete, and more facts will be found and analyzed throughout this Memorandum Opinion.

As noted previously, Sam and Charles are brothers who grew up in modest circumstances in northeast Louisiana. Charles was about a year older than Sam and they were close friends and business associates throughout their adult lives. As relevant here, Sam founded his first company, University Computing Company in 1963. [66] At this point he brought in Charles—who had been working in Houston for IBM—and grew University Computing Company to a successful public company. [67] Then, Sam and Charles bought the Bonanza Steakhouses company when it was insolvent and grew it from 15 or 20 stores to about 600 stores; [68] bought Gulf Insurance whose business included annuities; [69] founded Earth Resources; [70] bought Computer Technology company; [71] and founded Datran, an innovative firm that attempted a digital data transmission business in competition with AT & T. [72] Sam then co-founded Sterling Software, Inc. ("**Sterling Software**") with Charles and served as its Chairman of the Board from 1981 through its acquisition by Computer Associates in 2000. [73] The common stock of Sterling Software was publicly traded on the New York Stock Exchange. [74]

Sam was the Chairman of the Executive Committee and a Director of Sterling Commerce, Inc. ("**Sterling Commerce**") from December 1995 through its acquisition by SBC Communications in 2000. [75] The common stock of Sterling Commerce was publicly traded on the New York Stock Exchange. [76] Sterling Commerce was a wholly owned subsidiary of Sterling Software until March 1996 when Sterling Commerce completed an initial public offering in which it sold approximately 18.4% ***367** of its outstanding common stock. [77] In September 1996, Sterling Software declared a special dividend and distributed all the Sterling Commerce shares it owned to all the Sterling Software shareholders. [78]

Sam was the Chairman of the Board of Michaels Stores, Inc. ("**Michaels Stores**") from 1984 through July 2001 and Vice–Chairman of the Board from July 2001 through its acquisition by a consortium of private equity firms in 2006. [79] The common stock of Michaels Stores was publicly traded on the New York Stock Exchange. [80]

Charles was a co-founder of Sterling Software and served as its Vice–Chairman of the Board from 1984 through its acquisition by Computer Associates in 2000. [81] Charles was a member of the Executive Committee and a Director of Sterling Commerce from December 1995 through its acquisition by SBC Communications in 2000. [82] Charles was the Vice–Chairman of the Board of Michaels Stores from 1984 through July 2001 and the Chairman of the Board from July 2001 through its acquisition by a consortium of private equity firms in 2006. [83] Charles was killed in an automobile accident in Colorado on August 7, 2011. [84]

Given the wide variety of business ventures Sam and Charles were involved in, they needed administrative help. Sharyl Robertson ("**Robertson**") started working for the Wylys as a bookkeeper in the late 1970s and eventually became chief financial officer of Highland Stargate, Ltd., a Texas Limited Partnership, which is the Wyly family office located in Dallas ("**Highland Stargate**" or "**Wyly family office**"). [85] In late 1998, she left that position and became employed full time by Maverick Capital, Ltd. ("**Maverick**"), an investment management company that was established and initially run by Sam and his eldest son, Evan. [86]

Keeley Hennington ("**Hennington**") began working for Highland Stargate in January 1999 as tax director. [87] She became chief financial officer of Highland Stargate in June 2000 and still remains there in that position today. [88]

Given the wide variety of business ventures the Wylys were involved in, they also needed legal help. Michael French ("**French**") is an attorney licensed to practice law in Texas. [89] He was an equity partner in the law firm of Jackson Walker from 1976 through 1992 and a non-equity partner in that firm from 1992 through 1995. [90] Jackson Walker was the Wylys' law firm and French was their primary lawyer, controlling the Wyly business within the firm.

French testified that he left Jackson Walker to become a consultant to two Wyly-related entities—Sterling Software and Michaels Stores. [91] French also testified ***368** that after leaving Jackson Walker he worked with the Wylys to help set up Maverick, which was an investment management business. [92] When asked why he left Jackson Walker, French had a one-word explanation —"money." [93] He then elaborated, "I made more money as a consultant to Sterling Software and Michaels Stores and the other activities, Maverick activities." [94]

When Jeannette Meier, the general counsel of Sterling Software, expressed a preference for Jones Day as an outside law firm, French also became a "consultant" to Jones Day from 1995 through 2000, after which Jones Day started doing work for Sterling Software and Michaels Stores. [95] French was paid a consulting fee by Jones Day for bringing Wyly business to the firm. [96]

Starting in 1995, French officed with the Wylys at the Wyly family office. From 1993 to 2000, the Wylys decided the amount of French's total compensation paid by entities controlled by or affiliated with them. [97] In 1996, Sam and Evan promised French that his income would be at least $1.5 million per year or the Wylys would personally pay him the difference between what he made from the Wyly related entities and $1.5 million. [98] French also served as a director of Michaels Stores from July 1992 through March 2000, and as a director of Sterling Software from September 1992 through August 2000. [99]

Dee is Charles' widow, having met and married him during college at Louisiana Tech. [100] Dee did not finish college after Charles and she were married. [101] Charles and she had five children and she was their primary caregiver. [102] During her 50 plus year marriage to Charles, Dee was a homemaker. [103] She was not involved in Charles' business ventures and did not talk business with him. [104] Charles provided for the family financially and Dee took care of their home. [105]

By 1990, Sam and Charles had accumulated enormous wealth. As the SDNY Court found, and was independently established here, "in early to mid–1991, Sam Wyly asked Robertson to attend a seminar held by lawyer and trust promoter David Tedder ["**Tedder**"] on the use of foreign trusts as a method of asset protection and tax deferral." [106] Robertson circulated a ***369** memo about Tedder's proposed system of "Asset Protection and Tax Deferral" (the "**Tedder Seminar Memo**") to Sam, Charles, Evan, French, and an in-house CPA, Ethel Ketter. [107] In the Tedder Seminar Memo, Robertson identified six goals, four of which implicated the IRS: [108]

> 1. Never pay probate unless there is a tax advantage in your state (not in Texas).
>
> 2. Whenever possible eliminate inheritance tax—Tedder says everyone can reduce it to zero.
>
> 3. Wherever possible reduce income tax—both domestically and foreign.
>
> 4. Never let a creditor get your asset, no matter how bad your mistake. (In 18 years of practice, Tedder's firm has never had a creditor successfully pierce the asset protection setup).[109]
>
> 5. Be able to change your asset protection/tax savings system.
>
> 6. Feel comfortable with the setup you've got. If your [*sic*] not comfortable with a foreign setup don't do it.

The Tedder Seminar Memo further identified "[t]he three major sources of creditor problems—unknown creditor, IRS-inheritance, IRS-income tax."[110]

The Tedder Seminar Memo also warned to "[a]lways show your chart to the creditor, rely on law not secrecy."[111] The Tedder Seminar Memo also laid out an aggressive tax transaction in which assets are exchanged to a foreign system for an annuity, warning that due to the aggressive nature of the transaction that the taxpayer should "file every tax form available and any support schedule that seems pertinent."[112] Tedder later provided the Wylys with written information about his firm's view of asset protection, including a document entitled "An Overview of Asset Protection Estate and Income Tax Reduction Using Domestic and International Structures."[113] The goal, as stated in the overview, "is to ensure that a creditor will never be able to touch or get control of your assets, and allow you to maintain complete control of all your assets."[114]

Sam was interested in the programs outlined in the Tedder Seminar Memo and related documents. Thus, as found by the SDNY Court, and independently established here, "[s]hortly thereafter, the Wylys, Robertson, and French attended another Tedder seminar in New Orleans."[115] There, Tedder gave a presentation about ***370** the tax advantages of foreign trusts.[116] The SDNY Court also found, as do we, "Tedder, French, and the Wylys then had a private meeting at Sam Wyly's house in Malibu, California. At that meeting, Tedder 'talked about establishing trusts that would provide tax deferral, and how the Wylys could transfer assets to those trusts and get tax deferral on the growth of those assets.' "[117]

Specifically, in Malibu, Tedder told the Wylys that they could establish offshore trusts in the Isle of Man ("**IOM**") and transfer their stock options in Michaels Stores and Sterling Software to those trusts in exchange for annuities.[118] Tedder further stated that capital gains earned on securities held in the Isle of Man Trusts would not be taxed by U.S. tax authorities. As the SDNY Court found, as do we, "Tedder recommended transferring the Wylys' stock options in Sterling Software and Michaels Stores to a foreign trust in exchange for a private annuity 'in a tax-free kind of transaction.' Under Tedder's plan, it was 'expressly intended that [the Wylys] ... irrevocably surrender the enjoyment, control, ownership, and all economic benefits attributable to the ownership of the [options] which are sold in exchange for the private annuity.' "[119]

In part because of the complexity of the record keeping required to support the Wyly offshore system, and in part because of their desire for secrecy and to make access to the records of the offshore system more difficult for their creditors, including the IRS, to obtain if there was ever a challenge to the offshore system, Sam and Charles implemented an offshore version of their Dallas family office in the mid–1990s called Irish Trust Company ("**Irish Trust**"), an entity domiciled in the Cayman Islands and indirectly owned by two of the Wyly IOM trusts.[120]

Michelle Boucher ("**Boucher**") became a trusted Wyly advisor in approximately 1995 and then became a protector of the Wyly IOM trusts in 2001.[121] Boucher is a ***371** Canadian citizen who resides in the Cayman Islands.[122] The Wylys first met Boucher when she was working for MeesPierson in the Cayman Islands, where one of her clients was Maverick.[123] Acting on behalf of Sam and Charles, Robertson approached Boucher around 1995 and offered her a position as chief financial officer of Irish Trust.[124] Boucher accepted and continued in this position until 2010, when her role changed to consultant to Irish Trust.[125] Boucher remains at Irish Trust today.

At Irish Trust, Boucher reported to Robertson, French, and later Donnie Miller (Dee's son-in-law and executor of Charles' probate estate), and Evan (Sam's eldest son).[126]

Prior to becoming a trust protector herself, Boucher served as a conduit, the person who communicated the Wylys' recommendations between the protectors (Robertson and French) and the various IOM trustees.[127] Francis Webb, an employee of IFG, one of the trust management companies who served as trustee for certain of the Wyly IOM trusts,[128] summarized a meeting with French and Robertson concerning the hiring of Boucher and the movement of all records concerning the Wyly IOM trusts to the Cayman Islands in a memorandum dated September 29, 1995.[129] Webb's memorandum states that French and Robertson were concerned about the trail of communications to the trustees and records maintained in the United States:[130]

> We were already aware of the roles played by Michael French and Sharyl Robertson, representing Maverick Capital and the Wyly Family, and firstly the role of Michelle Boucher was explained.... *We will therefore have prime contact with Michelle in most situations as she is to act as the focus of communications and maintain records etc. which should not be seen in the USA....Michael and Sharyl are anxious that any trail of communications between themselves, Michelle and MeesPierson does not give rise to any potential claim that control is being exercised in the USA. Consequently we may anticipate that there will be telephone communications only from Dallas; suggestions possibly put forward via Michelle Boucher but it was agreed that there should be formal recommendations made by the Trustees to the Protectors Committee wherever appropriate to maintain a required direction of control.*

After a chance meeting in the Cayman Islands in mid–2003 between Charles Lubar ("**Lubar**"), a prominent international tax attorney, and Boucher, Boucher learned that Lubar (i) had previously concluded that there was a "significant risk" that the 1992 IOM trusts settled by Sam and Charles would be treated as grantor trusts to them under the Internal Revenue Code, and (ii) had informed French of his firm's conclusions a decade earlier.[131] ***372** Boucher informed Hennington, which led to a flurry of activity.[132]

First, Hennington and Boucher met with Lubar at his London office where Lubar's concerns with the offshore system dating back to 1993 were discussed in detail. Hennington and Boucher informed Sam and Charles, among others, of Lubar's legal conclusions.[133] Of note, while numerous witnesses at trial expressed surprise over this news because it was contrary to other advice that had been allegedly received,[134] Sam was not one of the witnesses expressing surprise.[135]

Second, acting as agents for Sam and Charles, Hennington and Boucher hired Lubar to reanalyze all of the issues surrounding the Wyly offshore system, which he did and which confirmed his original conclusions. Lubar ultimately recommended an anonymous meeting with the IRS on the Wylys' behalf to see if a global resolution of the tax issues surrounding the Wyly offshore system could be achieved, which recommendation the Wylys ***373** accepted and authorized.[136] Thus, in August 2003, Lubar and other Wyly attorneys had a meeting with the IRS, on an anonymous basis, to discuss the Wyly IOM offshore system and activities undertaken offshore in an attempt to secure a global resolution of the Wyly's looming tax issues.[137] Although the parties have different perspectives on this meeting, it is sufficient for our purposes to simply state that nothing ultimately came from this meeting.

Third, because the extended due date of Sam's 2002 tax return was quickly approaching (October 15, 2003), and given that Meadows Owens had been advising the Wylys for years and had apparently given advice to them previously about the offshore system,[138] the Wylys, acting through Hennington, requested additional advice from Meadows Owens.[139] By this time, the primary lawyer at Meadows Owens that the Wylys used, Rodney Owens ("**Owens**"), had passed away.[140] However, other

Meadows Owens attorneys that had worked with Owens on Wyly matters—primarily Charles Pulman ("**Pulman**") and Trey Cousins ("**Cousins**")—met with Hennington and quickly made recommendations on available alternatives, one of which was that the Wylys make formal disclosures of the tax positions identified by Lubar on their tax returns. Specifically, Meadows Owens recommended that Sam file a Form 8275 disclosure with his about-to-be filed 2002 tax return, which is a from that can be filed with the IRS when the position being taken on a tax return has only a reasonable basis of being sustained, in order to attempt to avoid accuracy related penalties from being imposed by the IRS. [141] Because Dee and Charles had already filed their 2002 joint tax return, Meadows Owens recommended that Dee and Charles file a Form 8275 disclosure with their 2003 joint tax return (filed in October 2004), which they did. [142]

Early in 2004, the IRS commenced an audit of the Wylys' returns for the 2000 tax year. From the beginning of the audit it was clear that the IRS was examining the offshore trusts and the annuity transaction undertaken offshore. [143]

The Permanent Subcommittee on Investigations of the United States Senate undertook an investigation of tax haven abuses. The Wylys offshore system was one of the offshore systems investigated. That investigation became public knowledge ***374** sometime in 2005. [144] Hennington testified that attorneys hired by the Wylys reviewed all of the files maintained in the Wyly family office and over 700 boxes of documents in off-site storage in response to document requests made in relation to the investigation. [145]

By April of 2005, Bickel & Brewer and Donald Lan [146] of Kroney Mincey PC were hired as counsel for the Wylys to handle the government's on-going tax and securities investigations. Prior to the filing of the Wylys' 2005 federal income tax returns in October 2006, Bickel & Brewer learned that certain IOM trusts settled in 1994 and 1995 had not been funded with the amount of funds required by the trust deeds of settlement, [147] which raises additional concerns about the validity of the IOM offshore system as will be discussed *infra* at pp. 415–23.

On July 30, 2010, the SEC sued Sam, Charles, and French, among others, in the SEC Action, asserting ten counts of securities fraud. French settled with the SEC. [148] As noted previously, following a jury trial on the liability phase and a bench trial on the remedies phase of the SEC Action, the SDNY Court entered judgment against Sam and the probate estate of Charles, for $123,836,958.75 and $63,881,743.97, respectively, plus prejudgment interest, [149] finding that Sam and Charles had committed securities fraud. This decision is currently on appeal to the Second Circuit Court of Appeals.

On October 19, 2014, shortly before judgment was entered against him in the SEC Action, Sam filed his Case here. Shortly thereafter, Dee filed her Case here. The Cases are being jointly administered. On the day each Case was filed, the Debtor's respective Motion was filed. The IRS timely filed the Proofs of Claim against each of the Debtors and the Debtors filed the Claim Objections, which brings us to the present dispute before the Court.

IV. LEGAL ANALYSIS

A. Burden of Proof

Like most aspects of the Cases, the burden of proof analysis is complicated. The fact that the IRS is asserting federal tax liability in the context of the Proofs of Claim implicates not only the burden-shifting analysis applicable to proofs of claim in bankruptcy generally, but also multiple additional burden shifting doctrines and statutory allocations of burdens of proof that apply specifically to tax matters. None of these burden of proof analyses are exactly alike, so the Court will proceed in the only way it can—by analyzing each burden of proof framework before coming to its ultimate conclusions.

1. Bankruptcy Law Burden of Proof—In General

[12] **[13]** In bankruptcy, a proof of claim filed in accordance with Bankruptcy Rule ***375** 3001 [150] is "prima facie evidence of the validity and amount of the claim." [151] However, this prima facie validity may be rebutted [152] by the objecting party producing evidence "of a probative force equal to that of the creditor's proof of claim." [153] In 2000, the Supreme Court held, in a bankruptcy case involving a proof of claim asserting tax liability, "bankruptcy does not alter the burden imposed by the substantive law."[154] Thus, once an objecting party produces evidence rebutting a proof of claim, the burden then lies with whichever party it would normally according to the relevant substantive law.[155] Here, that relevant substantive law is federal tax law, which often, but not always, puts the initial burden of proof on the taxpayer.

The Debtors' arguments here regarding burden of proof implicate every step of the bankruptcy burden of proof analysis, to which we now turn.

a) Prima Facie Validity under Bankruptcy Rule 3001(f)

The Debtors initially argue that the burden of proof lies with the IRS because the Proofs of Claim were not filed in accordance with Bankruptcy Rule 3001, and thus do not constitute prima facie evidence of the validity or amount of the IRS' claims.[156] In particular, the Debtors argue that the Proofs of Claim fail to comply with Bankruptcy Rule 3001 for three reasons: (i) they do not contain an itemized statement of the interest, fees, expenses, or charges required in individual bankruptcies under Bankruptcy Rule 3001(c)(2)(A),[157] (ii) they were not executed in accordance with Official Form 10 as required by Bankruptcy Rule 3001(b) because the IRS bankruptcy specialist who signed the Proofs of Claim "signed and filed the IRS Claims without any factual basis whatsoever, instead relying on IRS staff professionals to investigate and prepare the forms for his signature,"[158] and (iii) they lack sufficient information for the Debtors to evaluate the bases of them.[159] The Debtors also argue that the IRS' supposed missteps in failing to comply with Bankruptcy Rule 3001 are exacerbated by the fact that the Proofs of Claim contained numerous errors.[160]

Although much of the "fuss" surrounding the burden of proof issues revolved around the now-stipulated income tax liability amounts reflected in the Computation Stipulations, the Court undertakes the ***376** burden of proof analysis because of its potential relevance to other areas of dispute in the Cases.[161] For the reasons explained below, the Court rejects the Debtors' arguments and will accord prima facie validity to the Proofs of Claim.

Regarding the failure of the IRS to attach an itemized statement of the interest, fees, expenses, or charges to the Proofs of Claim, it must first be noted that such failure was not complete. In the Proofs of Claim filed by the IRS in these Cases, the IRS did break out the amount of income tax due and interest on income tax due on a year-by-year basis, as well as the amount of gift tax due and interest on gift tax due on a year-by-year basis.[162] However, the IRS did not similarly break out the amounts of penalties due on a year-by-year basis.[163] For the reasons explained below, the Court concludes that this failure was harmless under the highly unique facts of these Cases.

Bankruptcy Rule 3001(c)(2)(D) provides the appropriate remedies that a court *may* invoke for a creditor's failure to attach the itemized statement required by Bankruptcy Rule 3001(c)(2)(A). These remedies include precluding the IRS from presenting the omitted information (unless the Court determines that the IRS' failure to include this information "was substantially justified or is harmless"[164]) or awarding other appropriate relief.

In light of the highly unique facts of these Cases, the Court does not choose to exercise either of these (or any other) remedies. These Cases involved a great deal of back-and-forth between the parties, as is to be expected when billions of dollars of potential tax liability hang in the balance.[165] The IRS met with the Debtors shortly after filing the Proofs of Claim, at which meeting it made a presentation explaining how it had calculated its claims ***377** against them.[166] This presentation—along with the open lines of communication that existed between the parties' respective counsel throughout the pre-trial and trial phases of the Motions and Claim Objections—eventually allowed the parties to come to the Computation Stipulations resolving the vast majority of the calculations relevant to the Debtors' ultimate tax liability, once the Court determines certain factual and legal issues that remain in dispute between them. The presentation and these open lines of communication caused the essential purpose of the itemized statement required by Bankruptcy Rule 3001(c)(2) to be satisfied.

The Advisory Committee Notes that accompany Bankruptcy Rule 3001 state that subsection (c)(2) was added:

> to require additional information to accompany proofs of claim filed in cases in which the debtor is an individual. When the holder of a claim seeks to recover-in addition to the principal amount of a debt-interest, fees, expenses, or other charges, the proof of claim must be accompanied by a statement itemizing these additional amounts with sufficient specificity *to make clear the basis for the claimed amount.* [167]

Even though the IRS did not attach a completely itemized statement as required by Bankruptcy Rule 3001(c)(2)(A), it did "make clear the basis for the claimed amount" to the Debtors through the itemized statement that was attached to its Proofs of Claim, its presentation to the Debtors, and through regular communication with Debtors' counsel. The IRS did not act as a recalcitrant creditor who refused to provide information to the Debtors. On the contrary, the evidence shows that the IRS was very forthcoming with information about how it calculated its claims, and because of this, at least in part, the parties were able to come to the Computation Stipulations.

[14] In light of the fact that the Debtors were supplied with a great deal of information regarding the amounts of interest and penalties asserted in the Proofs of Claim, the IRS' failure to supply a fully itemized statement of interest, fees, expenses, or other charges as required by Bankruptcy Rule 3001(c)(2)(A) was harmless, and did not affect the Proofs of Claim's prima facie validity.

[15] **[16]** The Debtors also argue that the Proofs of Claim are not prima facie valid because the IRS insolvency specialist who signed them relied on other IRS staff to prepare them and simply accepted their calculations as true and accurate without checking them. [168] The Court is less troubled by this than the Debtors, as "IRS employees possess the properly delegated authority to file a proof of claim and participate in bankruptcy proceedings on behalf of the United States." [169] The IRS insolvency specialist who signed the Proofs of Claim testified that this authority was delegated to him pursuant to IRS Delegation Order 25–3. [170] Moreover, "Rule 3001 ***378** is not inflexible." [171] The Debtors failed to cite a single case where a court denied an IRS proof of claim prima facie validity because the signatory did not personally perform the claim calculations. This Court was likewise unable to locate such a case. That is likely because the fact that the signing insolvency specialist did not personally prepare the underlying calculations does not affect the claims' prima facie validity. As a practical matter here, given the variety of different components of the IRS' claims against the Debtors and the complexities of the claim calculations, it is unlikely that a single person could have actually calculated the amounts and then signed the claim. So, unless multiple people then have to sign a single claim on behalf of the IRS, the Debtors' argument is untenable. For all of these reasons, the Court rejects the Debtors' argument.

[17] Finally, the Debtors argue that the Proofs of Claim are deficient because "[t]he IRS Claims lack any explanation as to the basic facts on which the IRS relies to determine the alleged liabilities; instead the IRS Claims contain only bare-bones legal conclusions without reference to any facts whatsoever." [172] The Court rejects this argument as it overlooks the fact that the Proofs of Claim are based on a statute, not on a writing, and therefore it is not necessary for the IRS to attach *any* supporting documentation to the Proofs of Claim in order to comply with Bankruptcy Rule 3001. [173] Where, as here, the IRS chose to attach support to the Proofs of Claim when it was not required to do so and then made a specific presentation to the Debtors to explain the bases of its claims against them, [174] the Debtors' contention that the Proofs of Claim did not provide sufficient notice cannot be taken seriously.

When all is said and done, the Proofs of Claim fulfilled their "essential purpose of providing objecting parties with sufficient information to evaluate the nature of the claims." [175] The Proofs of Claim substantially comply with Bankruptcy Rule 3001, and are thus prima facie evidence of the validity and the amount of the IRS' claims against the Debtors under Bankruptcy Rule 3001(f).

b) Have the Debtors Raised Evidence of a Probative Force Equal to that of the Proofs of Claim?

The Debtors next argue that even if the Proofs of Claim are afforded prima facie validity, they have raised evidence of a probative force equal to that of the Proofs of Claim.[176] If this is true, then the burden of proof lies with whichever party it normally would under federal tax law.[177]

The Debtors imply that they could raise evidence of equal probative force to the Proofs of Claim merely by stating that the IRS' claimed amounts are "too high."[178] Their reliance on ***379** *In re 804 Congress, L.L.C.*,[179] however, is misplaced. *In re 804 Congress, L.L.C.* involved creditors asserting claims for contractual attorney fees who did not attach any supporting documentation to the proof of claim.[180] In that case, the bankruptcy court held that in a situation where no documents are provided to support a claim based on a writing—in clear contravention of Bankruptcy Rule 3001(c)(1)—a mere questioning of the claim's reasonableness could be construed as evidence of equal probative force to the proof of claim itself. Here, however, the Proofs of Claim are based on a statute, and no documents were required to be attached to them in the first instance. Thus, *In re 804 Congress, L.L.C.* is clearly distinguishable.

[18] Accordingly, we must further examine what sort of evidence could meet the standard of "equal in probative force" and whether the Debtors raised such evidence here. As this Court recently held, once the prima facie validity of a proof of claim under Bankruptcy Rule 3001(f) is established:

> The burden of going forward with the evidence then shifts to the objecting party to produce evidence at least equal in probative force to that offered by the proof of claim and which, if believed, would refute at least one of the allegations that is essential to the claim's legal sufficiency. This can be done by the objecting party producing specific and detailed allegations that place the claim into dispute, by the presentation of legal arguments based upon the contents of the claim and its supporting documents, or by the presentation of pretrial pleadings, such as a motion for summary judgment, in which evidence is presented to bring the validity of the claim into question.[181]

Here, the Proofs of Claim seek amounts from the Debtors that fall into four basic categories: (i) income taxes, (ii) gift taxes, (iii) fraud penalties, and (iv) failure to file penalties.[182] As noted previously, shortly before trial commenced, the parties reached agreement on the Computation Stipulations, which will enable the parties to calculate the amounts owed to the IRS depending on this Court's analysis of certain legal and factual issues that remain in dispute among them, rendering the pre-trial dispute over the burden of proof on the amount of the Debtors' income tax underpayments and gift tax underpayments moot.

However, a dispute remains regarding whether any gifts were actually made by the Debtors, for which the IRS is asserting gift taxes (and associated penalties). The Debtors have raised legal arguments that create doubts as to whether gifts were made. The Debtors also introduced evidence suggesting that the transactions that remain at issue were not gifts.[183] These arguments and evidence together ***380** form evidence that is of a probative force equal to that raised by the Proofs of Claim regarding the alleged gift tax issues. Thus, the ultimate burden of proof will be where federal tax law places it, as discussed further below.

The parties likewise agree—as does this Court—that the IRS bears the burden of proving its claim for fraud penalties (for both income and gift tax underpayments) by clear and convincing evidence.[184] But, even without their agreement, the Debtors presented evidence of a probative force equal to the Proofs of Claim regarding the fraud penalties being sought by the IRS.[185] Thus, the ultimate burden of proof on the issue of fraud penalties lies where the substantive federal tax law places it, as discussed further below.

Regarding the IRS' claims for international failure to file penalties, the Debtors also raised legal arguments that cast into doubt at least some of the IRS' assertions that the Debtors failed to file certain required forms.[186] Thus, the burden of proof on the issue of whether the Debtors are liable for international failure to file penalties also lies where federal tax law places it, as discussed further below.

2. Tax Law Burden of Proof—In General

As noted previously, in 2000, the Supreme Court held that "bankruptcy does not alter the burden imposed by the substantive law."[187] Because the Debtors have rebutted the Proofs of Claim as to the Debtors' alleged liability for gift taxes, fraud penalties, and international failure to file penalties, we must now determine where federal tax law places the burden of proof on these issues.

a) Gift Tax Deficiencies and the Presumption of Correctness[188]

[19] **[20]** **[21]** The burden of proof analyses—there are two relevant here—regarding gift tax deficiencies are by far the most complicated of the tax law burden of proof analyses that this Court must address. However, before reaching those analyses we must discuss one of the general rules regarding burden of proof in tax matters—*i.e.,* the presumption of correctness. In tax court proceedings, after the IRS has made a determination that a certain amount of tax is due, the burden of proof is usually on the taxpayer to show that the IRS' determination is incorrect. As the Supreme Court has stated, "[u]nquestionably the burden of proof is on the taxpayer to show that the *Commissioner's* determination is invalid."[189] Not surprisingly, the Fifth Circuit agrees: "it is well settled that the courts afford IRS determinations of deficiency a presumption of correctness."[190] Of course, in order to be afforded a presumption of correctness, the IRS' deficiency determination must be "supported by a minimal factual foundation."[191] If for some reason the presumption of correctness does not apply to the IRS' ***381** determination of tax liability, then the IRS has the burden of proving that the taxpayer owes tax.

Fifth Circuit precedent supports the view that a proof of claim filed by the IRS should be afforded the presumption of correctness. In *Portillo v. C.I.R.,*[192] the court noted that there is really no prescribed form for the statutory deficiency notice that normally contains the IRS' determination which receives the presumption of correctness, and that this notice simply must, at a minimum: (i) advise the taxpayer that the IRS has determined that a deficiency exists for a particular year, and (ii) specify the amount of the deficiency or provide the information necessary to compute the deficiency. In *Data Industries Corp. of Texas v. I.R.S.,*[193] the Fifth Circuit stated:

> Data Industries makes two contentions in its effort to overturn the District Court's order. First, Data contends that, notwithstanding the prima facie correctness of a claim filed in bankruptcy proceedings, the presumptive correctness arising from the underlying tax assessment cannot be invoked unless the Government produces additional evidence such as a copy of the assessment certificate. This contention simply has no merit, particularly since all pertinent information relating to the IRS assessment was contained in the proofs of claim filed by the Government in the bankruptcy proceedings.

Under this precedent, the Proofs of Claim are entitled to the presumption of correctness,[194] unless the Debtors' two arguments as to why the presumption of correctness does not apply here have merit.

(1) Is the IRS' Determination "Arbitrary and Erroneous?"

The Debtors first argue that the presumption of correctness should not apply because the IRS' determinations of gift tax deficiencies are arbitrary and erroneous.[195] If the presumption of correctness does not apply, then the IRS has the burden of proving up its claim that gift tax is owed by one or both Debtors. In *In re Olshan,*[196] the Ninth Circuit described how a taxpayer is able to shift the burden of proof to the IRS by arguing that the IRS' deficiency determination was arbitrary and erroneous:

> A bankruptcy court adjudicating a tax claim by the IRS must apply

> the burden-of-proof rubric normally applied under tax law. In an action to collect taxes, the government bears the initial burden of proof. That burden is satisfied by the IRS' deficiency determinations and assessments for unpaid taxes, which are presumed correct so long as they are supported by a minimal factual foundation. However, a showing by the taxpayer that a determination is arbitrary, excessive or without foundation shifts the burden of proof back to the IRS. Thus, once the debtor rebuts the presumption, the burden reverts to the IRS to show that its determination was correct.

Although *Olshan* states that the burden will be shifted to the IRS when its determinations ***382** are "arbitrary, excessive, or without foundation," the standard in the Fifth Circuit uses different words—*i.e.,* that the IRS' determinations must be "arbitrary and erroneous."[197] Moreover, as the *Olshan* court notes "where an assessment is based on more than one item, the presumption of correctness attaches to each item. Proof that an item is in error destroys the presumption for that single item; the remaining items retain their presumption of correctness."[198] However, "a pattern of arbitrariness or carelessness" may destroy the presumption for the entire assessment.[199] In the Fifth Circuit, the idea behind the "arbitrary and erroneous" analysis is that the IRS must have "some factual foundation" for its claims that unreported income is owed.[200]

Portillo v. C.I.R.[201] is a leading Fifth Circuit case applying an arbitrary and erroneous analysis. In *Portillo,* a taxpayer who worked as a contractor reported receiving $10,800 in income from a client, and that client subsequently issued a Form 1099 reporting that the taxpayer had received more than three times this amount.[202] The IRS then sought to collect additional tax from the taxpayer.[203] According to the client who issued the 1099 to the taxpayer, the vast majority of the difference between the $10,800 reported by the taxpayer and the much higher amount reported by the client was based on cash payments for which no records existed.[204] The IRS did little investigation to determine whether the taxpayer had actually received the extra income reported by his client.[205] Since the IRS insisted that its determination that additional tax was owed be afforded the presumption of correctness, the taxpayer was placed in the unenviable position of needing to prove a negative —that he had not received these cash payments.[206] The Fifth Circuit held that the IRS' determination was arbitrary and erroneous because faced with a 1040 from Portillo that was inconsistent with a 1099 on file, the IRS simply assumed that Portillo was the dishonest one without engaging in any further investigation or substantiation.[207] Thus, the IRS' determination that additional tax was due had no factual foundation.

[22] These Cases do not present a situation where the IRS' claim for gift taxes is arbitrary and erroneous by virtue of having absolutely no evidentiary foundation.[208] The IRS reviewed a voluminous record of information gathered from the Wylys and third parties before filing the Proofs of Claim. Nor are they cases where the IRS failed to consider the Wylys' tax returns and other information relevant to the alleged ***383** gifts.[209] In fact, the Debtors' objections to the IRS gift tax claims are largely legal, not factual. Obviously, allocation of burden of proof and shifts thereof is relevant only to factual issues, not legal ones.[210]

For these reasons, the Court finds that the Proofs of Claim were not arbitrary and erroneous.

(2) Burden Shifting under 26 U.S.C. § 7491

The Internal Revenue Code provides one more opportunity for the Debtors to shift the burden to prove gift tax deficiencies to the IRS—*i.e.,* 26 U.S.C. § 7491. An analysis under § 7491 focuses on the taxpayer's actions and asks if the taxpayer has submitted credible evidence and demonstrated "good behavior" by comporting with certain statutory requirements. Specifically, 26 U.S.C. § 7491 provides as follows:

> (a) Burden shifts where taxpayer produces credible evidence.—
>
> (1) General rule.—If, in any court proceeding, a taxpayer introduces credible evidence with respect to

> any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue.
>
> (2) Limitations.—Paragraph (1) shall apply with respect to an issue only if—
>
>> (A) the taxpayer has complied with the requirements under this title to substantiate any item;
>>
>> (B) the taxpayer has maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews; and
>
> * * *
>
> (3) Coordination.—Paragraph (1) shall not apply to any issue if any other provision of this title provides for a specific burden of proof with respect to such issue.
>
> * * *
>
> (c) Penalties.—Notwithstanding any other provision of this title, the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title.
>
> As explained by the district court in *Southgate Master Fund, LLC*,[211]
>
> The legislative history of Section 7491 defines "credible evidence" as "the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted ***384** (without regard to the judicial presumption of IRS correctness)." S.Rep. No. 105–174, 1998 WL 197371, at *45. Additionally, "[a] taxpayer has not produced credible evidence for these purposes if the taxpayer merely makes implausible factual assertions, frivolous claims, or tax protestor-type arguments. The introduction of evidence will not meet this standard if the court is not convinced that it is worthy of belief." Id. at *45–46.

This is not a case where either side has raised implausible factual assertions, frivolous claims, or tax protestor-type arguments. Rather, the Court finds, based on the evidence discussed more thoroughly in other sections of this opinion,[212] that the Debtors have introduced credible evidence questioning whether gifts were made and thus their liability for gift taxes. Thus, the Court must next consider whether the Debtors' behavior here satisfied the other statutory requirements.

As this is not a case involving deductions, losses, or credits, the substantiation requirement of § 7491(a)(2)(A) seems to meld into the record keeping requirement of § 7491(a)(2)(B). The legislative history of § 7491 confirms this:[213]

> Nothing in the provision shall be construed to override any requirement under the Code or regulations to substantiate any item. Accordingly, taxpayers must meet applicable substantiation requirements, whether generally imposed or imposed with respect to specific items, such as charitable contributions or meals, entertainment, travel, and certain other expenses. Substantiation requirements include any requirement of the Code or regulations that the taxpayer establish an item to the satisfaction of the Secretary. Taxpayers who fail to substantiate any item in accordance with the legal requirement of substantiation will not have satisfied the legal conditions that are prerequisite to claiming the item on the taxpayer's tax return and will accordingly be unable to avail themselves of this provision regarding the burden of proof. Thus, if a taxpayer required to substantiate an item fails to do so in the manner required (or destroys the substantiation), this burden of proof provision is inapplicable.

The legislative history of § 7491 in turn cites to 26 U.S.C. §§ 6001, 6038, and 6038A as examples of "generally imposed" substantiation requirements. Section 6001 states, in part, that "[e]very person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe." Likewise, §§ 6038 and 6038A require taxpayers to file information regarding certain foreign-owned corporations and partnerships. Thus, the very examples that Congress gives of "substantiation" requirements are in actuality requirements to keep records. With this in mind, these substantiation requirements will be analyzed under the framework of § 7491(a)(2)(B)'s record keeping requirement.[214]

[23] Under § 7491(a)(2)(B), the taxpayer must maintain all required records to qualify for a shift in the burden of proof to the IRS. The Motions and Claim Objections ***385** involve a multitude of documents, and the IRS' case-in-chief was proven largely by documentary evidence. Although there is evidence in the record that French asked that certain documents received by IOM trustees be destroyed, these documents were not destroyed and indeed were submitted as evidence at trial.[215] These are not cases where there was evidence of relevant records not being kept. Indeed, the evidence shows that the Wylys and their family offices kept voluminous records and retained them for long periods of time as opposed to improperly destroying them.[216] As the Court notes later in its opinion, there is no evidence that the Wylys kept inadequate books or records or kept a double set of books.[217] Thus, the Court finds that the Debtors maintained all records required under the Internal Revenue Code.

Under § 7491(a)(2)(B) taxpayers must also cooperate with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews in order to qualify for a shift in the burden of proof. The legislative history of § 7491 explains the cooperation requirement in this way:[218]

> the taxpayer must cooperate with reasonable requests by the Secretary for meetings, interviews, witnesses, information, and documents (including providing, within a reasonable period of time, access to and inspection of witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the Secretary). Cooperation also includes providing reasonable assistance to the Secretary in obtaining access to and inspection of witnesses, information, or documents not within the control of the taxpayer (including any witnesses, information, or documents located in foreign countries).

Although it is true that the Wylys exercised their rights during the audit process, they did not refuse to meet with IRS agents and worked diligently to respond to information document requests ("**IDRs**") submitted to them by the IRS.[219] In addition, the Wylys provided access to searchable databases containing literally millions of documents in response to approximately two hundred IDRs issued over the course of the IRS' examination.[220] These were certainly not cases where efforts at compliance were at best half-hearted and belated. Thus, the Court finds that the Debtors cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews.

For these reasons, the Court is satisfied that the Debtors have met their burden under 26 U.S.C. § 7491. Thus, at the end of a long journey through multiple burden of proof analyses, the burden lies with the IRS to prove the Debtors' liability for gift ***386** taxes by a preponderance of the evidence.[221]

b) Fraud Penalties for Income Tax and Gift Tax Underpayments

The burden of proof analysis regarding fraud is much more straightforward than the gift tax analyses. The statutes and procedural rules governing practice before the tax court make it clear that the IRS bears the burden of proving fraud by clear and convincing evidence.[222] The Fifth Circuit has also held that it is the IRS who bears the burden of proof on the issue of whether a taxpayer has committed civil tax fraud, and that the IRS must establish this civil fraud by clear and convincing evidence.[223]

That the IRS bears the burden of establishing a taxpayer's fraud by clear and convincing evidence seems to be universally understood, and statements to this effect are found in both tax court cases and Circuit level cases outside of the Fifth Circuit.[224] Just as it must prove fraudulent underpayment under § 6663 by clear and convincing evidence, so too must the IRS prove fraudulent failure to file gift tax returns under § 6651 by clear and convincing evidence.[225]

[24] Moreover, courts agree that the IRS must carry its burden of establishing fraud by clear and convincing evidence separately for each tax year at issue.[226] In addition, at least one tax court judge has ***387** ruled that fraudulent intent must be proven at the time of filing the return for each year in question.[227]

26 U.S.C. § 6663—the statute mandating penalties for fraudulent underpayment of taxes—itself also contains instructions to follow regarding burdens of proof, and states in subsection (b) that "[i]f the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud."[228] In turn, § 6663(c) states that "[i]n the case of a joint return, this section shall not apply with respect to a spouse unless some part of the underpayment is due to the fraud of such spouse."[229]

As relevant here then, the burden of proof regarding its claims for fraud penalties pursuant to 26 U.S.C. §§ 6663 and 6651 is on the IRS, who must carry that burden by clear and convincing evidence. Of course, and as the parties agree, if the IRS carries its burden of proof, the statute of limitations under 26 U.S.C. § 6501(c)(1) remains open for each year in which the IRS proves the return was fraudulent.[230]

c) International Failure to File Penalties

Again, the burden of proof analysis regarding international failure to file penalties is straightforward. 26 U.S.C. § 7491(c) provides that:

> Notwithstanding any other provision of this title, the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title.

***388** Thus, the IRS has the burden of production and must come forward with "sufficient evidence" that it is appropriate to impose international failure to file penalties on the Debtors.[231]

3. The Debtors' Defenses

The Debtors assert various defenses to their liability to the IRS. Each is discussed below.

a) Reasonable Cause Defenses

The Debtors assert multiple reasonable cause defenses under multiple sections of the Internal Revenue Code. These reasonable cause defenses, if proven by the Debtors, will allow them to avoid liability for various penalties asserted by the IRS in the Proofs of Claim. First, the Debtors assert a reasonable cause defense to the IRS' assertion of fraud penalties under 26 U.S.C. § 6664(c).[232] Second, they assert a reasonable cause defense to the IRS' assertions of international failure to file penalties under 26 U.S.C. § 6677(d).[233] Third, they assert a different reasonable cause defense to a different set of international failure to file penalties under § 6038(c)(4)(B).[234]

[25] All of these reasonable cause defenses would negate a taxpayer's liability upon similar showings of a combination of "reasonable cause," "good faith," and a "lack of willful neglect." Absent contrary guidance from Congress (and there is no such contrary guidance here), it makes sense to assume that these phrases have the same meaning throughout the Internal Revenue Code.[235] According to Fifth Circuit precedent, "the [taxpayer] bears the burden of proof on a reasonable cause defense."[236] And, the evidentiary standard is by a preponderance of the evidence.[237]

*389 b) Dee's Innocent Spouse Defense

Dee's "innocent spouse defense" is codified at 26 U.S.C. § 6015. It provides an exception to the general rule of federal income taxation that a husband and wife filing a joint return are jointly and severally liable for the taxes due on that return.[238] According to the Fifth Circuit and the plain language of the statute, "[s]ection 6015 provides three distinct types of relief for taxpayers who file joint returns."[239] Under § 6015(b), all joint filers have the opportunity to qualify for relief if they meet the five requirements established under § 6015(b)(1)(A)–(E).[240] Under § 6015(c), taxpayers who are no longer married may limit their income tax liability to their separate liability amount.[241] Finally, § 6015(f) provides a kind of wildcard provision for spouses who do not qualify for relief under §§ 6015(b) or (c).

Dee claims that she is eligible for innocent spouse relief under §§ 6015(b) and (c), but not § 6015(f). As relevant here, Dee bears the burden of proof on the innocent spouse defense:

> Except for the knowledge requirement of § 6015(c)(3)(C) (the provision disallowing election of separate liability to a spouse with actual knowledge of the item giving rise to the deficiency), the taxpayer bears the burden of proving that she has met all the prerequisites for innocent spouse relief. *See Reser v. Comm'r,* 112 F.3d 1258, 1262–63 (5th Cir.1997). Section 6015(c)(3)(C) explicitly places the burden of proof on the Secretary.[242]

Dee must satisfy her burden here by a preponderance of the evidence.[243] For § 6015(c)(3)(C), the IRS must meet its burden by a preponderance of the evidence.[244]

Armed with this understanding of the applicable burdens of proof, we turn to the substantive issues we must address.

B. Was the Debtors' Underpayment of Income Taxes Due to Fraudulent Intent?

[26] **[27]** As noted previously, to prevail here on its claim for fraud penalties under 26 U.S.C. § 6663, the IRS must prove, by clear and convincing evidence for each tax year in question, that: (i) the Debtors underpaid their respective income tax that year,[245] and (ii) the underpayment for that ***390** year was due to fraud. Fraud for this purpose is defined as intentional wrongdoing, with the specific purpose of avoiding a tax known or believed to be owed.[246] As was obvious from the outset of the Cases, which were filed in large part to bring these tax issues to conclusion, the parties have a vastly different perspective on what transpired here.

From Sam's perspective, he is the embodiment of the American dream—small town boy of modest background makes good through, among other things, a close family, hard work, intelligence, business savvy, some good ideas, and a willingness to take entrepreneurial risks, which combine to transform him into one of the wealthiest individuals in the world. This spin on the tale at trial started with a lengthy tracing of Sam's and Charles' childhood in small towns in northeastern Louisiana, through their teenage years as Boy Scouts (including a recitation of the Boy Scout oath) and student athletes (according to Sam, he was the better student and Charles was the better athlete), to college at Louisiana Tech where Charles met and ultimately married Dee, his wife of 56 years before his death in 2011, to Sam's graduate school at the University of Michigan on scholarship, to Sam's first job at IBM where he met his friend Ross Perot, who was just starting out in the business world like he was, to the start of Charles and his first business venture, and so on. The upshot of Sam's story is that he is a loyal American, who loves his family[247] and country, and who has never complained about his obligation as an American citizen to pay taxes, which he has done each and every year of his life as advised by his professionals[248] and as required by applicable law.

Conversely, while the IRS does not dispute the impressive rags to riches story of Sam and Charles, or the impressive nature of their overall business successes, it spins its own tale of two brothers, who are extraordinarily wealthy by the early 1990s and who decide to evade taxes in order to ***391** preserve as much wealth as possible for themselves and their families by taking much of their wealth offshore in known tax havens, where they continued (and Sam continues to this day) to exercise control over the offshore assets through trustees who follow their every "wish." [249] The upshot of the IRS' story is that Sam and Charles, along with their army of lawyers and other professionals, set up one of the most complicated offshore structures ever seen, and then manipulated that structure in such a way as to evade their legitimate tax obligations. And then, when the highly secretive offshore system was about to be fully exposed, Sam asked certain of his most trusted advisors if he could avoid his looming potential tax problems by renouncing his American citizenship. [250]

This Court's job is to take the parties' respective stories, of which there is certainly evidence of support in the record, and decide which version of the facts or, in all likelihood, combination of versions of the facts, is most credible and reflects what happened here (by clear and convincing evidence if the IRS is to prevail on their fraud penalty claims). To say this has been a difficult process of weighing the conflicting evidence and arguments is a great understatement. The Court's analysis of the fraud penalties issue—as it relates to the Debtors' income tax underpayments—follows.

[28] **[29]** As virtually every case addressing fraud penalties pursuant to 26 U.S.C. § 6663 acknowledges, a taxpayer rarely confesses his or her fraud in what the parties here have called a Perry Mason moment. [251] And, not surprisingly given the parties' respective stories, there was no Perry Mason moment here. [252] However, when direct proof of fraudulent intent is not available, fraud may be established by circumstantial evidence and reasonable inferences drawn from the record. [253] Courts have developed a nonexclusive list of badges of fraud useful in determining whether there is circumstantial evidence of fraudulent intent. Among the badges of fraud that can be gathered from the case law are the following: (i) understatement of income, (ii) inadequate maintenance of records, (iii) failure to file tax returns or make estimated tax payments, (iv) offering implausible or inconsistent explanations of behavior, (v) concealment of income or assets, (vi) failure to cooperate with tax authorities, (vii) engaging in illegal activities, (viii) dealing in cash, (ix) offering false or incredible testimony, and (x) filing false ***392** documents. [254] The taxpayer's background, level of education, and relative business sophistication is also a relevant consideration, as it informs the court about the taxpayers ability to understand the transactions at issue. [255] Although no single factor may necessarily be sufficient to establish fraud, the existence of several indicia may be persuasive circumstantial evidence of fraud. [256]

1. Relevant Statutes and Badges of Fraud

With this general statement of the law in mind, the Court begins by analyzing the relevant statutes and the badges of fraud it believes applicable here. 26 U.S.C. § 6663 provides:

> (a) Imposition of penalty.—If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.
>
> (b) Determination of portion attributable to fraud.—If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.
>
> (c) Special rule for joint returns.—In the case of a joint return, this section shall not apply with respect to a spouse unless some part of the underpayment is due to the fraud of such spouse.

In turn, 26 U.S.C. § 6664 provides, in relevant part, that:

> (b) Penalties applicable only where return filed.—The penalties provided in this part shall apply only in cases where a return of tax is filed (other than a return prepared by the Secretary under the authority of section 6020(b)).
>
> (c) Reasonable cause exception for underpayments.—
>
> ***393** (1) In general.—No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.
>
> (2) Exception.—Paragraph (1) shall not apply to any portion of an underpayment which is attributable to

> one or more transactions described in section 6662(b)(6).[257]

And, while the Debtors assert a reasonable cause and good faith defense to the imposition of fraud penalties for their income tax underpayments (and which will be discussed *infra* at pp. 475–513), their initial argument is a bit more nuanced. In short, the Debtors argue that we do not need to get to their reasonable cause and good faith defense as to their income tax underpayments, as the IRS has failed to prove fraudulent intent by clear and convincing evidence, as it is required by law to do. And, the nuance comes by virtue of the Debtors' argument that their reliance on the advice of their various professionals in preparing and filing their tax returns in each of the relevant years negates any possible fraudulent intent. In other words, according to the Debtors, we received all this advice from all these professionals who said what we are doing was appropriate, so how could we have possibly avoided payment of a tax we believed we owed?[258] So, before analyzing the Debtor's reasonable cause defense, the Court determines whether the IRS carried its burden of proof to establish fraudulent intent by clear and convincing evidence for each of the relevant years for each taxpayer, starting with Sam.[259]

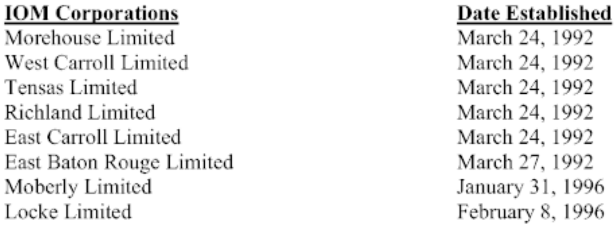
[30] It bears repeating that the lists of badges of fraud relied upon by courts is described as a non-exclusive list, clearly indicating that the courts have flexibility to analyze the particular facts and circumstances of their cases and to supplement the "typical" or "usual" badges of fraud with ones that may be unique to the facts of any specific case.[260] As is presumably apparent from the parties' 122 pages of stipulated facts and the additional facts that are set forth herein for context, the ***394** facts and procedural history of the Cases are truly unique. In short, the complexity of the offshore system of trusts and corporations implemented by Sam and Charles (and unknowingly acquiesced in by Dee) is nothing short of mind-numbing (as any reader of this Memorandum Opinion will soon see), with identically named domestic and foreign corporations, and layers upon layers of foreign entities, the business purpose of many of which remains unclear in the record following the conclusion of three weeks of evidence. So, from this Court's perspective, while certain of the "usual" or "typical" badges of fraud are applicable here, they do not fully address what this Court must grapple with. Thus, the Court will analyze those of the "usual" badges of fraud that could support a finding of fraudulent intent here, along with other badges of fraud that are more tailored to our unique facts and circumstances.

[31] The more "usual" badges of fraud that the Court will analyze include:[261] (i) understatement of income, (ii) concealment of income or assets, (iii) offering implausible or inconsistent explanations of behavior, (iv) offering false or incredible testimony, (v) filing false documents, and (vi) failure to cooperate with tax authorities. In addition, the Court will consider: (i) the complexity of the offshore system and whether there was any legitimate business purpose to that complexity, (ii) the Wylys' willingness to commit securities fraud to preserve their secret offshore system and to maintain its tax advantages, (iii) the Wylys' failure to take action to resolve the conflicting advice they received regarding the 1992 IOM trusts, (iv) the creation of false documents to support the settling of the IOM trusts in 1994 and 1995 to attempt to obtain favorable tax benefits for the Wylys, (v) the treatment of the offshore system as the Wyly family piggy bank, directing purchases of art, jewelry, home furnishings, and real estate for the benefit of individual Wyly family members, while legal title to those assets remains offshore purportedly out of the reach of creditors, including the IRS, and (vi) the planned insolvency of various of the IOM corporations that were supposed to be what made the purpose of the offshore system one of legitimate tax avoidance (not tax evasion). Our analysis starts with the specifically tailored badges of fraud.

a) The Complexity of the Offshore System

The offshore system of trusts and corporations set up by Sam and Charles starting in 1992 is enormously complex. In summary, Sam and/or Charles established 16 offshore trusts and 38 offshore corporations, each of which was owned by one of the 16 offshore trusts. The offshore trusts were all settled in the IOM, which is an ***395** autonomous and self-governing island nation in the middle of the Irish Sea between Great Britain and Ireland. While the IOM is a dependency of Great Britain, it is not part of the United Kingdom.[262] The foreign corporations were established in either the IOM (32 of the corporations) or the Cayman Islands (6 of the corporations). In addition to these 54 offshore trusts and corporations, there were 10 domestic corporations established in Nevada, each of which (i) shared an identical name with an IOM corporation, and (ii) was involved in a complicated annuity transaction that will be discussed further below. Finally, Sam and Charles caused a number of other domestic entities to be created that then facilitated complicated real estate transactions that will be discussed in detail in connection with the Court's gift tax analysis. [263]

With this general background of the offshore system in mind, we turn to the specifics of each brother's offshore system. On March 11, 1992, Sam settled the Bulldog Non–Grantor Trust ("**Bulldog IOM Trust**") in the IOM. [264] The Bulldog IOM Trust was intended to be a non-grantor trust to him under 26 U.S.C. §§ 671–679. [265] Sam contributed corpus of $100.00. [266] The beneficiaries of the Bulldog IOM Trust included (i) the British Red Cross and the Community Chest of Hong Kong and their respective successors, and (ii) Sam's children and issue, specifically including, but not limited to, Evan A. Wyly ("**Evan**"), Laurie W. Matthews ("Laurie"), Lisa L. Wyly ("**Lisa**"), Kelly Wyly ("**Kelly**"), Andrew Wyly ("**Andrew**"), and Christiana P. Wyly ("**Christiana**"), but contingently, that is, only after the expiration of the second anniversary following Sam's death. [267] The following IOM Corporations are wholly owned by Bulldog IOM Trust: [268]

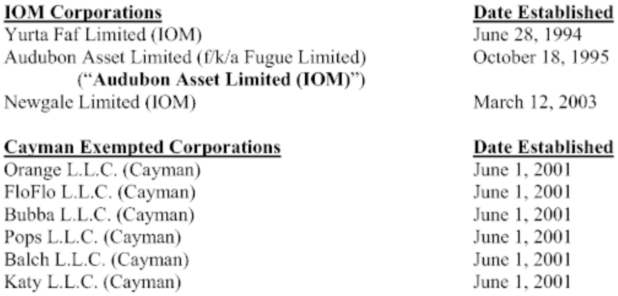


IOM Corporations	Date Established
Morehouse Limited	March 24, 1992
West Carroll Limited	March 24, 1992
Tensas Limited	March 24, 1992
Richland Limited	March 24, 1992
East Carroll Limited	March 24, 1992
East Baton Rouge Limited	March 27, 1992
Moberly Limited	January 31, 1996
Locke Limited	February 8, 1996

On December 4, 1992, Sam settled the Lake Providence International Trust ("**Lake Providence IOM Trust**") in the IOM. [269] The Lake Providence IOM Trust was intended to be a non-grantor trust to ***396** him under 26 U.S.C. §§ 671–679. [270] Sam contributed corpus of $100.00. [271] The beneficiaries of the Lake Providence IOM Trust included (i) the British Red Cross and the Community Chest of Hong Kong and their respective successors, and (ii) Sam's children and issue, specifically including, but not limited to, Evan, Laurie, Lisa, Kelly, Andrew, and Christiana, but contingently, that is, only after the expiration of the second anniversary following Sam's death. [272] Sarnia Investments Limited, an IOM corporation ("**Sarnia Investments Limited (IOM)**"), established on January 8, 1991, was ultimately wholly owned by Lake Providence IOM Trust. [273]

On December 14, 1992, Sam settled the Delhi International Trust ("**Delhi IOM Trust**") in the IOM. [274] The Delhi IOM Trust was intended to be a non-grantor trust to him under 26 U.S.C. §§ 671–679. [275] Sam contributed corpus of $100.00. [276] The beneficiaries of the Delhi IOM Trust included (i) the British Red Cross and the Community Chest of Hong Kong and their respective successors, and (ii) Sam's children and issue, specifically including, but not limited to, Evan, Laurie, Lisa, Kelly, Andrew, and Christiana, but contingently, that is, only after the expiration of the second anniversary following Sam's death. [277] Greenbriar Limited, an IOM corporation ("**Greenbriar Limited (IOM)**"), established on November 10, 1992, was wholly owned by Delhi IOM Trust. [278]

On February 2, 1994, Keith King ("**King**"), a resident of the IOM, settled the Bessie Trust ("**Bessie IOM Trust**") in the IOM. [279] The Bessie IOM Trust was intended to be a grantor trust to King under 26 U.S.C. §§ 671–679. [280] The beneficiaries of the Bessie IOM Trust at various points in time were (i) King, Sam, Sam's wife, Sam's issue, (ii) The University of Michigan, any Church of Christ Scientist, the Community Foundations of Texas, (iii) Camp Leelanau and Camp Kohahna, (iv) The Episcopal School of Dallas, (v) the wife or widow of Evan and all the children and more remote issue of Evan, and (vi) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors. [281] The following IOM Corporations ***397** and Cayman Island Exempted Corporations were wholly owned by Bessie IOM Trust, along with other IOM corporations not listed but separately discussed below: [282]



IOM Corporations	Date Established
Yurta Faf Limited (IOM)	June 28, 1994
Audubon Asset Limited (f/k/a Fugue Limited) (**"Audubon Asset Limited (IOM)"**)	October 18, 1995
Newgale Limited (IOM)	March 12, 2003

Cayman Exempted Corporations	Date Established
Orange L.L.C. (Cayman)	June 1, 2001
FloFlo L.L.C. (Cayman)	June 1, 2001
Bubba L.L.C. (Cayman)	June 1, 2001
Pops L.L.C. (Cayman)	June 1, 2001
Balch L.L.C. (Cayman)	June 1, 2001
Katy L.L.C. (Cayman)	June 1, 2001

The Cayman Exempted Corporations listed above were liquidated in 2006 and ownership of their assets reverted 100% to the Bessie IOM Trust (to the extent there remained any assets after the payment of liabilities).[283] The IOM Corporations listed above remain in existence today, as do those discussed immediately below.

Mi Casa Limited, an IOM corporation ("**Mi Casa Limited (IOM)**"), established on March 28, 2001, was initially wholly owned by the Bessie IOM Trust. Mi Casa Limited (IOM) was later owned by FloFlo L.L.C. (Cayman) and the Bessie IOM Trust.[284] After the liquidation of FloFlo L.L.C. (Cayman), Mi Casa Limited (IOM) is once again wholly owned by the Bessie IOM Trust**.**[285]

Cottonwood I Limited, an IOM corporation ("**Cottonwood I Limited (IOM)**"), established on July 14, 2000, was initially wholly owned by the Bessie IOM Trust. As of June 1, 2002, Cottonwood I Limited (IOM) was owned by Bubba L.L.C. (Cayman) and Bessie IOM Trust.[286] After the liquidation of Bubba L.L.C. (Cayman), Cottonwood I Limited (IOM) was once again wholly owned by the Bessie IOM Trust.[287]

Cottonwood II Limited, an IOM corporation ("**Cottonwood II Limited (IOM)**"), ***398** established on July 14, 2000, was initially wholly owned by the Bessie IOM Trust. As of June 1, 2001, Cottonwood II Limited (IOM) was owned by Orange L.L.C. (Cayman), Pops L.L.C. (Cayman), FloFlo L.L.C. (Cayman), Bubba L.L.C. (Cayman), Katy L.L.C. (Cayman), Balch L.L.C. (Cayman), and the Bessie IOM Trust.[288] After the liquidation of Orange L.L.C. (Cayman), Pops L.L.C. (Cayman), FloFlo L.L.C. (Cayman), Bubba L.L.C. (Cayman), Katy L.L.C. (Cayman), and Balch L.L.C. (Cayman), Cottonwood II Limited (IOM) is once again wholly owned by the Bessie IOM Trust.[289]

Spitting Lion Limited, an IOM corporation ("**Spitting Lion Limited (IOM)**"), established on February 3, 2000, was initially wholly owned by the Bessie IOM Trust.[290] As of June 1, 2001, Spitting Lion Limited (IOM) was owned by Orange L.L.C. (Cayman), Pops L.L.C. (Cayman), FloFlo L.L.C. (Cayman), and Bubba L.L.C (Cayman).[291] After the liquidation of Orange L.L.C. (Cayman), Pops L.L.C. (Cayman), FloFlo L.L.C. (Cayman), and Bubba L.L.C (Cayman), Spitting Lion Limited (IOM) is once again wholly owned by the Bessie IOM Trust.[292]

Woody Creek Ranch Limited, an IOM corporation formed on September 30, 1999 (whose name was changed to Two Mile Ranch Limited on April 14, 2000, and ultimately to Rosemary's Circle R Ranch Limited on August 26, 2003) ("**Rosemary's Circle R Ranch Limited (IOM)**"), was initially wholly owned by Devotion Limited (IOM), another Sam IOM corporation discussed further below.[293] As of April 11, 2000, Rosemary's Circle R Ranch Limited (IOM) was owned by the Bessie IOM Trust and Orange L.L.C (Cayman).[294] As of June 1, 2001, Rosemary's Circle R Ranch Limited (IOM) was owned by Orange L.L.C. (Cayman), Pops L.L.C. (Cayman), FloFlo L.L.C. (Cayman), Bubba L.L.C. (Cayman), Balch L.L.C. (Cayman), Katy L.L.C. (Cayman), and the Bessie IOM Trust.[295] After the liquidation of Orange L.L.C. (Cayman), Pops L.L.C. (Cayman), FloFlo L.L.C. (Cayman), Bubba L.L.C. (Cayman), Balch L.L.C. (Cayman), and Katy L.L.C. (Cayman), Rosemary's Circle R Ranch Limited (IOM) is once again wholly owned by Bessie IOM Trust.[296]

On July 18, 1995, the La Fourche Trust ("**La Fourche IOM Trust**") was settled in the IOM by Shaun Cairns ("**Cairns**"), an IOM resident.[297] The La Fourche IOM Trust was intended to be a grantor trust to Cairns under 26 U.S.C. §§ 671–679.[298] The beneficiaries of the La Fourche IOM Trust at various points in ***399** time were (i) Sam, Sam's wife, Sam's issue, (ii) The University of Michigan, the First Church of Christ Scientist, the Leaves, Inc., the Community Foundations of Texas, (iii) Denison University and A Grass Roots Aspen Experience, (iv) the Humboldt Legal Foundation, (v) Cairns, and (vi) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[299] Devotion Limited, an IOM corporation ("**Devotion Limited (IOM)**"), established on July 18, 1995, was wholly owned by La Fourche IOM Trust.[300] Relish Limited, an IOM corporation ("**Relish Limited (IOM)**"), was also wholly owned by the La Fourche IOM Trust.[301]

On March 11, 1992, Sam settled the Tallulah International Trust ("**Tallulah IOM Trust**") in the IOM with $100.00.[302] Tallulah IOM Trust was a grantor trust to Sam under 26 U.S.C. §§ 671–679.[303] Tallulah IOM Trust terminated and was dissolved on December 31, 1996.[304] The beneficiaries of the Tallulah IOM Trust were (i) Sam, Sam's spouse, and Sam's issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[305]

On December 21, 1995, Sam settled The Crazy Horse Trust (“**Crazy Horse IOM Trust**”) in the IOM with $100.00.[306] Crazy Horse IOM Trust was a grantor trust to Sam under 26 U.S.C. §§ 671–679.[307] Crazy Horse IOM Trust terminated and was dissolved on December 31, 1996.[308] The beneficiaries of the Crazy Horse IOM Trust were (i) Sam, Sam's spouse, and Sam's issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[309]

On December 28, 1995, Sam settled The Arlington Trust (“**Arlington IOM Trust**”) in the IOM with $100.00.[310] Arlington IOM Trust was a grantor trust to Sam under 26 U.S.C. §§ 671–679.[311] Arlington IOM Trust terminated and was dissolved on December 31, 1996.[312] The beneficiaries of the Arlington IOM Trust were (i) Sam, Sam's spouse, and Sam's issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[313]

On January 23, 1996, Sam settled The Sitting Bull Trust (“**Sitting Bull IOM Trust**”) in the IOM with $100.00.[314] Sitting Bull IOM Trust was a grantor trust to *400 Sam under 26 U.S.C. §§ 671–679. Sitting Bull IOM Trust terminated and was dissolved on December 31, 1996.[315] The beneficiaries of the Sitting Bull IOM Trust were (i) Sam, Sam's spouse, and Sam's issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[316]

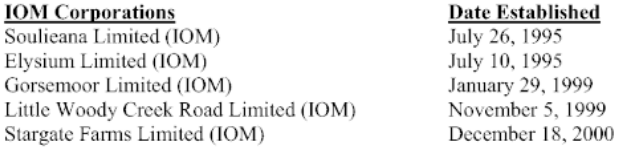
A chart depicting Sam's overall offshore system is attached as Exhibit B.

While using fewer entities, a similarly complex offshore system was established simultaneously by Charles. Specifically, on March 23, 1992, Charles settled the Pitkin Non-Grantor Trust (“**Pitkin IOM Trust”**) in the IOM.[317] The Pitkin IOM Trust was intended to be a non-grantor trust to him under 26 U.S.C. §§ 671–679.[318] Charles contributed corpus of $100.00.[319] The beneficiaries of the Pitkin IOM Trust included (i) the British Red Cross and the Community Chest of Hong Kong and their respective successors, and (ii) Charles' children and issue, specifically including, but not limited to, Martha Wyly Miller (“**Martha**”), Charles J. Wyly, III (“**Chip**”), Emily Wyly (“**Emily**”), and Jennifer Wyly Lincoln (“**Jennifer**”), but contingently, that is, only after the expiration of the second anniversary following Charles' death.[320] The following IOM Corporations are wholly owned by the Pitkin IOM Trust:[321]

IOM Corporations	Date Established
Rugosa Limited	October 31, 1989
Little Woody Limited	March 27, 1992
Roaring Fork Limited	April 3, 1992
Roaring Creek Limited	April 3, 1992

On December 4, 1992, Charles settled the Castle Creek International Trust (“**Castle Creek IOM Trust**”) in the IOM.[322] Castle Creek IOM Trust was intended to be a non-grantor trust to him under 26 U.S.C. §§ 671–679.[323] Charles contributed corpus of $100.00.[324] The beneficiaries of the Castle Creek IOM Trust included (i) the British Red Cross and the Community Chest of Hong Kong and their respective successors, and (ii) Charles' children and issue, specifically including, but not limited to, Martha, Chip, Emily and Jennifer, but contingently, that is, only after the expiration of the second anniversary following *401 Charles' death.[325] Quayle Limited, an IOM corporation (“**Quayle Limited (IOM)**”), established on January 15, 1992, is wholly owned by the Castle Creek IOM Trust.[326]

On February 2, 1994, King settled The Tyler Trust (“**Tyler IOM Trust**”) in the IOM.[327] Tyler IOM Trust was intended to be a grantor trust to King under 26 U.S.C. §§ 671–679.[328] The beneficiaries of Tyler IOM Trust at various points in time were (i) King, Charles, Dee, Charles' issue, (ii) the First Church of Christ Scientist or any United States Church associated with the Christian Science faith, (iii) Lady Thatcher's Archive at the Cambridge Foundation, (iv) Donald R. Miller, Jr., all the children and remote issue of Donald R. Miller, Jr., Deborah Paige Miller, and (vi) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[329] The following IOM Corporations are wholly owned by Tyler IOM Trust:[330]



IOM Corporations	Date Established
Soulieana Limited (IOM)	July 26, 1995
Elysium Limited (IOM)	July 10, 1995
Gorsemoor Limited (IOM)	January 29, 1999
Little Woody Creek Road Limited (IOM)	November 5, 1999
Stargate Farms Limited (IOM)	December 18, 2000

[**Editor's Note:** The preceding image contains the reference for footnote[331]].

On July 8, 1995, Cairns settled The Red Mountain Trust ("**Red Mountain IOM Trust**") in the IOM.[332] Red Mountain IOM Trust was intended to be a grantor trust to Cairns under 26 U.S.C. §§ 671–679.[333] The beneficiaries of Red Mountain IOM Trust are (i) Charles, Dee, Charles' issue, (ii) the First Church of Christ Scientist or any United States Church associated with the Christian Science faith, (iii) Cairns, and (iv) such persons or classes of persons appointed as beneficiaries by the ***402** Trustees with the prior written consent of the Trust Protectors.[334] Elegance Limited, an IOM corporation ("**Elegance Limited (IOM)**") established on July 10, 1995, is wholly owned by Red Mountain IOM Trust.[335]

On March 23, 1992, Charles settled the Woody International Trust ("**Woody Int'l IOM Trust**") with $100.00 in the IOM.[336] Woody Int'l IOM Trust was a grantor trust to Charles under 26 U.S.C. §§ 671–679. Woody Int'l IOM Trust terminated and dissolved on December 31, 1996.[337] The beneficiaries of Woody Int'l IOM Trust were (i) Charles, Dee, Charles' issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[338]

On December 28, 1995, Charles settled the Maroon Creek Trust ("**Maroon Creek IOM Trust**") with $100.00 in the IOM. Maroon Creek IOM Trust was a grantor trust to Charles under 26 U.S.C. §§ 671–679.[339] Maroon Creek IOM Trust terminated and dissolved on December 31, 1996.[340] The beneficiaries of Maroon Creek IOM Trust are (i) Charles, Dee, and Charles' issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[341]

On January 23, 1996, Charles settled The Lincoln Creek Trust ("**Lincoln Creek IOM Trust**") with $100.00 in the IOM. Lincoln Creek IOM Trust was a grantor trust to Charles under 26 U.S.C. §§ 671–679. Lincoln Creek IOM Trust terminated and dissolved on December 31, 1996.[342] The beneficiaries of Lincoln Creek IOM Trust were (i) Charles, Dee, Charles' issue, and (ii) such persons or classes of persons appointed as beneficiaries by the Trustees with the prior written consent of the Trust Protectors.[343]

A chart depicting Charles' overall offshore structure is attached as Exhibit C.

Once the offshore system was established (or at least part of it was established), Sam and Charles undertook a series of complex annuity transactions in order to get substantial amounts of their wealth offshore in the IOM. Specifically, in 1992 and 1996, Sam and Charles entered into multiple transactions whereby they transferred securities that they had earned from Sterling Software, Sterling Commerce, and Michaels Stores in exchange for private annuities. These transactions are described in detail in Joint Stipulations ¶¶ 119–160, but two of Sam's transactions will be summarized here for context.

For example, in 1992, Sam transferred 375,000 options to purchase stock in Michaels Stores to East Baton Rouge Ltd. (Nevada), a newly formed entity that had no assets, in exchange for an unsecured private annuity.[344] Immediately thereafter, ***403** East Baton Rouge Ltd. (Nevada) transferred the options and the obligation to pay the private annuity to East Baton Rouge Limited (IOM), an IOM entity that had no assets or liabilities prior to the transfer of the options and the private annuity obligation to it.[345] East Baton Rouge Ltd. (Nevada) was wholly owned by East Baton Rouge Limited (IOM), which was wholly owned by the Bulldog IOM Trust.[346] Sam did five more similarly structured private annuity transactions in 1992, but using five different Nevada and IOM corporations.[347]

The structure of the private annuity transactions changed in 1996,[348] although those transactions were equally complex for no apparent business reason. For example, on December 29, 1995, Sam assigned 650,000 options to purchase stock of Sterling Software to Crazy Horse IOM Trust, a foreign trust he settled, which trust then assigned the options to Locke Limited (IOM), an entity wholly owned by the Bulldog IOM Trust, in exchange for an unsecured private annuity payable to Crazy Horse IOM Trust. Crazy Horse IOM Trust was then terminated, the effect of which was to put the right to receive the annuity payments to Sam who, as just noted, was the grantor of the now-liquidated Crazy Horse IOM Trust. Sam did five more similarly structured annuity transactions in 1996, using different entities.[349]

The structure of the annuity transactions undertaken by Charles was identical to those undertaken by Sam in 1992 and 1996. Charles did four private annuity transactions in 199 2[350] and four more in 1996.[351]

After deferring receipt of his annuity payments,[352] Sam began receiving annuity payments on some of the annuities in 2004 and on others in 2007.[353] Similarly, after deferring receipt of his annuity payments,[354] Charles' annuity payments commenced ***404** in 2003, 2004, and/or 20 06.[355] To date, in exchange for approximately $105 million worth of options, Sam has received—and paid tax on—approximately $282 million in annuity payments.[356] However, Sam has forgiven approximately $60,972,221 in annuity payments from three IOM corporations (and agreed to forego all future annuity payments from those corporations)[357] and does not expect to receive $70,544,877 in annuity payments currently due (or any further annuity payments) from another four IOM corporations,[358] because all of those corporations have been rendered insolvent financing the Wyly "family's lifestyle and domestic business ***405** interests,"[359] thereby enabling the remaining Wyly wealth to remain offshore untaxed,[360] as will be discussed further below. And, as the IRS correctly points out (and as will be discussed further below), the annuity payments only commenced after the Wylys admittedly learned of serious potential risks associated with their offshore system and/or when it became apparent to them that the offshore system would likely come under public scrutiny through some combination of (i) the filing of certain disclosures their then tax lawyers recommended they file with the IRS regarding potential problems with the positions they had taken on prior filed tax returns, (ii) an IRS audit, (iii) an impending Senate subcommittee investigation of them and tax haven abuses in general, and (iv) investigations of securities fraud allegations against them by, among others, the SEC.[361]

The Wylys offered some explanation for the complexity of their offshore structures, but often those explanations only lead to an analysis of other badges of fraud. For example, Sam's private annuity transactions in 1992 involved six Nevada corporations[362] and six identically named IOM corporations and Charles' private annuity transactions that year involved four Nevada corporations and four identically named IOM corporations. All of those transactions could have been accomplished in a single transfer for Sam (and another for Charles), as one of the attorneys on whose advice the Debtors are relying, Michael Chatzky ("Chatzky"), admitted on cross-examination.[363] However, if structured as a single assignment of opinions and warrants, the IOM entity that ultimately received the options and warrants would have been subject to SEC reporting requirements, which the Wylys were desperate to avoid. In fact, considerable effort went into attempting to insure that no IOM entity held more than 5% of the stock of Sterling Software, Sterling Commerce, and/or Michaels Stores, on whose boards Sam and Charles sat, as will be discussed further below.[364]

***406** Similarly, no explanation was provided as to why the 1996 private annuity transactions were structured as they were (other than the attempt to avoid SEC reporting once again). As noted previously, unlike the 1992 annuity transactions, in 1996 Sam assigned options and warrants in Sterling Software, Sterling Commerce, and/or Michaels Stores to four IOM grantor trusts he had settled in 1992, 1995 and 1996 (Tallulah IOM Trust, Crazy Horse IOM Trust, Arlington IOM Trust, and Sitting Bull IOM Trust), who then assigned the options and warrants to six IOM corporations (Locke Limited (IOM), Moberly Limited (IOM), Sarnia Investments Limited (IOM), Audubon Asset Limited (IOM), Yurta Faf Limited (IOM), and Devotion Limited (IOM)) in exchange for those corporations issuing an annuity back to the four IOM trusts. Shortly after those four IOM trusts received the annuities, the trusts were terminated and the annuity contracts were assigned to Sam, who had been the grantor of those trusts. So, if the purpose of the transaction was for Sam to assign options and warrants to offshore entities in exchange for annuities, why not do it simply and directly? The inference the IRS asks this Court to draw from the elaborate and apparently unnecessary structure is that the use of so many entities and so many transfers would make the scheme harder to unravel and understand, which is a reasonable inference given the absence of any evidence suggesting a legitimate business purpose to this myriad of entities and transfers.

Similarly complex structures were undertaken through the Bessie IOM Trust's ownership of five IOM corporations (Mi Casa Limited (IOM), Cottonwood I Limited (IOM), Cottonwood II Limited (IOM), Rosemary's Circle R Ranch Limited (IOM), and Spitting Lion Limited (IOM)) that were used to indirectly purchase and hold title to real estate in the United States through the five IOM corporations establishment of a domestic “management” trust, which would then establish a Texas or Colorado limited liability company depending on where the real property was located, which would hold legal title to the real property. As the IRS correctly points out, if the Bessie IOM Trust had wanted to invest in U.S. real estate, it certainly could have done so in a much simpler structure. But, the layers upon layers of entities made it that much more likely that the existence and complexity of the offshore system could remain secret from the IRS. And, through this structure, a Wyly family member or former family member could obtain a small percentage ownership interest in the management trust and then, according to Wyly family tax lawyers, enjoy the benefits of that real property, by living in a home rent free or operating a business rent free in the property. In addition to the alleged lack of economic substance to these structures, the IRS attacks them as gifts from Sam to the respective family member(s) who enjoyed the use of the real property, which will be discussed further below. [365]

Another IOM entity owned by the Bessie IOM Trust, Audubon Asset Limited (IOM), [366] and an entity owned by Tyler IOM Trust, Soulieana Limited (IOM), [367] were used to purchase works of art, household furnishings, jewelry, and similar items of personal property that were then provided to various Wyly family members ***407** to use and enjoy pursuant to “possession agreements” between the IOM entity and the applicable Wyly family member. [368] While these transactions will be analyzed in greater detail in connection with the Court's analysis of another badge of fraud—*i.e.,* the use of the offshore system as the Wyly families' personal piggy bank, the point here is structural—if the two IOM trusts had wished to own items of personal property, they could have simply made the purchase and held title to the asset directly. However, the additional layer of entities made it more likely that the offshore system would remain undiscovered by the IRS.

As the above analysis demonstrates, the Wyly's offshore system was more complex than it needed to be. There is little credible evidence in the record suggesting a legitimate business reason requiring this level of complexity. As the Court can now independently attest, attempting to understand the structure and the myriad of transactions undertaken through the structure has required days and days (if not weeks and weeks) of thoughtful analysis. With little legitimate business explanation for the complexity, the Court infers—which inference is unquestionably supported by the record—that a primary reason for making the offshore system this complex was the hope that no one, including the Court, could ever figure out what was going on here and why. This badge of fraud was established by clear and convincing evidence from 1992 through 2013 as to Sam, which are all of the tax years at issue in the Motions, and from 1992 through 2011 as to Charles.

As this badge of fraud relates to Dee, however, the Court concludes that there is simply no evidence that Dee participated in the formation of the offshore system to any great extent, although she did sign some documents that Charles asked her to sign—albeit, without reading them. Dee testified credibly that (i) she was not involved in Charles' business affairs, (ii) never discussed business with him, and (iii) trusted him such that when he asked her to sign a document she would, without question. The Court believes her and simply cannot imagine her even being interested ***408** in having a conversation with Charles about the complexities of the Wyly offshore system. Although Dee is intelligent, she is not financially sophisticated. The Court is satisfied that even if she had asked Charles questions, it is unlikely that she would have understood the implications of what she heard—particularly given the complexities of the offshore system here.

By way of background, and to give context for the above findings, Dee and Charles met and married while in college at Louisiana Tech. While Dee completed three years of college, she did not finish her degree after they married. In short, Dee was a homemaker who raised their children while Charles supported the family financially.[369] Dee is now 82 years old; the offshore system began to be established when she was about 58. After having asked no questions about Charles' business affairs for 36 plus years of their married life to that point, it strains credibility to think that she would have started in 1992 when the offshore system began to be implemented.

For these reasons this badge of fraud does not apply to Dee.

b) The Wylys' Willingness to Commit Securities Fraud to Preserve the Secret Offshore System and to Maintain its Tax Advantages.

The SDNY Court made the following findings and conclusions, which this Court has given collateral estoppel effect to and most of which were independently established here:

> Between 1992 and 1996, Sam and Charles Wyly created a number of IOM trusts, each of which owned several subsidiary companies. Michael French, the Wylys' family attorney, Sharyl Robertson, the Chief Financial Officer ("CFO") of the Wyly family office, and Michelle Boucher, the CFO of the Irish Trust Company, a Wyly-related entity in the Cayman Islands, served as protectors of the IOM trusts. French, Robertson, and Boucher conveyed the Wylys' investment recommendations to the trust management companies administering the Wylys' IOM trusts (the "IOM trustees"). All of the IOM trustees' securities transactions were based on the Wylys' recommendations and the IOM trustees never declined to follow a Wyly recommendation.[370]
>
> The Wylys served as directors of Michaels Stores, Sterling Software, Sterling Commerce, and Scottish Annuity and Life Holdings, Ltd. ("Scottish Re"). As part of their compensation, the Wylys received stock options and warrants. "Between 1992 and 1999, Sam and Charles Wyly sold or transferred to the [IOM] trusts and companies stock options in Michaels Stores, Sterling Software and Sterling Commerce" in exchange for private annuities while simultaneously disclaiming beneficial ownership over the securities in public ***409** filings with the SEC. Between 1995 and 2005, the IOM trusts and companies exercised these options and warrants, separately acquired options and stock in all four companies, and sold the shares, without filing disclosures.[371]

The jury found that the Wylys were beneficial owners of the Issuer securities transferred to, held, and sold by the IOM trusts because the Wylys, directly or indirectly, had or shared voting and/or investment power over these securities. Thus, the jury concluded that the Wylys failed to accurately disclose the extent of their beneficial ownership in the Issuer securities under sections 13(d) and 16(a) of the Securities Exchange Act (the "Exchange Act"). The jury also found that the Wylys caused the Issuers to violate section 14(a) of the Exchange Act, because the Wylys misrepresented the extent of their beneficial ownership to the Issuers in their Director and Officer ("D & O") questionnaires, which were incorporated by the Issuers in proxy statements.[372]

In addition to these disclosure violations, the Wylys were found liable for securities fraud in violation of section 10(b) of the Exchange Act and section 17(a) of the Securities Act of 1933 (the "Securities Act"), and for aiding and abetting the Issuers' and the IOM trusts' securities law violations.[373]

In early to mid–1991, Sam Wyly asked Robertson to attend a seminar held by lawyer and trust promoter David Tedder on the use of foreign trusts as a method of asset protection and tax deferral. Shortly thereafter, the Wylys, Robertson, and French attended another Tedder seminar in New Orleans. Tedder, French, and the Wylys then had a private meeting at Sam Wyly's house in Malibu, California. At that meeting, Tedder "talked about establishing trusts that would provide tax deferral, and how the Wylys could transfer assets to those trusts and get tax deferral on the growth of those assets."[374]

Specifically, Tedder recommended transferring the Wylys' stock options in Sterling Software and Michaels Stores to a foreign trust in exchange for a private annuity "in a tax-free kind of ***410** transaction." Under Tedder's plan, it was "expressly intended that [the Wylys] ... irrevocably surrender the enjoyment, control, ownership, and all economic benefits attributable to the ownership of the [options] which are sold in exchange for the private annuity." [375]

The Wylys pursued the offshore program primarily for its tax advantages. [376]

However, because Tedder suggested transferring stock options in publicly traded companies—Sterling Software and Michaels Stores—any such transaction would implicate the securities laws. French testified that he raised concerns about whether the Wylys would continue to have filing obligations as directors of Sterling Software and Michaels Stores, even after the transfers. Tedder responded that making SEC filings could threaten the Wylys' tax benefits, because "disclosure of the offshore trusts in SEC filings may lead the IRS to discover and investigate the tax issue, and ... the IRS might use the Wylys' SEC filings against them if the tax issue was ever litigated." [377]

But Sam Wyly corroborated French's account by testifying that Tedder told him that SEC filings 'could trigger tax problems if you had these things on file and [were] reporting the trust shares on [Schedule] 13Ds.' Further, it would be logical to draw an inference that the Wylys would have been concerned about taking inconsistent positions in their SEC and IRS filings when millions of dollars of tax savings were at stake. [378]

The jury found that the Wylys always had beneficial ownership over the options, warrants, and securities held by the IOM trusts. [379]

Thus, the Wylys were obligated to disclose, on the filings required by sections 13 and 16, any time they or the trusts transacted in those securities. Because beneficial ownership under the securities laws turns on having voting and/or investment power, truthful SEC filings would have forced the Wylys to admit having some element of control over the securities held by the trusts. To the Wylys, this would mean conceding some element of control over the trustees. But the Wylys believed—rightly or wrongly—that it was critical to conceal their control of the trustees in order to maintain the tax-free status of the trusts, including income from transactions in the Issuer securities. [380]

***411** Footnote 91. [381] (Sam Wyly) ("We took steps to avoid control, and those are steps to create the appearance of avoiding control. It's reality and it's appearance. You want the appearance to match the reality.") Accord PX 890 (11/3/00 email from Robertson to Evan Wyly) ("Remember that it is critical from a U.S. tax standpoint that there is no appearance that the Wyly's [sic] are in control of the trusts or the protectors."). [382]

Because the Wylys made public filings showing the transfer of options to foreign trusts, and at other times publicized their relationship to the foreign trusts, the Wylys also took affirmative steps to minimize the trusts' SEC filings to conceal the ultimate exercise and sale of those options. For example, the Wyly family office tracked the percentage of ownership each trust management company had in a particular Issuer to avoid triggering mandatory SEC reporting. Thus, as Sam Wyly testified, not making SEC filings was logically "something that consistently went on" throughout the duration of the offshore system. [383]

Even when it would have been otherwise helpful to assert beneficial ownership over the stock held by the foreign trusts, such as during Sam Wyly's proxy battle for control of Computer Associates (the acquirer of Sterling Software) in February 2002, the Wylys chose not to do it in fear of inconsistent tax positions. From these facts, it is logical to draw the inference that making misleading statements in SEC filings, or not making SEC filings at all, was part of the Wylys' plan to maintain the appearance of separation and independence from the foreign trusts. [384]

***412** Footnote 95. See PX 1101 (2/26/02 email from Keeley Hennington, tax director and, starting in 2000, CFO of the Wyly family office, to Boucher, attaching Hennington's note to Sam Wyly) ("The trusts are record owners of the shares on C[omputer] A[ssociates]' books. If it is represented [that] there are $2.9 shares [sic], I think it is likely CA may say we show the Wyly's [sic] only own 1.5M options and again the difference would need to be explained.... Our friendly IRS agent is still looming around and although he has verbally agreed not to look further at any foreign entities or trusts, I would not want to give him any fresh ammunition."). [385]

> The Wylys ultimately hired Tedder to help establish the first group of offshore trusts and subsidiary companies in 1992 (together with the Plaquemines Trust, the "Bulldog Trusts"). These trusts were settled by Sam or Charles Wyly and had beneficiaries including the Wylys' wives and children and several charitable organizations. The trust deeds permitted the protectors to "add [ ] or substitut[e]" a charitable organization "by notice in writing to the trustees." These trusts were explicitly set up as "non-grantor trust[s] rather than [ ] grantor trust[s] under Section 671–678 of the Code." Under the terms of the trusts, no United States beneficiary could receive a distribution from the trust until two years after the settlor's death.[386]
>
> Footnote 97. (Robertson). The 1992 Trusts relevant to the remedies phase are: 1) the Bulldog Non–Grantor Trust; 2) Lake Providence International Trust; 3) the Delhi International Trust; 4) the Pitkin Non–Grantor Trust; and 5) the Castle Creek International Trust. In 1995, the Bulldog Trust settled the Plaquemines Trust, which had a class of beneficiaries including Sam Wyly's children. These trusts are referred to as the "Bulldog Trusts" for purposes of this Opinion and Order. The terminology was coined by defendants' expert, Professor Robert Danforth, and has been adopted by the parties in their briefing and argument.[387]

As the above findings and conclusions make clear, and the record here independently establishes, Sam and Charles went to great lengths, using elaborate webs of entities, to avoid accurately and completely reporting the extent of their offshore holdings and the securities transactions that were occurring offshore at their direction. As found by the SDNY Court, and as independently established here, the offshore program was pursued primarily for its tax advantages.[388] That Sam and Charles were prepared to commit securities fraud to attempt to preserve those tax benefits is clear as Tedder told them before the first offshore trust was ever established (and the first private annuity transaction was ever undertaken) that "disclosure of the offshore trusts in SEC filings may lead the IRS to discover and ***413** investigate the tax issue, and ... the IRS might use the Wylys' SEC filings against them if the tax issue was ever litigated."[389]

These facts support the existence of a badge of fraud by clear and convincing evidence as to Sam and Charles from the outset of the implementation of the Wyly offshore system in 1992 through 2005. However, there is no evidence that Dee participated in the securities fraud. While she may have benefited from it, that alone is insufficient for it to constitute a badge of fraud against her here.

c) The Failure to Take Action to Resolve the Conflicting Advice Sam and Charles Received Regarding the 1992 IOM Trusts

In his role as the Wylys' primary outside lawyer, French handled the details and was fully authorized to hire and consult with specialist advisors when he considered it necessary.[390] Moreover, as the Wylys' primary outside lawyer, French was intimately involved in the creation and maintenance of the Wyly offshore structure from its inception in 1992 until his relationship with the Wylys ended in 2001.[391] In fact, while not a tax specialist, French played a key role in the implementation of the Wyly offshore system and in facilitating many of the transactions undertaken through that system until his relationship with the Wylys ended in 2001.[392]

As was found in the SEC Action, and was independently established here:[393]

> [i]n 1993, French approached the law firm of Morgan, Lewis & Bockius ("**Morgan Lewis**") to discuss whether the Bulldog Trust was 'a grantor or non-grantor trust.' Morgan Lewis prepared a memorandum concluding 1) that there was a 'significant risk that the [Bulldog] ***414** Trust will be characterized as a grantor trust under § 679 [because] income is being currently accumulated for the benefit of U.S. beneficiaries,' and 2) that '[i]t is also likely that the Trustee's power to add or substitute other foreign charities (within the class [of beneficiaries]) causes the Trust to be characterized as a grantor trust under § 674. Charles Lubar, the partner at Morgan Lewis retained to work on this matter, gave the memorandum to French and spoke with him about its conclusions.[394]

To amplify this finding a bit based on our record, Lubar was an experienced tax lawyer with impressive credentials. He graduated from Yale University in 1963 magna cum laude, received his JD from Harvard Law School in

1966 and received an LLM in tax from Georgetown University in 1967.[395] Lubar explained the significance of the distinction between foreign grantor and non-grantor trust status as follows: "[i]f you are a U.S. citizen and you set up a foreign trust that is treated as a grantor trust, then you are treated as owning all of the income of that trust, even if it is a completed gift to the foreign trust."[396] If the foreign trust was a valid non-grantor trust, "[t]here would be no tax."[397]

Recall that Sam settled the Bulldog IOM Trust as a foreign non-grantor trust in 1992 and that Charles settled the Pitkin IOM Trust as a foreign non-grantor trust then too. Obviously, if Lubar's concerns were well-founded, the impact on the Wyly offshore system and the annuity transactions undertaken by Sam and Charles in 1992 created substantial tax problems for them.

On this record there can be no doubt that French was Sam's and Charles' agent. French was undoubtedly acting on their behalf when he went to Lubar for a second opinion, as he had been authorized to do, on whether the 1992 IOM trusts settled by Sam and Charles were non-grantor trusts.[398] That French sought a second opinion in 1993 is significant because it confirms that: (i) French had lingering concerns about Tedder's legal opinion (ghost-written by Chatzky) concerning the tax consequences to the Wylys of the 1992 annuity transactions undertaken by Sam and Charles through the Bulldog IOM Trust and the Pitkin IOM Trust, respectively, and (ii) supports this Court' later finding that French had no specialized tax knowledge with which to evaluate the ***415** proper status of the offshore trusts and the tax consequences flowing from the Wylys' 1992 annuity transactions. Significantly, knowledge of four facts can be imputed[399] to Sam and Charles from French's actions as their agent: (i) that French had lingering concerns about the proper characterization of the 1992 IOM trusts and the tax consequences flowing to the Wylys from the 1992 annuity transactions and the Wylys' reporting requirements regarding the 1992 IOM trusts, (ii) that French sought a second opinion from Lubar, a prominent international tax lawyer, (iii) that French learned that Lubar believed there was a "significant risk" that the 1992 IOM trusts would be characterized as grantor trusts to Sam and Charles, and (iv) that French learned that the tax consequences to the Wylys were vastly different if the 1992 IOM trusts were grantor trusts as to Sam and Charles.

Charged with knowledge of these facts, neither Sam nor Charles did anything further themselves, or acting through French, to resolve the conflicting advice they now had from two tax professionals they had hired to give them advice—Tedder and Lubar. And, rather than resolve this legal uncertainty, Sam and Charles continued with the offshore structure in its then form. And, they then chose to expand the offshore structure the following years through the settling of other foreign trusts with falsified documents, which we discuss below, and by continuing to transact business through the offshore system. These facts support the existence of a badge of fraud by clear and convincing evidence from 1993 through 2013 as to Sam and from 1993 through 2011 as to Charles.

However, there is no evidence that Dee *ever* knew about Lubar's conclusions—whether in 1993 or in 2003[400]—or that if she had known she would have understood the implications of those conclusions. This badge of fraud does not apply to Dee.

d) The Creation of False Documents to Support the Settling of IOM Trusts in 1994 and 1995 to Attempt to Obtain Favorable Tax Benefits for the Wylys

The SDNY Court made the following findings and conclusions, which are independently established here:

> The following year, French asked Lubar to advise the Wylys about whether a trust settled by "a foreign person who had done business with Sam Wyly" would be treated as a grantor trust. Lubar advised that "as long as there wasn't an indirect transfer of assets by the U.S. person and the foreign person put the money up, and there were certain powers in the trust, then it would be a foreign grantor trust, and the distributions then would not be taxable." For the purposes of rendering his opinion, Lubar assumed that the foreign grantor would be the "sole transferor of property to the trust[ ]," unless the taxpayers transferred funds "on an 'arm's length' basis."[401]
>
> In 1994 and 1995, two foreign citizens established several trusts for the benefit of the Wylys and their families (collectively, the "Bessie Trusts"). The Bessie ***416** Trust and the Tyler Trust were purportedly settled by Keith King, an individual associated with

Ronald Buchanan, an IOM trustee selected by the Wylys, with initial contributions of $25,000 each. However, no such contribution was ever made. The trusts "were settled with a factual dollar bill ... plus an indebtedness of $24,999 each on the part of Keith King as settlor." That indebtedness was immediately forgiven.[402]

Footnote 107. The 1994/1995 trusts relevant to this Opinion and Order are: 1) the Bessie Trust; 2) the La Fourche Trust; 3) the Red Mountain Trust; and 4) the Tyler Trust. These trusts will be referred to as the "Bessie Trusts," as per Professor Danforth's grouping.[403]

The La Fourche Trust and the Red Mountain Trusts [*sic*] were purportedly settled by Shaun Cairns, another individual associated with Buchanan, also with initial contributions of $25,000 each. Cairns testified that French prepared letters stating that Cairns was establishing the trusts "to show [his] gratitude for [the Wylys'] loyalty to our mutual ventures and [their] personal support and friendship," and asked Cairns to sign them. In truth, Cairns had never met nor dealt with the Wylys before establishing the trusts, and had provided only $100 towards the trusts. Shortly after these trusts were settled, Cairns's trust management company was hired to serve as trustee for some of the Wylys' IOM trusts.[404]

These transactions were shams intended to circumvent the grantor trust rules. French and Buchanan, acting as the Wylys' agents, recruited King and Cairns to create a falsified record of a gratuitous foreign grantor trust. The trust documents are admittedly false—King and Cairns never contributed $25,000 towards the initial settlement.[405]

There were no gratuitous transfers here. First, I am doubtful that King provided even the factual $1 towards the trusts. In a November 26, 1995 fax to French, Buchanan writes that "Keith never produced the money." Buchanan explains that the King-related trusts "were settled with a factual dollar bill" only so that "there [was] no question of the[ ] [trusts] being voidable by reason of the ***417** absence of assets" pending the Wylys' transfer of options. Even if King had contributed the $1, the premise that an unreimbursed dollar bill is sufficient to establish a tax-free foreign grantor trust cannot be taken seriously. Second, Cairns's transfer of $100 cannot be considered gratuitous because shortly after settling these trusts, he received lucrative work from the Wylys as trustee. Finally, in light of the falsified trust deeds and supporting documentation surrounding these trusts, it would be unjust to consider anyone but the Wylys to be the true grantors of these trusts.[406]

As was unquestionably established—both here and in the SEC Action—the establishment of the Bessie IOM Trust and the Tyler IOM Trust by King in 1994 and the establishment of the La Fourche IOM Trust and the Red Mountain IOM Trust by Cairns in 1995 was highly irregular from the outset. Of significance, the SDNY Court found that French and Buchanan were acting as Sam's and Charles' agents. This Court has given collateral estoppel effect to that finding, but at least as to French, the record here independently supports such a finding—by clear and convincing evidence. Moreover, that French was acting within the scope of that agency when he (i) consulted with Lubar about the potential tax ramifications to U.S. beneficiaries of a foreign trust settled by a non-U.S. person, and (ii) then proceeded to facilitate the implementation of those trusts through false documentation and other acts cannot be questioned.[407]

The law is clear, Sam and Charles, as French's principals, are charged with French's conduct in (i) facilitating the creation of the 1994 and 1995 IOM trusts, and (ii) creating false documentation that purports ***418** to support the creation of the trusts. In explaining why this is so, the Court will first analyze the law regarding the general rule that an agent's conduct is imputed to his principal and will then explain why the Debtors' attempt to distinguish their situation from this general rule is ineffective.

[32] **[33]** First, and of significance, the Debtors have never argued that French was not the Wylys' agent regarding the implementation of the Wyly offshore system. Nor could they. Under Texas law, "an agency relationship arises when the principal consents to the agent acting on the principal's behalf."[408] An agency relationship need not be expressly established, and instead may be implied based on the conduct of the parties under the circumstances.[409]

Second, the evidence here unquestionably established that French was acting as Sam's and Charles' agent regarding the implementation of the Wyly offshore system from 1992 until his association with the Wylys' ended in early 2001.[410] For example, when explaining the roles of Robertson and French regarding the implementation of the 1992 IOM trusts, Evan testified that Robertson "as CFO, she did a lot of the research as well because there's accounting and finance related to this as well. So she would head up that part of the details, and Mike [French] would head up the legal details. That's typically how it worked whenever they worked on a project."[411] Then, Evan explained how the allocation of responsibility to implement the 1994 and 1995 IOM trusts was allocated between Robertson and French when he testified "[t]hat was handled by Mike French and Shari Robertson again ... We really left the legal part for Mike to work on. We left the accounting and financial part for Shari to work on. So we didn't get into too much of the details, but we felt comfortable that it was, you know, a fair and appropriate structure."[412] Sam also admitted that French acted with his authority with respect to the offshore system when he testified that French was "sort of the coordinator or the commander of the lawyers" who worked on creating the entities to create the offshore system.[413]

It is well settled that "a principal is chargeable with notice or knowledge concerning a matter within the scope of the agency, received by his agent while acting within the scope of his authority."[414] Comment b to § 5.03 of the Restatement (Third) of Agency illustrates the operation of, and reasoning behind, this legal rule:[415]

> Imputation charges a principal with the legal consequences of having notice of a material fact, whether or not such fact would be useful and welcome. If an agent has actual knowledge of a fact, the principal is charged with the legal ***419** consequences of having actual knowledge of the fact. If the agent has reason to know a fact, the principal is charged with the legal consequences of having reason to know the fact. A principal may not rebut the imputation of a material fact that an agent knows or has reason to know by establishing that the principal instructed the agent not to communicate such a fact to the principal. Imputation thus reduces the risk that a principal may deploy agents as a shield against the legal consequences of facts the principal would prefer not to know.

[34] **[35]** **[36]** The Fifth Circuit, citing Texas law, also agrees that "[i]t is a fundamental rule of agency law that notice to the agent constitutes notice to the principal."[416] Moreover, long standing precedent from the Texas Supreme Court holds that an agent's knowledge may be imputed to a principal,[417] as has its more recent jurisprudence, which confirmed that Texas law "regard[s] it as well settled that if an agent's acts are within the scope of his authority, then notice to the agent of matters over which the agent has authority is deemed notice to the principal."[418]

[37] While an agent's knowledge is *not* imputed to the principal when the agent is acting in a manner that is actively adverse to that of his principal,[419] that adverse interest exception to the general rule is not applicable here, as French's actions were not adverse to the Wylys but were to benefit them. Even the Debtors agree in their post-trial briefing that the adverse interest exception is inapplicable here—*i.e.,* we "have *never* argued that the 'adverse interest exception' applies."[420]

In an attempt to get out from under their agent's *objective* acts or conduct here, the Debtors argue that French's *subjective* fraudulent intent cannot be imputed to Sam and Charles for purposes of determining whether Sam and Charles underpaid their taxes in any year with fraudulent intent for purposes of 26 U.S.C. § 6663. The Court agrees that it is improper to impute French's subjective fraudulent intent to Sam and Charles ***420** when it is Sam's and Charles' subjective intent that is at issue in determining whether fraud penalties are appropriate here, but that is not what the Court is doing, as will be explained below.

Moreover, relying on the Restatement (Third) of Agency, the Debtors argue that "[i]n other words, imputation is the general rule, but there is an exception 'when knowledge as distinguished from reason to know is important,' and circumstances exist where personal knowledge—as opposed to imputed knowledge—is the relevant question."[421] The Debtors go on to state that "case law bears out these principles and shows that only the Debtors' personal knowledge—not imputed knowledge—should be considered for purposes of the fraud penalties."[422] Significantly, the Debtors then cite to five cases decided in the tax law area and provide a parenthetical explanation of the holding of those cases. However, if those cases are examined closely, what the courts there are addressing is whether the specialized knowledge of a tax advisor can be imputed to the taxpayer in the context of the taxpayer's reliance on the advice of a tax professional to defeat the recovery of fraud or negligence penalties by the IRS.

For example, the first case cited by the Debtors is *Henry v. C.I.R.,*[423] with a parenthetical explanation as follows: ("holding that 'there is no evidence that [accountant] ever told [taxpayer] of this risk or of the [relevant treasury] regulation, and [accountant's] knowledge of the risk cannot be imputed to [taxpayer]' "). First, that is not the actual holding of the case, but irrespective of this, the quote does appear in the decision. Second, the Ninth Circuit's point in *Henry* is simply that the specialized knowledge of the accountant cannot be imputed to the taxpayer consistent with the Supreme Court's decision in *U.S. v. Boyle*[424] where the Supreme Court observed:

> When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a 'second opinion,' or to try to monitor counsel on the provisions of the [Tax] Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. 'Ordinary business care and prudence' do not demand such actions.[425]

The next case cited by the Debtors is *Davis v. C.I.R.,*[426] along with the following parenthetical ("[t]o hold a taxpayer guilty of fraud, who [files a return] without actual knowledge that a return is false, and after a full disclosure to the expert preparing the same, would be untenable.") While this quote appears in the Tenth Circuit's decision, once again it appears in the context of imputing the tax expert's knowledge to the taxpayer as the court made clear when it also stated:

> [t]o impute to the taxpayer the mistakes of his consultant would be to penalize him for consulting an expert; for if he must take the benefit of his counsel's or accountant's advice *cum onere,* then he ***421** must be held to a standard of care which is not his own and one which, in most cases, would be far higher than that exacted of a layman.[427]

By way of one last example, the Debtors next cite *Haywood Lumber & Min. Co. v. C.I.R.,*[428] along with the following parenthetical ("[t]o impute to the taxpayer the mistakes of his consultant would be to penalize him for consulting an expert[.]"). While this quote appears in the Second Circuit's decision, it is simply repeating the substance of the *Davis* court's holding, but now in the context of deciding whether the taxpayer's reasonable cause defense should prevent the imposition of a 25% penalty.

As the Debtors themselves acknowledge later in their Post–Trial Brief, "[s]pecial rules have developed in the tax context for purposes of determining how to analyze taxpayer's relations with their advisors."[429] According to the Debtors, "[b]ecause tax law is such a complex area, specific rules have developed regarding the ability of taxpayers to rely on tax advice."[430] According to the Debtors, because of this complexity,

> taxpayers have no obligation to second-guess or monitor their tax advisors. Because the imputation of knowledge rule that exists in other areas of the law is grounded in the principal's ability to monitor his agent to ensure compliance with the

> agent's duty to transmit material facts to the principal, imputation conflicts with the special tax rule that no monitoring is required.[431]

The Court agrees with these statements and the holdings of the courts in *Henry, Davis,* and *Haywood Lumber.* But, what the Debtors' arguments overlook is that French was not the Debtors' specialized tax advisor. French had no specialized competence to address tax matters. That's why the Wylys looked to, among others, Tedder, Chatzky, Lubar, Owens, Pulman, and Cousins for their tax advice—not French. French was a securities lawyer.[432] And, in the context that this Court is discussing, French was simply the Wylys' agent; in essence, their middleman. Instead of the Wylys going to Lubar themselves for his tax advice, they sent French. So French, directly, and they, indirectly, consistent with the holdings of these cases and the Supreme Court in *Boyle,* may be able to reasonably rely on the advice of their specialized tax advisors, but the Court is not imputing Lubar's specialized tax knowledge to the Wylys for purposes of analyzing this objective badge of fraud.

Rather, all the Court is doing is imputing to Sam and Charles certain things their agent, French, did—again, not as their specialized tax advisor, but as their agent charged with responsibility to facilitate the implementation of the offshore system. So what acts did French do in his capacity as the person responsible to facilitate the implementation of the offshore system?

First, French went to Lubar and told Lubar to assume, as relevant here, three facts for purposes of offering his advice on the tax consequences to U.S. citizen beneficiaries ***422** (Sam and his family, and Charles and his family) of transactions done within valid foreign grantor trusts settled by an individual who is a nonresident alien of the United States (King and Cairns). The three facts French told Lubar to assume were true were: (i) "[t]he Grantor, although not related to the Taxpayers, has known the Taxpayers for a considerable period of time," (ii) "[the Grantor] will establish the Trusts for the Taxpayers' benefit as an entirely gratuitous act," and (iii) "[a]ll moneys contributed to the Trusts, now or in the future, will belong to the Grantor, and he has not previously and will not in the future receive any consideration, reimbursement, or other benefit for, or in respect of, this act, directly or indirectly."[433]

Second, after enlisting Buchanan's help, French asked two virtual strangers to the Wylys—King and Cairns—to settle foreign grantor trusts with $25,000 of King's and Cairns' own money per trust—a total of $50,000 for each of them. One must wonder why French would ask virtual strangers to settle the trusts (given the facts he told Lubar to assume were true) or that either King or Cairns would settle trusts with $50,000 of their own money for the benefit of Americans one of them (King) barely knew[434] and the other of them (Cairns) did not know at all,[435] particularly since it was to be "an entirely gratuitous act." Of course, as was later discovered, they did not settle the trusts with the required money. None of the 1994 or 1995 Wyly IOM trusts was settled with the $25,000 that each Deed of Settlement required.

Third, after Cairns agreed to settle his trusts, French prepared and had false documents signed to attempt to create a paper record to show that the Cairns-settled trusts "fit" into the proper mold for (i) the establishment of a valid foreign trust by a non-U.S. grantor, and (ii) the Wylys to obtain the tax benefits such a structure would offer. In short, French "papered" the transactions in such a way that the trusts might later withstand scrutiny by the IRS—or so French and his principals, Sam and Charles, hoped.[436]

Fourth, shortly after these trusts were settled, Cairns' trust management company was hired to serve as trustee for some of the Wylys' IOM trusts.[437] Thus, Cairns received "consideration, reimbursement, or other benefit ..., directly or indirectly," for purportedly settling these trusts for the benefit of Sam, Charles, and their respective families.

Fifth, although the record does not reflect that King received business from the Wylys after settling the Bessie IOM Trust and the Tyler IOM Trust, it does reflect that King had previous dealings with Maverick, ***423** [438] trading in South African bonds. This is why French reached out to King to settle the trusts, because French believed that King had made a substantial amount of money on these dealings, and had reason to "want to give something back" to the Wylys.[439]

These acts undertaken by French, acting within the scope of his agency, in order to obtain favorable tax treatment for the Wylys offshore transactions undertaken through the 1994 and 1995 IOM trusts supports the existence of a badge of fraud from the date of the creation of each trust through 2013 as to Sam and from 1992 through 2011 as to Charles.

One final point must be addressed. During closing arguments, the Wylys' counsel argued that French had gone rogue—out acting on his own without the Wylys' knowledge. The Court rejects this argument for at least two reasons. First, it is simply incredible that a "trusted advisor"—French; in fact, one of the Wylys' "most trusted advisors"[440]—would go rogue. And, if he was acting out as they now argue, that they would keep him around for another six years all the while guaranteeing him an annual income of at least $1.5 million.[441] On this record, that is not a credible assertion and the Court rejects it. Second, as a matter of law, it does not matter if French was a rogue actor. Sam and Charles chose to rely on him to act as their agent to facilitate the implementation of their offshore system, and they are stuck with what he did on their behalf.

However, there is no evidence that Dee *ever* knew about the falsified documents or other things that were done to try to make the 1994 and 1995 IOM trusts fit into the proper mold for a valid foreign trust settled by a non-U.S. person. Moreover, there is no evidence that French was Dee's agent in connection with the implementation of the offshore system. This badge of fraud does not apply to Dee.

e) The Treatment of the Offshore System as the Wyly Family Piggy Bank

The IRS argues, and the Court agrees, that the Wyly family treated the offshore system as their personal piggy bank, of that there is no doubt on this record. The record is replete with instances where a Wyly family member would purchase an item and, after making the purchase, figure out a way to have it paid for with offshore funds.

A prime example is the purchase of an expensive piece of art, Noon Day Rest, by Cheryl Wyly, Sam's wife. Cheryl apparently attended an art auction at Sotheby's in London where she found a painting she liked by a British artist, John Frederick Herring. The invoice is dated July 10, 1996 and the purchaser is shown to be Mrs. Cheryl Wyly, along with the address of their Dallas home.[442] The purchase price is £155,000. Nine days later French sends a memorandum to Ronald Buchanan at Lorne House Trust, the IOM trust management company that served as trustee for the Bessie IOM Trust, in which French ***424** directs that the painting be purchased with offshore funds:[443]

> Attached is language from the Deed of Settlement of the Bessie Trust. This language *clearly* authorizes a purchase of personal property for personal use or enjoyment in specie by any beneficiary.
>
> Unless there is a clear and unequivocal requirement of IOM law (which I doubt), that any such purchase that is specifically authorized by the trust agreement must nevertheless be weighed against the investment returns that could otherwise be obtained on the funds, then I must assume that this transaction is authorized and lawful. If you wish to search for such a legal prohibition, you should do so at your own expense and not that of the Trust.
>
> The Protectors have already recommend [*sic*] this transaction. Please advise if you are willing to proceed on that basis in light of the *explicit* authorization for the transaction contained in the Trust Deed.
>
> We need to resolve this issue at once.

In a rare instance of an offshore trustee pushing back against a recommendation of the Wyly trust protectors (French and Robertson at that time), Buchanan wrote back to Boucher stating his concerns regarding the purchase:[444]

> Thank you for your overnight fax.[445] We will put in train the necessary actions *but we would draw to the Committee of Protectors' attention that they are recommending the substitution of a very safe, income-producing asset by one which might be difficult to sell at a profit at short notice and which generates no income, especially since it is suggested that the Trustees should buy it—through Fugue Limited, which is wholly owned by the Bessie Trust—at 222% of the pre-auction estimated price.*

> We would therefore ask them to confirm, either directly to us or though you under your delegated authority, that:
>
> they do not believe that the beneficiaries will need the income which the proposed purchase price could have generated in the near or medium-term future.
>
> that [sic] they believe that, over the long term, the painting will gain appreciably more in value than would Treasury Bills with the income reinvested."

On July 24, 1996, French sent a draft letter back to Buchanan, asking if the draft letter will suffice and, if it will, advising that he will get it signed by Sam.[446] Although Buchanan asked for confirmation that the *trust protectors* believed that the beneficiaries will not need the income and that they believe that the painting will appreciate in value more than Treasury Bills would earn, no trust protector responds; rather, Sam apparently responds, saying that the beneficiaries of the Bessie IOM Trust have no need for the money,[447] although it is unclear in the record whether Sam actually signed the draft letter prepared by French, as no signed copy was introduced into evidence. Moreover, the draft letter ignores the IOM trustee's ***425** question of whether the painting will appreciate in value.[448]

Then, on July 26, 1996, Sotheby's reissues an invoice for Noon Day Rest—but now to Fugue Limited, Mr. Ronald Buchanan Esq. C/O Lorne House Trust at the trust company's IOM address.[449] Fugue Limited (n/k/a Audubon Asset Limited (IOM)) is one of the IOM corporations wholly owned by the Bessie IOM Trust,[450] of which Lorne House Trust (acting through Buchanan) served as trustee.[451] Noon Day Rest was immediately hung in the home of Sam and Cheryl in Dallas after Fugue Limited's purchase of it, where it hung until it was recently sold pursuant to an Order of this Court.

During his trial testimony, Sam appeared to recall little about the transaction, but when he realized what painting he was being cross-examined about he testified "[i]t's a Herring. Yeah, we love Herrings."[452] Buchanan's inquiry about appreciation of the painting from an investment perspective proved insightful (although he ignored his own instincts as Sam "wished"), as Noon Day Rest was recently sold at an art auction in Dallas, for an amount substantially less than the amount paid to acquire it.[453]

Two things stand out about this transaction. First, Cheryl made the purchase as the initial invoice demonstrates. After the fact, the purchase is recharacterized as an offshore purchase. Second, it is the first instance in the record where trust protectors recommend that offshore funds be used to purchase personal property for use by a Wyly family member. When Buchannan (the relevant IOM trustee) expresses concern regarding the wisdom of an entity owned by the Bessie IOM Trust making the purchase, he is sharply reprimanded by French and directed to make the purchase, which brings to mind a comment from Sam that an IOM trustee would simply be fired if he failed to follow a Wyly "wish".[454] In an instance where Buchannan tries to exercise independent judgment, he is immediately shut down. Clearly, this transaction set the tone for future dealings between the Wylys and the various IOM trustees, demonstrating that Sam's and Charles' "wishes" were to be followed without question.

While the record is replete with other instances on the Sam side of the Wyly family, the Court will only discuss one other example in detail and six others briefly before turning to the Charles side of the Wyly family. On January 25, 2000, Hennington emails Owens at the Meadows Owens law firm, copying two of Sam's children and Boucher, stating:[455]

> *Evan, Lisa, Laurie and Kelly are planning to purchase a house for their mother using off-shore funds.* I think we would like to use the same Texas LLC, Texas Trust and off-shore corp to get this done. The house will cost around $850,000. I assume we will need her to come in for 1% to the trust. They are coming up with names now and Michelle ***426** Boucher is starting the process for the off-shore side. Can you please get someone started ASAP on drawing up these documents. I do not think it should take a lot of time since we have basically done this a few times now. We have told her to give us 2 weeks to have the necessary documents drawn up. I will get you the names in the next few days. Please let me know if there is anything else we should be thinking about. As always, thanks for your help.

Owens responds 20 minutes later:[456]

> Will do, with pleasure. Please forward names of mother, offshore company and Texas Trust name, as well as legal description of property, and finally the total capital needed. To which file do you want this billed? If to one of the offshore Trusts, please ask Shari to let me know which one. This is fun!

Two days later, on January 27 Hennington emails Owens again stating: [457]

> Here are the names for the entities to do Rosemary Acton's house that *Lisa, Laurie, Evan and Kelly are purchasing.*
>
> Offshore corp—Spitting Lion Limited
>
> Domestic Texas Trust—Spitting Lion Management Trust
>
> Domestic Texas LLC—Spitting Lion LLC
>
> Michelle Boucher is going to let me know as soon as the name is approved (I do not think we will have a problem). *We are planning to fund $900,000 from off-shore to cover closing costs, etc.* I am assuming Rosemary will come into trust with $9,000. Does anyone else need to be co-settlor of the trust? ? Please let me know if you need anything else.

Four days later, on February 1, Hennington emails Owens to advise: "they have formed the off-shore entity Spitting Lion Limited. Would you please let me know where the other stuff is or who is working on it so I can bug them. As with everything, it has a short fuse. Thanks." [458]

There are so many problems captured by this rather simple 4–page exhibit of emails that the Court is almost at a loss where to begin. First, the emails make clear that four of Sam's children have decided to buy their mother and Sam's first wife, Rosemary Acton, a house in Dallas. That's a lovely thought, but they apparently don't want to use their own money or pay gift tax on their gift to her, so they decide to use offshore funds, which leads us to the second issue. The use of offshore funds is not their decision to make—*i.e.,* "Evan, Lisa, Laurie, and Kelly are planning to purchase a house for their mother using off-shore funds," followed by "[w]e are planning to fund $900,000 from off-shore to cover closing costs, etc." Rather, it is the decision of the Trustee of the Bessie IOM Trust, which will ultimately own Spitting Lion Limited (IOM), through which this transaction is ultimately undertaken. However, as the emails also make clear, there is not a single thought in anyone's mind that the offshore Trustee will not simply do as instructed by the Wylys—*i.e.,* "Michelle Boucher is starting the process for the off-shore side," followed by "[w]e have told her [Rosemary Acton] to give us 2 weeks to have the necessary documents drawn up," and concluding with "I do not think we will have a problem."

***427** Hennington was right—there was apparently no problem offshore, as the Spitting Lion transaction was consummated through the creation of Spitting Lion Limited (IOM) on February 3, 2000 as a wholly owned corporation of the Bessie IOM Trust, and Rosemary Acton was provided a $850,000 home in which to live for her contribution of $9,000 to Spitting Lion Management Trust for a 1% ownership interest in that trust, which enabled her, according to Owens' alleged advice, to live in the home rent free for the remainder of her life. [459]

Finally, the Court has puzzled over Owens' comment in his original reply "This is fun!" For context, the Court understands that Owens was the lawyer who came up with the rather complex structure the Wylys used—repeatedly—to bring offshore money back onshore for real estate transactions like this one, where one or more Wyly family member would have the use and enjoyment of the property without it being taxed as a distribution from an offshore trust and without the family member having to pay tax on the value of their use of the property. As one of Owens' law partners, Pulman, explained in his testimony: [460]

> Rodney [Owens] was a very good lawyer and a creative lawyer, and he worked very hard for his clients. Rodney came up with the idea that generally in the real estate area, co-tenants can use property, they both have the right to it, and the use of it is not income from one to the other. So—
>
> Q. Excuse me. Is that under state law or federal law?
>
> A. It's under state law, but it's general—it's co-tenants, joint tenants can use any kind of property, but we were talking about real estate. So the concept was we were going to have a foreign corporation, because of the liability and because of the estate tax, that would be the investor. But then we had to have a

> structure so we could have co-tenants, but not owning the property directly, so Rodney came up with the idea of this joint manage—of this management trust. And the management trust would own the entity that owns the real estate. And the management trust was structured specifically to say that the—that the grantors—in this case, it would be Sam Wyly and the offshore company—would have the right to use of the property as co-tenants, and that if they withdrew, which either partner had the right to do at any time, they would get back what they put in, plus their percentage share of the value of the property. So we were trying to structure it so that it was truly a co-ownership arrangement that under state law, whether it would be Texas or Colorado, would have the right as a co-tenant, and the LLCs agreements were also drafted consistently so that the owners—so that the co-grantors or the management trust would have the right to use the property as co-tenants.

Pulman went on to explain that Owens took a personal interest in the Wylys and reviewed all of the work done by other lawyers at Meadows Owens on a Wyly matter. [461]

Turning back to Owens' "this is fun!" remark, the only realistic inference the Court can draw from this rather unfortunate comment is that Owens thinks it is ***428** "fun!" to have devised a clever structure to bring money onshore for Wyly family members' use tax free (in his view) and to then see his structure being implemented several times, as Hennington's email makes clear—*i.e.,* "Can you please get someone started ASAP on drawing up these documents. I do not think it should take a lot of time since we have basically done this a few times now." [462]

This same structure was used on the Sam side of the family on at least four other occasions—in connection with the Rosemary Circle R Ranch property near Aspen Colorado, for the use and enjoyment of Lisa and Kelly, two of Sam's daughters; for the Cottonwood I and Cottonwood II condominium purchases in Aspen, also for the use and enjoyment of Kelly (she operates an art gallery on the first floor of the condominium (the Cottonwood I transaction) and apparently has an apartment and office on the second floor of the condominium (the Cottonwood II transaction); [463] and in connection with the Mi Casa property located in Dallas, where Laurie, another of Sam's daughters, lives with her husband and children. [464]

Finally, as found by the SDNY Court, in June 2002, Sam Wyly contacted a broker directly and instructed him to 'hold on' to 100,000 shares of TYCO stock, overriding a previous order from the IOM trustee, based on an earlier Wyly recommendation, to sell all TYCO shares." [465]

Turning to the Charles side of the Wyly family, the same structure devised by Owens was used to bring offshore money onshore to purchase real estate for the use and enjoyment of his and Dee's children at least twice. First, Little Woody LLC, which was owned by Little Woody Management Trust, which was owned by Little Woody Creek Road Limited (IOM)(98%) and Emily (1%) and Jennifer (1%), which was owned in turn by the Tyler IOM Trust, bought a piece of real estate near Aspen in 2001 (LL Ranch) for the use and enjoyment of Emily and Jennifer, two of Charles and Dee's daughters. [466] Second, Stargate Sport Horses, LP, which was owned by Stargate Horse Properties, Inc. (91.21%) and Stargate Sport Horse Management LLC (8.79%), which was owned by Stargate Farms Limited (IOM), which was owned in turn by the Tyler IOM Trust, bought a piece of property in Texas where Emily ran an equestrian center for several years, after which it was liquidated after experiencing net operating losses over the life of the Tyler IOM Trust's indirect "investment." [467]

For other examples of property desired by a family member being purchased by ***429** them, but then paid for by an offshore entity, we turn to Dee's testimony at trial. Charles gave Dee two very expensive pieces of jewelry for Christmas in 2000, a diamond necklace and a diamond ring that he purchased from Eiseman Jewels in Dallas for $759,000 and $667,000, respectively. The invoice reflecting the sale to Charles is dated November 21, 2000. [468] The invoice reflects that it is to be shipped to Aspen Colorado, where Dee and Charles have a home and where they were spending Christmas that year. Because the jewelry is to be shipped out of state, no Texas sales tax is charged to Charles. [469] Dee testified: [470]

> Q. So, they were given to you in Aspen. Is that right?
>
> A. Right, by my husband.
>
> Q. Now, with respect to this ring and this necklace, it's fair to say that you didn't consider anyone else other than yourself as the owner of those two pieces of jewelry. Is that correct?

> A. Correct.
>
> Q. And, in fact, do you still possess these items?
>
> A. Yes.
>
> Q. They're in a safe in your home?
>
> A. Yes.

However, apparently unbeknownst to Dee, Soulieana Limited (IOM), an entity wholly owned by the Tyler IOM Trust, paid for those two pieces of jewelry at Charles' direction, and Soulieana Limited (IOM) also claims to own those pieces of jewelry, which are kept in Dee's safe in Dee's home in Dallas, which home is the same home she shared with Charles when he was alive. Soulieana Limited (IOM) purchased other jewelry that Charles gave Dee and that Dee considers herself to be the owner of.[471]

Moreover, Dee purchased pieces of art from the Huntsman gallery, which were hung in one of her homes —either in Dallas or Aspen, but which were paid for by Soulieana Limited (IOM).[472] For example, on February 10, 1997, Amy Browning, who worked at the Wyly family office,[473] sent a fax to Paul at Huntsman stating:[474]

> Pursuant to my telephone conversation, *please invoice the recent purchase by Dee Wyly* as follows:
>
> Soulieana Limited
>
> Lorne House Trust Limited
>
> c/o Lorne House
>
> Castletown, Isle of Man
>
> British Isles
>
> Each invoice should be accompanied by a picture of the item being purchased. In addition, please send these invoices and the necessary documentation to the attention of Shari Robertson, 8080 North Central Expressway, LB 31, Dallas TX 752–6. *The Wyly name should not be noted on the invoices.*
>
> If you have any questions, do not hesitate to contact me.

***430** As another example, the Court will note Dee's purchases from Marguerite Theresa Green & Associates, which is an interior design firm Dee used when Charles and she remodeled their home in Dallas. Dee testified that, with Ms. Green's assistance, she selected a number of items —largely collectibles and furnishings—for their Dallas home.[475] Yet, once again, those items were invoiced to, and paid for by, Soulieana Limited (IOM).[476]

Finally, in late 2000, someone apparently decided it would be a good idea to create a better paper trail, so what the Court will refer to as “possession agreements” were thereafter entered into by the offshore entity who had paid for the items and the person who had selected them and had possession of them in the United States. An example of such a possession agreement between Soulieana Limited (IOM) and Charles is IRS Exhibit 26.[477] Of note, Schedule A lists the items Soulieana Limited (IOM) claims to own, the location of the items, their acquisition dates, from whom the items were purchased, and the total cost of each item in USD. This schedule includes 9 pages (single spaced) of art purchases; wall sculptures; photographs (several original Ansel Adams photographs); china and silver; and furniture, furnishings, and ornaments, all of which are located at Charles' and Dee's home in Dallas.

There are many other examples in the record that amply support the finding that Sam, certain of Sam's family members, and Charles considered the offshore system to be their personal piggy banks, through which they could purchase items using offshore money on a tax-free basis. This badge of fraud is established by clear and convincing evidence as to Sam from 1996 through 2013 and for Charles from 1997 through 2011.

The record, however, does not support such a finding with respect to Dee. Although the record shows that Dee purchased items paid for with offshore funds, her uncontroverted testimony was that (i) she was not aware of this,[478] and (ii) her lifestyle did not measurably change as a result of Charles establishing the various ***431** IOM trusts and corporations.[479] Indeed, Dee was surprised that Soulieana Limited (IOM) claims to be the owner of various pieces of jewelry Charles gave her, believing she is the owner.[480]

f) The Planned Insolvency of Various IOM Corporations that Owed Annuity Obligations

As discussed previously, Sam did six private annuity transactions in 1992 and six more in 1996. Charles did four private annuity transactions in each of those years (though one in 1992 involved Dee). With respect to the 1992 annuity transactions, Sam, Dee, and Charles were each scheduled to begin to receive payments when they reached the age of 65 (which was 1998 for Charles, and 1999 for each of Sam and Dee).[481] With respect to the 1996 annuity transactions, Sam and Charles were each scheduled to receive additional annuity payments when they reached the age of 68.[482] However, the payment commencement date for each set of annuities was extended, so that Sam, Dee, and Charles would begin to receive payments on the 1992 annuity transactions on their 70th birthdays, and payments on the 1996 annuity transactions on their 73rd birthdays.

In 2003, Charles began receiving annuity payments,[483] as did Dee and Sam in 2004. To the date of his death in 2011, which terminated the annuities payable to him, Dee and Charles received, and paid tax on, $112,693,782.00 in annuity payments.[484] To date, Sam has received, and paid tax on, $281,852,553.00 in annuity payments.[485] Dee is still receiving some annuity payments, as is Sam.

However, several of the IOM corporations that owed annuity payments to Sam became insolvent, causing them to be unable to pay and causing Sam to forgive those payments and any future payments from them prior to his bankruptcy filing ***432** here. For example, in a letter dated May 31, 2013 from Tensas Limited (IOM) to Sam, Tensas Limited (IOM) stated that it was not in a position to make the required annuity payment and that it did not anticipate being able to do so in the future.[486] The letter acknowledged that Tensas Limited (IOM) had not made full payments to Sam since 2010 and, consequently, owed Sam a total annuity payment of $5,403,975, plus accrued interest to May 31, 2013 of $787,742.13, with further interest accruing at a daily rate of $1,006.77.[487] Tensas Limited (IOM) proposed assigning to Sam all of the assets then belonging to Tensas Limited (IOM)—approximately $2,068,000 in cash—as full and final payment against all outstanding annuity payments and annuity interest owed, plus any future annuity payments due under its agreement with Sam.[488] Sam accepted the proposal, signing the letter "as full and final payment against all outstanding annuity payments and annuity interest owed, plus any future annuity payments."[489] And, having reached this result with Sam, it appears that Tensas Limited (IOM) was voluntarily liquidated.[490] According to the Tensas Limited (IOM) Financial Statements for the year ended December 31, 2012, the value of the annuity for future payments was $10,789,436.[491] Thus, Sam agreed to forego approximately $14,913,153 million owed to him by Tensas Limited (IOM).[492]

Sam forgave other annuity obligations owing from IOM corporations. In a letter dated the same day, May 31, 2013, East Baton Rouge Limited (IOM) notified Sam that it was not in a position to make the required annuity payment of $2,467,258 and that it did not anticipate being able to do so in the future.[493] The letter acknowledged that East Baton Rouge Limited (IOM) had not made full payments to Sam since 2011 and, consequently, owed Sam a past due annuity payment of $3,416,187, plus accrued interest to May 31, 2013 of $252,553.97, with further interest accruing at a daily rate of $786.19.[494] Just like Tensas Limited (IOM), East Baton Rouge Limited (IOM) proposed assigning to Sam all of the assets then belonging to it—approximately $1,987,646 in cash—as full and final payment against all outstanding annuity payments and annuity interest owed, plus any future annuity payments due under its agreement with Sam.[495] Sam accepted the proposal, thereby accepting about $2 million in satisfaction of an approximate $3.6 million current obligation[496] and agreeing to forgo future payments ***433** valued at $19,266,843 million.[497] East Baton Rouge Limited (IOM) was apparently then liquidated.[498]

Similarly, by letter dated October 4, 2013, East Carroll Limited (IOM) notified Sam that it was not in a position to make the required annuity payment of $3,142,095 and that it did not anticipate being able to do so in the future.[499] Just like the other IOM corporations just discussed, East Carroll Limited (IOM) proposed assigning to Sam all of the assets then belonging to it—approximately $1,283,807.74 in cash—as full and final payment against all outstanding annuity payments and annuity interest owed, plus any future annuity payments due under its agreement with Sam.[500] Once again, Sam accepted the proposal, thereby accepting approximately $1.3 million in satisfaction of a $3.1 million obligation and agreeing to forgo future payments valued at $23.2 million.[501] East Carroll Limited (IOM) was presumably then liquidated.[502]

Sam and Charles structured the IOM corporations that were liable to make the annuity payments in such a manner that they could manipulate whether annuity payments would be made due to the planned illiquidity or insolvency of the IOM corporations, including by moving funds between the various IOM and Cayman corporations and deciding when loans would be repaid (as discussed below). While the IOM corporations owing annuity obligations to Sam were provided stock options worth at least the value of the annuities they issued, by 2003, Hennington and Boucher advised Sam and Charles, among others, that several of those corporations had insufficient assets to fulfill those annuity obligations.[503] In other words, their insolvency was a virtual certainty, unless the Wylys infused these corporations with additional funds from other IOM or Cayman corporations, something that they had done in the past and continued to do from time to time. For example, in 2007, Audubon Asset Limited (IOM) borrowed money from three of the Cayman ***434** LLCs to pay the $5,793,464 annual annuity payment owed to Sam,[504] and Moberly Limited (IOM) borrowed $8 million from Morehouse Limited (IOM) to pay the $8 million annual annuity payment owed to Sam.[505] But, nothing in the record explains why loans were sometimes made to fund annuity payments but not always made.

As a result, and as the Court analyzed the trial record, it wondered about the timing of the forgiveness of these annuity receivables since these IOM corporations had not been able to make a full payment to Sam for years. Specifically, why were the annuity receivables forgiven in 2013? Why were loans not made? The Court has come to an answer—albeit one that shows further efforts to protect the offshore system and family members from creditor collection actions, as explained below.

Given that we know that nothing happened offshore unless Sam or Charles "wished" for it to happen, the Court reasonably infers that Sam "wished" that the letters proposing that the annuity obligations due to him be forgiven be sent to him. So, Sam "wished" for the offers to forgive the annuity receivables to be sent to him and he then accepted the offers he caused to be made. But, why did Sam "wish" for these letters to be sent to him in May and October of 2013? The answer is obvious if you think about it—even briefly. Trial in the SEC Action commenced on March 31, 2014,[506] which date had been known by the parties from at least July 23, 2013.[507] Sam was "cleaning up" the offshore system just in case the SEC prevailed in its claims against him there. If the SEC obtained a judgment against Sam and he had annuity receivables owing to him, the SEC could attempt to collect those receivables in order to collect on its judgment. That could trigger the possible unraveling of other offshore transactions and entities that Sam "wished" to avoid. How do you avoid this possibility? Simple, forgive the annuity receivable and liquidate the IOM obligor, which is what the Court reasonably infers Sam directed be done here. Thus, by the time any judgment was entered against him, there was no annuity receivable to collect and no entity to collect it from.

Moreover, and as noted previously, other IOM corporations could not fulfill their annuity obligations to Sam by the time Sam filed his Case here in October 2014. Specifically, Audubon Asset Limited (IOM) owed him $43,085,167, Moberly Limited (IOM) owed him $16,519,813, Yurta Faf Limited (IOM) owed him $1,007,096, and Locke Limited (IOM) owed him $9,932,801 in annuity payments.[508] According to Sam's testimony at trial, no payment is realistically expected from any of these IOM corporations.[509] Moberly Limited (IOM) is unable to make annuity payments ***435** to Sam[510] because it loaned its money to Greenbriar Limited (IOM) and no payments are due from Greenbriar Limited (IOM) for years.[511] Audubon Asset Limited (IOM) is not in a position to make annuity payments to Sam[512] because its assets have been invested in illiquid assets like art or its indirect interest in real estate in Texas and/or Colorado[513] being enjoyed by a Wyly family member(s). Locke Limited (IOM) is illiquid due to $11 million in loans it made to other IOM entities that remained outstanding as of 2013,[514] while its annuity liability to Sam was valued at $59,183,748.[515]

And, once again, the only credible inference to make from the evidentiary record is that Sam "wished" for (i) Moberly Limited (IOM) to loan money to Greenbriar Limited (IOM) and he dictated the terms of that loan, (ii) the assets that Audubon Asset Limited (IOM) purchased to be purchased, and (iii) the loans that Locke Limited (IOM) made to be made. And, equally clear is that if Sam "wished" for assets to be sold so that his annuity payments could be made, that would happen too. But, Sam does not "wish" for that to happen because that might require a Wyly family member to give up their use and enjoyment of a house, a piece of art, jewelry, or other items of property and, of course, would cause him to pay tax on the annuity payment he then received, while the net receivable after tax would be available to pay to his creditors with allowed claims here. From Sam's perspective, it is much better to have uncollectable annuity receivables and leave the bulk of the IOM structure in place offshore, which makes it much more difficult for his creditors with allowed claims here to collect on those claims.

In total, Sam has forgiven $60,972,221 in annuity obligations, and will not collect another $70,544,877 in annuity obligations—all because Sam "wished" for that ***436** to be the outcome. But we get a bit ahead of ourselves in the timeline, to which we return.

It is clear from the evidence that there were concerns about the commencement of annuity payments and the effect of reporting those payments as income on Sam's and Charles' tax returns. And, while the record supports an inference that these concerns had existed for some time, they are captured in a memorandum dated June 30, 2003 from Hennington and Boucher to Sam, Charles, Evan, and Donnie Miller.[516] To put the timing in perspective, this memorandum is prepared after Hennington and Boucher have met with Lubar in London to discuss his concerns with the Wyly offshore system, most of which concerns were communicated to French in 1993 as discussed *supra* at pp. 371–74. The memorandum starts with a background section as follows:[517]

> As you are aware, we have been planning for some time for the commencement of the annuity payments. As we have studied the impact of these payments we have become increasingly concerned with the logistical problems of paying the annuities. Our concerns include the following:
>
> 1. When the payments are reported on your 1040, they will be on a separate line on page one for annuity payments. *It is almost certain given the large amount of these payments that the reporting will result in an IRS audit. There is also a high likelihood that as a result of this audit the entire structure of the foreign system will be audited by the IRS.*
>
> 2. *As the annuities pay over your lifetime you will pay 35% ordinary tax on all payments. In addition, whatever is not consumed in living expenses will be included in your estate and taxed at up to 55%.* See the attached spreadsheet detailing the impact of these taxes.
>
> 3. *The annuity payments will bankrupt several of the I0M companies, which could bring the validity of the annuity transaction into question.*
>
> 4. *After a few years of payments, the companies will be left with non-liquid assets, which will result in payments being made in-kind.* This is mostly the case with real estate, Green Mountain and First Dallas, which cannot be easily liquidated to make payments. It could also be the case with assets that could be negatively impacted by a liquidation like Michaels, Maverick, or Ranger.
>
> 5. *The possibility of an in-kind payment raises a few issues. First, the value of the property will be taxed at 40% with no resulting cash to pay the tax. Secondly, the acceptance of property in-kind may also call into question the validity of the transaction and the 'arms-length' nature of the transaction. The annuities are structured as retirement annuities and most annuitants would not deem non-liquid assets acceptable payment.*

From these statements and others made in the June 30, 2003 memorandum, the Court makes several inferences of significance. First, these statements shed light on why Sam and Charles decided to defer receipt of the annuity payments in the first place. Sam and Charles knew that given the amount of the required annuity payments, the reporting of them as income to them on their tax returns would "almost certain[ly]" trigger an IRS audit, something that they had expended great effort (and committed securities fraud) to avoid from the outset.

***437** Second, supporting the Wyly family's lifestyle had left the IOM corporations with the annuity obligations without the financial ability to make their required payments. Additional explanation is required. The principal means Sam and Charles used to move money from the IOM corporations was through Security Capital, Ltd. ("**Security Capital**"). Security Capital, a Cayman Island corporation formed in August 1998, is wholly owned by Security Capital Trust, whose grantor and trustee was Queensgate Bank & Trust.[518] As explained herein, Security Capital was a conduit entity that would receive offshore funds from various Wyly IOM corporations and then loan those funds to Sam, Charles, and/or Wyly-related businesses in order to domesticate the offshore funds.[519] In fact, Boucher testified that Security Capital was created to act as a loan company.[520] As Sam or Charles "wished" loans to be made, money was loaned from IOM corporations, including Richland Limited (IOM), Morehouse Limited (IOM), East Carroll Limited (IOM), Locke Limited (IOM), and Greenbriar Limited (IOM), among others, to Security Capital, which would then loan substantially similar amounts to Sam, Charles, or a Wyly-related onshore entity.[521] In fact, Boucher could not recall Security Capital ever making a loan that wasn't to a Wyly family member or a Wyly-related entity.[522]

Indeed, the record is replete with evidence that money was moved from one IOM corporation to another at the whim of the Wylys for a variety of purposes including (i) enabling Security Capital to loan funds to Sam, Charles, and Wyly-related entities,[523] (ii) making funding available for ***438** real estate, art, jewelry and other personal property purchases already discussed,[524] and (iii) making investments in other Wyly-related business ventures.[525] This memorandum itself makes this point clearly when it says "[b]ased on current and projected cash flow analysis, there is a need to bring a substantial value of assets onshore to provide for general expenses and maintenance of the family's lifestyle and domestic business ventures."[526]

Finally, the fact that the IOM corporations will become unable to make the payments at all, or will be left with illiquid assets, which will result in in-kind payments being made, will call into question the validity of the annuity transactions and the arms-length nature of those transactions. It goes without saying that getting the wealth associated with the options and warrants, which underlie the annuity transactions, offshore was the primary purpose for establishing the IOM trusts in the first place. Thus, the inability to make annuity payments when due puts the entire system at risk and jeopardizes the enormous tax savings realized through the implementation of the offshore structure.

While these inferences are strongly supported by the record (by clear and convincing evidence), another that the IRS asks this Court to make is not. The IRS argues that the record supports an inference that Sam and Charles *never* intended to have the offshore corporations obligated on the private annuity contracts make payments to Sam, Dee, and Charles as contractually obligated to do. The Court cannot make that leap, as it stretches the record too far. While there is some evidence to support the IRS' argument at least as of 1996,[527] the Court is not convinced—certainly not by the evidentiary standard of proof required here (clear and convincing evidence)—that Sam and Charles entered into the annuity transactions intending, from the outset, that the annuities would not be paid. And, while the document the IRS points to for its argument could be read as the IRS asks the Court to read it, that is not the only credible reading. Specifically, the IRS points to its Exhibit 93, which is an analysis of the Wyly Offshore Tax Savings (By Year and Since Inception), and which has two lines of particular importance to the IRS' argument here. The first line is the ***439** Annuity Payable (Potential add back).[528] The second line is the Equity Valuation (Potential if annuity not paid) line. According to the IRS, by calculating the tax savings if the annuity is not paid, the Wylys are admitting that they did not intend to have the annuities paid to them. However, another equally plausible reading of this document is, as the Debtors' argue, simply that the Chief Financial Officer of Highland Stargate was calculating what would happen if the annuities were not paid for whatever reason, for example if they were terminated by Sam's or Charles' death. And, of course, we know that Charles' annuities terminated upon his death in 2011, which is at least part of the reason that he has received less in annuity payments than has Sam.

Moreover, the Wylys in fact received annuity payments and paid tax on these payments. While the Court is not convinced that Sam and Charles intended from the outset that the annuities never pay out (such that there would never be any income received onshore that would be taxed to them as ordinary income), the Court is satisfied that along the way they had a better idea that was facilitated by their "creative" lawyers—*i.e.,* if they could get the money onshore to support their families' lifestyles through loans to themselves and other family members, direct purchases of assets by IOM entities for the family members' use and enjoyment, or indirect transfers of offshore funds through a myriad of onshore management trusts and limited liability companies or limited partnerships (and do it tax free if Owens was correct), they simply didn't need to bring the money onshore through the mechanism originally intended—*i.e.,* the annuity payments, which everyone agreed would be taxable to them at ordinary income rates.

The Court asked a question in closing that is of significance to it in evaluating this badge of fraud, which question could not be, or was not, answered by Debtors' counsel—where is the money that should have been available offshore to make the annuity payments to Sam when they came due? If there was a legitimate explanation —frankly, even a bad explanation—for where the money went the Court wanted to hear it. But, when questioned, the Debtors' various counsel could only state that they were not aware of any evidence in the record showing where the money went. [529]

In the absence of direct evidence tracing [530] the monies realized from the sale of the stock received through the exercise of the options and warrants offshore, which was the money that was supposed to be available to make annuity payments to the Wylys when they came due, to investments that simply didn't pan out or some other even unreasonable explanation of bad money management by the IOM trustees that controlled the IOM corporations that owed the annuity obligations, the Court will draw the inferences it believes the record amply supports—by clear and convincing evidence. In short, the Wylys raided the offshore system, causing money to be moved from offshore entity to offshore entity where it was "needed" at the time to finance the latest Wyly purchase or domestic business venture, as directed by Sam through making his every "wish" ***440** known to the IOM trustees who allegedly controlled the IOM entities—at least on paper. This badge of fraud—the planed insolvency of the IOM corporations that owed annuity obligations—is established as to Sam, by clear and convincing evidence, from 1996 through 2013.

However, there is simply insufficient evidence in the record to support the application of this badge of fraud to Dee. Although a document was admitted at trial that indicates that Dee forgave an annuity obligation owed to her through Stargate Investments (Texas), for the reasons explained below, the Court concludes that there is no evidence in the record that supports a finding that Dee understood the import of this document. Thus, this badge of fraud does not apply to Dee.

For context, the Court notes that Dee's receipt of annuity payments works differently than Sam's. Recall that Dee and Charles assigned all of their rights to receive annuity payments from the various IOM corporations that were a part of Charles' offshore system to Stargate Investments (Texas). [531] Charles and Dee each own half of Stargate Investments (Texas) through their respective Revocable Trusts. [532] Thus, Dee receives half of all annuity payments made to Stargate Investments (Texas). [533]

One of the private annuity agreements assigned to Stargate Investments (Texas) was between Dee and Rugosa Limited (IOM). [534] Prior to Dee's assignment of this private annuity agreement to Stargate Investments (Texas), Rugosa Limited (IOM) was required to make annuity payments to Dee from age 65 until her death. [535] Acting on behalf of Stargate Investments (Texas), in 2011 Dee accepted a proposal to settle the amounts owing on this private annuity agreement because Rugosa Limited (IOM) became insolvent. Specifically, IRS Exhibit 401 is a draft document titled "RUGOSA LIMITED SCHEME OF ARRANGEMENT between the Company and its Creditors" ("**Scheme of Arrangement**") with the phrase "DRAFT—27 September 2011" crossed out at the top. [536] The Scheme of Arrangement is signed by Dee as the general partner of Stargate Investments (Texas). [537] The Scheme of Arrangement states that Rugosa Limited (IOM) is insolvent and that "the Company also has an ongoing liability to Stargate [Investments (Texas)] to pay to it an annuity calculated in accordance with detailed provisions contained in the Stargate Annuity; this annuity is payable for so long as Ms [*sic*] Caroline D Wyly shall remain alive." [538] The Scheme ***441** of Arrangement values Dee's right to receive future payments at $8,988,971 and her past due payments at $5,067,119, [539] and proposes that Rugosa Limited (IOM) will pay all of its creditors "approximately thirty-nine per cent of the debts owed to each Creditor by the Company; payment of sums due under the Scheme will be in full and final settlement of each Creditor's Claim." [540] Thereafter, Rugosa Limited (IOM) made an annuity payment of $5,538,594 to Stargate Investments (Texas), [541] which was slightly over 39 percent of the total value of Dee's past due and future annuity payments as listed in the Scheme of Arrangement. [542]

There is little evidence in the record regarding the Scheme of Arrangement other than: (i) it exists, and (ii) Dee signed it. While Dee testified that her signature appears on the document, she also credibly testified that she had no knowledge of the information that was referenced in it. [543] Beyond asking Dee whether the signature on the Scheme of Arrangement was hers—it is—and whether she had any knowledge of the statements contained within it—she did not—the IRS asked Dee no further questions about the Scheme of Arrangement. [544] Based on the limited evidence in the record regarding the Scheme of Arrangement and Dee's uncontroverted testimony at other points during trial, the Court infers that the Scheme of Arrangement was simply one more document that Dee had placed in front of her by people she trusted, and she signed this document without question.

In order for the Court to conclude that this badge of fraud applies to Dee, the Court would have to conclude that Dee understood the effect of the Scheme of Arrangement. Based on Dee's uncontroverted testimony during trial that she had no involvement in the family's financial affairs and no understanding of the offshore system, the Court cannot so conclude. For these reasons, this badge of fraud does not apply to Dee. [545]

g) Understatement of Income

As reflected in the Computation Stipulations, Sam understated his income in the following tax years: 1992 through 2003, 2005 through 2006, 2010. [546] Similarly, Charles and Dee or Dee understated their or her income in the following tax years: 1992, 1994 through 2003, 2006, 2008, 2011, 2013. [547]

Accordingly, this badge of fraud is present for the listed years, unless it requires some sort of intentional for deliberate conduct, to which we now turn. For the reasons explained below, the Court concludes ***442** that while an understatement of income that is not intentional has little weight as a badge of fraud, Sam engaged in an intentional understatement of income from 1999 forward due to his deferral, forgiveness, and non-receipt of annuity payments. [548] This badge of fraud does not apply to Dee because any understatement of income by her was not intentional.

Sam argues that, "to constitute a badge of fraud, underpayment of income must be knowing or deliberate." [549] It is true that when listing the classic badges of fraud, the Fifth Circuit has indicated that "*[i]ntentional* understatement of income, substantial in amount per se or substantial in relation to the total reported income" is a badge of fraud. [550] However, other courts listing badges of fraud have dropped this "intentional" qualifier, indicating that a mere understatement of income can constitute a badge of fraud. [551] Thus, there are authorities that cut both for and against Sam's argument that only an *intentional* understatement of income can be a badge of fraud.

Common sense concerns also cut both ways on this issue. On the one hand, underpayment of tax—which necessarily comes about by way of understatement of income or overstatement of deductions—is itself an element of civil tax fraud under 26 U.S.C. § 6663. [552] Therefore, in a case where fraud penalties are applicable, there will almost always be an understatement of income. Thus, unless understatement of income as a badge of fraud is always a given for the IRS in any case that does not involve overstated deductions, then it seems that the mere fact that an understatement of income exists should not be a badge of fraud, and some kind of intent should be required.

On the other hand, there are also problems with stating that understatement of income *must be intentional* in order to constitute a badge of fraud. At least one court has pointed out that if it is shown that a taxpayer intentionally understated income, that this is not just a badge of fraud, it is direct proof that fraud has occurred. [553] Indeed, civil tax fraud is defined as an underpayment of tax with the specific purpose to evade a tax known or believed to be owing. [554] If the IRS in fact shows that a taxpayer has *intentionally* understated his or her income, then it seems that the fraud inquiry could end ***443** there. Resort to the badges of fraud as circumstantial evidence that fraud occurred is no longer necessary, because there is now direct evidence that fraud occurred.

However, before we agonize too much over these apparent inconsistencies, we must stress two things. First, the Supreme Court has noted that "any conduct, the likely effect of which would be to mislead or to conceal" can indicate tax fraud.[555] Thus, the phrasing that courts choose to employ when enumerating their lists of badges of fraud may be more of a product of the particular cases at hand than any hard and fast rule regarding understatement of income. Second, because this Court is bound by Fifth Circuit precedent, it will follow *Webb* and require the understatement of income here to be intentional.[556]

Sam engaged in intentional understatement of income of a certain, albeit subtle, kind. Although Sam did not do something as simple as omit wages from his return or neglect to report a realized capital gain, he did engage in a subtler form of intentional understatement of income when he deferred and eventually forgave annuity payments contractually due to him from IOM corporations that should have been paid to him. Moreover, Sam's income was intentionally understated when he manipulated the assets of other of the IOM corporations that owe annuity obligations to him such that those obligations are now uncollectible.

At trial, Sam testified that it was his understanding that annuity payments he received from the complicated annuity transactions he entered into in 1992 and 1996 involving the transfer of the options and warrants offshore would be taxed as ordinary income to him when he actually received those annuity payments from the IOM corporation that had received the options and warrants in exchange for issuing an annuity payable to him:[557]

> Q. (By Mr. Daniel) Mr. Wyly, how did you understand that taxes will be paid on the assets that were placed into the trust?
>
> A. [By Sam] That taxes would be paid when they were paid back a—in cash to—on the annuity I received or any other distribution ...

And, despite Sam's argument that the annuity transactions were done to simply defer taxes upon the exercise of the options and warrants transferred offshore, not avoid the payment of taxes, Sam then took actions that insured that those taxes would never be paid.

***444** As found previously, Sam caused several of the IOM corporations that owe annuity obligations to him to become insolvent by manipulating how their assets were used by him and other members of his family.[558] While the IOM corporations owing annuity obligations to Sam were provided stock options worth at least the value of the annuities they issued to Sam, after supporting Sam's extended families' lifestyles, several of those IOM corporations are no longer able to make their contractually required annuity payments to Sam, as their assets were dissipated consistent with Sam's "wishes."

So, where did the cash these IOM corporations realized upon the exercise of the options and the sale of the associated stock go? The short answer is it went wherever Sam "wished" it to go. And, as previously found, Sam "wished" for it to be used to purchase, among other things, (i) domestic real estate on which homes for Wyly family members were built in Texas and Colorado (also using offshore monies), (ii) two floors of the Paragon building in Aspen, which provided Sam's daughter Kelly with space for her art gallery, a condominium and an office, and (iii) art, jewelry, and other items of personal property, which various members of Sam's family keep in their homes and continue to use and enjoy today.[559] All of these purchases were made with offshore funds using structures Sam allegedly believed prevented them from being taxed as gifts or other distributions from offshore.[560] And, to be sure, Sam "wished" for each of these expenditures of offshore funds to be made, which expenditures, along with other uses of the funds that Sam "wished" to occur, drained certain of the annuity obligors' assets such that they were no longer able to make their contractually required annuity payments to Sam.

By manipulating the IOM corporations and their assets in this way, Sam intentionally insured that the annuity payments he was due could not be paid to him, thus enabling him to escape his obligation to pay tax on the annuity income he was contractually entitled to receive. And, instead of liquidating assets or otherwise ceasing his families' extravagant expenditures, Sam deferred all annuity payments due to him for five years.[561] Then, once the deferred payment date was reached, Sam began accepting less than full annuity payments from certain of those corporations whose monies had been used for other purposes.[562] Ultimately, Sam chose ***445** to forgive certain of the annuity obligations due to him totaling

$60,972,221.[563] And, as Sam admitted at trial, another $70,544,877 in annuity obligations due to him from certain IOM corporations that received valuable options and warrants in exchange for its annuity obligation to him are now uncollectible.[564]

As previously found, all of this happened because Sam "wished" for that to be the outcome here.[565] In this way, Sam insured that he did not pay the taxes he was obligated to pay. Sam deferred the commencement date of his annuity payments in 1998[566] knowing that his receipt of large annuity payments would likely trigger an IRS audit, thereby exposing the extent of his offshore system.[567] While the private annuity agreement amendments recite that Sam deferred the annuities because he wasn't ready to retire at age 65 or 68,[568] inferring that Sam did not yet need the annuity income, that testimony rings hollow given that Sam began borrowing money from offshore through Security Capital in 2002 on sweetheart terms.[569] And, of course, we know that Security Capital had no money of its own to loan to Sam; rather, it borrowed the money it loaned to Sam from one or more of the IOM corporations that form a part of Sam's offshore system. We also know that Sam would not pay income tax on loan proceeds—*i.e.,* the money he borrowed from offshore to support his families' lifestyle, but that he would have paid tax on any annuity income he received from offshore. Finally, we ***446** know that Sam began using the offshore funds to support extravagant purchases of real estate for the benefit of himself and his family members beginning in late 1999 and continuing into early 2001.[570]

Because Sam deferred his annuity payments in 1998 as part of a scheme to keep the extent of his offshore system secret from the IRS and then began to excessively manipulate how funds within the offshore system were used by at least 1999,[571] the Court concludes that this badge of fraud is present as to Sam beginning in 1999 through 2013, the last year at issue in the Motions and Claim Objections.

Dee's situation is different. While Charles' and Dee's annuity payments were also deferred,[572] it is clear that Dee was not the person who chose to defer their receipt of annuity payments. This is because Dee relied completely on Charles regarding all business, legal, and tax matters.[573] On this record, the Court doubts that Dee understood that deferrals of annuity payments occurred or the significance of those deferrals.[574] Furthermore, there is no evidence in the record that annuity payments due to Dee will not be able to be made per the annuity agreements. For these reasons, this badge of fraud does not apply to Dee.

h) Concealment of Income or Assets

It is obvious from the facts already found that the Wylys went to considerable effort to conceal the extent of their offshore assets and activities. There is little to be gained here by repeating this analysis ***447** except to say that the IRS has established this badge of fraud—by clear and convincing evidence—as to Sam from 1992 to through 2013. However, once again, there is insufficient evidence in the record to support such a finding as to Dee.

i) Offering False or Incredible Testimony

Sam was not a great witness at trial. His memory was vastly superior on direct examination than it was on cross-examination. He easily remembered events dating back to his childhood in Louisiana; his college years and professors who made an impact on him there; the progression of his wide-ranging business ventures; to concerns over the domestic banking industry in the 1980s, and on and on through events to the present day. However, on cross-examination, his memory seemed to fail him and he was impeached regularly with either the deposition testimony he gave in connection with the Motions, the testimony he gave during trial of the SEC Action, or documentary evidence.[575]

And, while the Court appreciates that Sam is 81 and suffers from some health issues, the Court accommodated those issues by scheduling Sam's testimony early each day as his counsel requested in two hour or less increments, which meant Sam's testimony occurred over nine trial days. Moreover, breaks were taken any time Sam's counsel or he requested one. And, of course, neither Sam's age nor his health issues explains the obvious disparity between his ability to recall facts on direct as opposed to cross-examination.

That Sam was an uncooperative witness on cross-examination by the IRS was obvious. That he had to be impeached frequently to get him to admit to fairly obvious facts is equally clear. In fact, given the difficulty in getting Sam to admit facts that were obviously true, the Court encouraged his counsel to offer to stipulate to those facts when Sam was asked a question that he was struggling to crisply answer, assuming it wasn't more prejudicial to Sam's case to do so than a patient and tedious cross-examination followed finally by a grudging admission from Sam would be. However, that rarely happened and so a slow and tedious cross-examination of Sam continued for days, with Sam regularly ***448** being impeached by either documentary evidence or his own prior testimony, resulting in what should have been an easy answer finally being given.

Sam's obvious reluctance to answer questions asked of him directly reflects poorly on him. As a result, the Court does not have confidence that it can rely on Sam's testimony to accurately reflect what really transpired here, absent other, disinterested evidence corroborating his testimony.

Attempting to apply this badge of fraud on a year-by-year basis is problematic, as it is less susceptible to that type of breakdown than most of the other badges of fraud.[576] Rather, the presence of this badge of fraud casts a shadow over a taxpayer's entire course of conduct. This is understandable because, in most instances, the taxpayer offers false or incredible testimony after the fact—often at trial or during an IRS examination—rather than during a specific year in which it is alleged that fraud has occurred.

The Fifth Circuit grappled with these principles in *Toussaint v. C.I.R.,*[577] where a taxpayer made a truly incredible claim—that his grandfather, an admittedly poor man, had given him a Picasso painting worth $190,000, which he failed to register or insure and simply stored in his closet for years. After the painting was stolen, Toussaint filed a police report in which he claimed that three items were stolen: one car battery, one brown business suit and the Picasso. Toussaint carried a casualty loss deduction related to the supposed theft of the Picasso back and forward on his tax returns, resulting in deficiencies for years 1971 through 1975.[578] The IRS disagreed with these deductions. At trial before the tax court, Toussaint testified that not one but several suits were stolen (he did not know how many nor could he describe any of them—even the "brown" one) and that not one but several car batteries were stolen. He could not explain why he failed to report these additional items as stolen to the police. Moreover, to the police, Toussaint described the Picasso painting as depicting a boat on an island but he could give no further details. Before the tax court, Toussaint testified that the painting actually depicted "a woman" from about the waist up. Possibly, he said, there was a small boat in one corner of the painting. Again, Toussaint could not explain the discrepancy in the two descriptions of the subject matter of the painting, nor could he describe the painting further.

In affirming the tax court's imposition of fraud penalties for all five of the years at issue there, the Fifth Circuit noted that "in an action for fraud, the honesty of the accused is not only important, it is controlling."[579] The Fifth Circuit affirmed based in part on the implausible and false nature of Toussaint's testimony, even going so far as to note that it most likely would have found clear error if the tax court had found that Toussaint had *not* committed tax fraud.[580] In assessing Toussaint's testimony as an indicator of fraud, the Fifth Circuit did not proceed on a year by year basis, but instead viewed the incredible nature of Toussaint's testimony as casting ***449** a shadow over his conduct in all of the tax years at issue.[581] The Fifth Circuit did caution, however, note that "[a]lthough mere refusal to believe the taxpayer's testimony does not discharge the Commissioner's burden, the lack of credibility of the taxpayer's testimony, the inconsistencies in his testimony and his evasiveness on the stand are heavily weighted factors in considering the fraud issue."[582]

Similar to the Fifth Circuit in *Toussaint,* tax court judges have also looked to a taxpayer's false or incredible testimony[583] as indicative of fraud generally as opposed to applying it on a year-by-year basis. This approach makes sense here. Thus, this badge of fraud is found as to Sam for 1992 through 2013.

Conversely, while Dee is uninformed on a wide range of business issues and activities, she was credible. The Court is convinced that she testified truthfully; and thus, this badge of fraud does not apply to Dee.

j) Offering Implausible or Inconsistent Explanations of Behavior

It is hard to believe that Sam didn't know what French was up to on his behalf—both when French (i) received a second opinion from Lubar in 1993 due to French's lingering concerns about the proper legal characterization of the Bulldog IOM Trust and the resulting tax treatment to the Wylys of the 1992 annuity transactions, and (ii) created false documents to "paper" the 1994 and 1995 IOM trusts in such a way that those trusts would "fit" the mold for foreign grantor trusts of a non-resident alien in order that the Wylys, as beneficiaries of those trusts, could obtain favorable tax treatment for transactions undertaken through them.[584] That Sam would not know of French's concerns and actions seems inconsistent with what the Court has learned about him here.

While Sam may be an "idea guy" who hires the best and the brightest to run his ventures or otherwise work for him because they know more about the business or their work than he does, as he described himself and as others described him, it is abundantly clear that Sam does not suffer fools gladly. Sam is obviously a very smart man, who is incredibly savvy in the business world and who expects to be kept informed and for things to happen as he directs. You don't amass the kind of wealth that he was able to amass unless you are smart, savvy, prepared to take risks and cut loose dead weight. That he had no idea what French was doing, or that there were problems associated with the offshore system that was put in place at his direction, is highly unlikely if not unthinkable.

***450** A businessman as savvy and sophisticated as Sam could not truly believe that it was appropriate for him to do what he did here. Put hundreds of millions of dollars of value offshore in exchange for unsecured annuity obligations from newly-formed domestic and IOM corporations that owned no assets other than the stocks and warrants that he assigned or sold to them. And then, after those options and warrants are exercised by the IOM corporations and the stocks are sold, thereby generating hundreds of millions of dollars of cash in the corporations owing him the annuity obligations, Sam manipulated the corporations in such a way that the obligations owing to him cannot now be paid. However, his lifestyle and the lifestyle of his loved ones have not suffered. In fact, the Wyly family lifestyles have prospered through the enormous wealth that his offshore-directed activities have permitted him to accumulate tax-free.[585] As the SDNY Court found, and was independently established here,[586]

> [r]easonable and savvy businessmen do not engage in such activity unless it is profitable. Of course it was profitable—by transferring property, including valuable options and warrants, to the trusts, by exercising the options and trading in secret, and using the proceeds to reinvest in other ventures, the Wylys were able to accumulate tremendous tax-free wealth.

It is abundantly clear here that the IOM trustees chosen by Sam (and Charles) did not have an original thought or idea for the last 25 years. Or, if they had had one (and Sam or Charles didn't like it), they were bullied into acquiescing to a Wyly "wish" under threat of being fired ("removed" in trust speak) if they didn't go ***451** along.[587] In short, all original thoughts and ideas came from Sam, Charles, another family member, or one of their "trusted" or "creative" advisors. But, rest assured, Sam and/or Charles blessed each and every idea. The record is clear—nothing happened offshore without Sam's or Charles' express approval, all under the guise of expressing their demands or directions as "wishes." In short, money moved or didn't move within the offshore system as Sam and/or Charles, and no one else, "wished." For example, when Laurie wanted to know if she could use the structure that she and two of her sisters had used in Colorado for the homes they use and enjoy there,[588] she did not go to the trustee of the Bessie IOM Trust to ask permission to use that same structure in Dallas for the home she and her husband have lived in for the last fourteen or so years (rent free), she went to her dad—Sam. And, with his blessing, it happened, as did the overwhelming majority of the funding for the design and building of the home.[589] Although the record does not divulge exactly how much in offshore funds were used to build the Mi Casa home, financial statements appear to value the home at a book value of $3,215,000 as of November 30, 2015.[590] All without a whimper from the trustee of the Bessie IOM Trust.

This badge of fraud has been established by clear and convincing evidence as to Sam from the outset of the offshore system in 1992 through 2013.[591]

As it relates to Dee, the IRS asks this Court to conclude that Dee's story is equally incredible—but for different reasons. The IRS says she had to have known about what was going on here because, among other things, she: (i) signed some of the documents concerning the offshore system, (ii) signed and filed false and fraudulent tax returns, and (iii) she learned of the Senate investigation of her family's offshore system but did nothing thereafter. According to the IRS' theory, once Dee learned of the Senate investigation, she should have asked Charles tough questions and when she wasn't satisfied, she should have hired independent counsel to advise her with regard to the offshore system and what she needed to do. The Court has several problems with this argument.

First, the IRS asks too much of Dee under the facts and circumstances here. While it is admittedly surprising that after learning of the Senate investigation of her ***452** family she didn't speak to Charles about it, there is no evidence in the record to the contrary. And, after listening carefully to her testimony and observing her demeanor, the Court is convinced that she was being truthful and candid. That she didn't participate in business affairs is clear; that she doesn't understand her financial circumstances—now or then—is clear. Charles took care of her and the family financially and she took care of the children and the home. Even after his death in 2011, Dee has not had to grapple with learning about business issues, leaving those issues to her son-in-law and executor of Charles' probate estate, Donnie Miller, and Hennington, the CFO of the Wyly family office. The Court is satisfied that Dee is a genuinely nice person who was largely oblivious to both the facts of the offshore system and its expected tax advantages, the controversy surrounding it, and the securities fraud that occurred to try to protect it. That she may be unsophisticated in financial matters or a beneficiary of the family wealth does not make her story incredible.

Second, the IRS assumes that had she consulted independent counsel that counsel would have given her different advice from that Sam and Charles received in 2003 from Meadows Owens regarding the filing of the Form 8275 disclosures with their tax returns. While it is certainly possible that she would have gotten different advice, that conclusion is pure speculation on this record.

Third, the IRS audit of the offshore system was already underway by the time Dee learned of the Senate investigation. It would not be unreasonable for Dee (or her separate counsel) to conclude that the issues would get resolved there in a reasonable period of time, even assuming Dee was aware of the audit.

Finally, given what the Court has learned about Dee and Charles' marriage, the Court can infer what would have happened, in all likelihood, if Dee had done as the IRS suggests. She grills Charles, which would have, again in all likelihood, resulted in him simply reassuring her that all was fine—Sam and he had consulted various professionals throughout the time the offshore system was in existence and had been assured that it was legal. By now it is 2005, Dee is about 72 and has been a homemaker for about 50 years during which she knew virtually nothing about the offshore system or Charles' business affairs. Really —at this point she should have hired her own lawyer to investigate what her husband of 50 years assured her had been amply investigated and was fine? To be honest, that seems the more implausible of the behavior options under the circumstances here.

After carefully considering the evidence, the IRS has failed in its proof of this badge of fraud as to Dee.

k) Filing False Documents.

So, what documents does the IRS claim were false or misleading when filed with it by the Wylys? The IRS argues that: (i) the manner in which the Debtors reported the annuity payments they received from the offshore system on their tax returns was false and misleading, (ii) the Forms 3520 and 3520–A[592] that the Debtors did file were false and misleading, particularly in light of the Forms 3520 and 3520–A that should have been filed and were not, and (iii) the Debtors' tax returns were false and misleading because they (a) underreported their income from offshore, and (b) ***453** chose to check “no” in response to the Form 1040 question “[d]uring [relevant year], did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust?”[593] Each is addressed below.

Throughout trial, the IRS argued that the manner in which the Debtors reported annuity income from the offshore system was misleading. Instead of reporting annuity income on the face of their tax returns on line 16a, which is labeled "Pensions and annuities," [594] the Debtors reported their annuity income from the offshore system on Schedule C, and labeled this income simply as "ANNUITIES." [595] The IRS contrasted the way this offshore annuity income was reported and the way other annuity income Sam received domestically was reported. Unlike the IOM annuity payments, a domestic annuity payment Sam received was reported as income on line 16a of his tax return, and included the name of the entity making the payment to him. [596] In contrast, when Sam reported his offshore annuity income on Schedule C, the name of the IOM corporation(s) making the payment(s) to him was not included. [597]

At trial, a revenue agent involved with the Wylys' audit, Charles Herrick ("**Herrick**") testified that this manner of reporting is unusual—*i.e.,* "annuity income is generally reported on Line 1 or on the face of the return. Here it was on a Schedule C, which is unusual." [598] Herrick also testified that the way in which Sam, Charles, and Dee reported their offshore annuity income caused some confusion during the audit and caused the IRS to be uncertain whether the annuity income was actually reported by them on their tax returns. [599]

In contrast, Hennington explained why Sam, Charles, and Dee reported offshore annuity income in the way that they did. Specifically, she testified that the offshore ***454** annuities were reported on Schedule C because these annuity payments needed to be subject to self-employment tax. [600] According to Hennington, reporting the offshore annuity income on line 16a would have led to the Wyly family office's tax software calculating a tax amount that was too low. [601] Hennington also testified that domestic annuity payments were reported with the name of the entity making the annuity payment included because "there would have been a 1099 that needed to be matched" against it by the IRS. [602]

In its Amended Proposed Findings of Facts and Conclusions of Law, the IRS argues that this characterization of the offshore annuity payments as self-employment income is specious, because there was no nexus between the income received and the trade or business operated by Sam and Charles. [603] However, Hennington testified that she understood that because the stock options transferred in exchange for the offshore annuity obligations had been received by Sam and Charles as compensation, the required nexus for the payments to be subject to self-employment tax exists. [604] Moreover, Hennington did not come up with this reporting position herself; she testified that Pulman, a tax lawyer at Meadows Owens, and French advised her that the Wyly offshore annuity income was subject to self-employment tax. [605]

[38] **[39]** Hennington's explanation that the offshore annuity income was subject to self-employment tax is not unreasonable. 26 U.S.C. § 1402 defines "net earnings from self-employment" as "the gross income derived by an individual from any trade or business carried on by such individual" less any applicable deductions. [606] According to the Fifth Circuit, "[t]he common-law determines whether a taxpayer is self-employed...." [607] In its Amended Proposed Findings of Facts and Conclusions of Law, the IRS cites a number of cases for the proposition that "in order to be classified as net earnings from self-employment under 26 U.S.C.S. § 1402(b), there must be a nexus between the income received and the trade or business that was actually operated by a taxpayer." [608] These cases go on to say that "[t]he income must arise from some actual (whether present, past or future) income-producing activity" and that "self-employment income is determined by the source of the income, not the taxpayer's status at the time the income is realized." [609]

Although the Court does not here decide whether the Wylys' annuity payments ***455** needed to be subject to self-employment tax, the Court notes that the Debtors' belief that such payments would be treated as self-employment earnings under the "nexus" test cited by the IRS makes sense. The IRS' own expert characterized the stock options that initially funded the offshore system as "compensatory stock options ... and that income, then, is basically considered wage income under the Internal Revenue Code." [610] This understanding comports with Hennington's understanding. From the Court's perspective, (i) Hennington provided a coherent explanation as to why the offshore annuity income was reported in the manner that it was, and (ii) although the IRS complains that the source of the annuity payments was not disclosed, the instructions to Form 1040 do not require that the source be identified and the IRS has not cited us to anything requiring the disclosure of the source.

The IRS also argues that the manner in which the Debtors went about reporting—or not reporting—their dealings with the offshore system on Forms 3520, 3520–A, and 5471 [611] was false and misleading. The Court notes that one of the largest portions of the IRS' claims against the Debtors consists of penalties for the Debtors' failures to file these forms. [612] The Debtors' failures to file these forms—when they were actually required to be filed [613] —can be properly considered as a part of the badge of fraud of filing false documents. This is because, as the Supreme Court has noted, "any conduct, the likely effect of which would be to mislead or conceal" can be weighed as a badge of fraud. [614] As found in other portions of this opinion, Sam and Charles attempted to structure, and in certain circumstances succeeded in structuring, their offshore transactions in such a way as to avoid reporting requirements that would reveal the true nature and extent of their offshore holdings. [615] But, even when required, the Wylys chose not to file those forms as part of their efforts to keep the extent of their offshore holdings secret from the IRS.

Moreover, the Forms 3520 and 3520–A that the Wylys did file were, in the context ***456** of their overall offshore system, at least misleading. First, most of the forms that were filed related to entities that were not significant players in the Wyly offshore system—*i.e.,* the forms were filed for entities that were not the entities through which the majority of the Wyly offshore transactions were conducted. [616] This, when considered in the context of the other similar forms that were required to be filed but were not, makes the filed forms misleading. Second, many of the forms that were introduced into evidence here were not signed and not dated, [617] signed but not dated, [618] or were completely missing their signature pages, [619] despite the fact that both Forms 3520 and 3520–A contain a signature and date line and are to be signed under penalty of perjury. [620] Finally, and oddly, two of the Forms 3520 that the parties stipulate that Sam filed for transactions that occurred during the 1992 tax year used versions of IRS forms that would not have been available until 1995, despite that fact that § 6048—in 1992, 1995, and currently—requires a Form 3520 to be filed on or before the ninetieth day after a reportable event. [621] Although Sam signed these two forms under penalty of perjury, they were not dated on the signature line. [622] Notably, while the Joint Stipulations indicate that those Forms 3520 and 3520–A that are in the record as Joint Exhibits 142 through 175 were filed with the IRS, there is no stipulation that they were timely filed. [623]

Although some required Forms 3520 and 3520–A were filed for trusts that had a ***457** larger role in the Wyly offshore system, those forms by no means gave a complete picture of the operation of the trusts or the extent of their holdings. For example, Sam filed a Form 3520 for the Bulldog IOM Trust, which indicated that the trust had been created and that $100.00 of property was transferred into it. [624] Charles filed a similar, single Form 3520 for the Pitkin IOM Trust indicating that it had been settled with $100.00. [625] However, no annual Forms 3520–A were filed for either the Bulldog IOM Trust or the Pitkin IOM Trust, as was required since Sam was the owner of the Bulldog IOM Trust under the Grantor Trust Rules and Charles and Dee were the owners of the Pitkin IOM Trust under the Grantor Trust Rules. [626] The failure to file the Forms 3520–A makes the earlier filed forms misleading.

From the Court's perspective, the misleadingly incomplete picture the filed forms provide of the Wyly offshore system when you consider the other forms that were required to be filed, but were not, strongly suggest that Sam and Charles acted with fraudulent intent. [627]

Finally, the IRS argues that the Wylys' tax returns were false and misleading in two ways—*i.e.,* by (i) underreporting their offshore income, and (ii) falsely answering a question on their tax returns. The Court agrees with the IRS with respect to (i) for all tax years in which there was unreported income and agrees with the IRS with respect to (ii), at least with respect to tax years 1992 through 2002 as to Sam and 1992 through 2003 as to Charles and Dee, as explained below.

It is certainly true that the Wylys' underreported their offshore income on their tax returns, as the parties stipulated in the Computation Stipulations. In that sense, ***458** the IRS is obviously correct—the Wylys' tax returns for those years in which there was unreported income were false. As found previously, for Sam that is tax years 1992 through 2003, 2005 through 2006, and 2010; while for Dee that is tax years 1992, 1994 through 2003, 2006, 2008, 2011, and 2013.

Moreover, it is true that the Wylys' checked "no" in response to the Form 1040 question "[d]uring [relevant year], did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust?" from 1992 through 2013 as to Sam and from 1993 through 2013 as to Charles and/or Dee.[628] And, in that sense, the IRS is again obviously correct—the Wylys' tax returns for those years were false given the SDNY Court's determination in the SEC Action that certain of the IOM trusts were grantor trusts as to Sam and Charles, which determination we have given collateral estoppel effect to here.

But even without the SDNY Court's grantor trust determination, checking the "no" box was misleading on their tax returns once Sam and Charles were on notice of Lubar's advice that there was a significant risk that the 1992 IOM trusts were properly characterized as grantor trusts as to them. While their 1992 tax returns were filed before they were on notice of Lubar's advice, every other return they filed that checked "no" in response to the Form 1040 question "[d]uring [relevant year], did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust?," was filed with knowledge of the significant risk that they could be found to be the grantor of a foreign trust that existed during each year from 1993 through 2013.[629]

Equally, if not more, troubling is the fact that even when Sam and Charles knew they had established trusts in the IOM that they intended to be characterized as grantor trusts as to them—*i.e.,* all of the trusts involved in the 1996 annuity transactions (Sitting Bull IOM Trust, Tallulah IOM Trust, Arlington IOM Trust, and Crazy Horse IOM Trust as to Sam and Maroon IOM Trust, Woody International IOM Trust, and Lincoln Creek IOM Trust as to Charles)—they still checked the box "no." Again, this made their tax returns false and misleading from 1992–1996, the years in which those trusts were in existence.

But, to be fair, for tax years 2002 through 2013, Sam attached Form 8275 disclosures to his filed tax returns.[630] Similarly, ***459** for tax years 2003 through 2011, Charles and Dee attached Form 8275 disclosures to their filed tax returns.[631] According to the Debtors, the attachment of the Forms 8275 to their respective tax returns should cure the false and misleading problem created by their failure to check the correct box on their tax returns—at least in the years in which those forms were filed. The Court agrees, as explained below.

The Form 8275 disclosures were substantially identical for both Debtors. Beginning with Sam's 2002 tax return, the attached Form 8275 disclosure noted that he had created a trust in a foreign country and that—although he did not regard himself as the grantor of the trust —this conclusion might run counter to certain IRS regulations issued in 2000 under 26 U.S.C. § 679, as well as certain statutory provisions of 26 U.S.C. § 674.[632] The Form 8275 disclosure attached to Charles' and Dee's 2003 tax return was substantially identical to the Form 8275 disclosure attached to Sam's 2003 tax return and which contained essentially the same information as Sam had provided the prior year.[633] In tax year 2004, most of the previously disclosed information remained in the Form 8275 disclosure, along with certain additional information. Specifically, the Form 8275 disclosures attached to Sam's and Charles and Dee's 2004 respective tax returns included information that property had been transferred to subsidiaries of the foreign trusts in exchange for private annuities, and it was admitted that there were "one or more trusts."[634] However, while the Form 8275 disclosures attached to the 2002 and 2003 tax returns estimated the amount of income tax that Sam and Charles might owe if they were in fact grantors of the IOM trusts, Form 8275 disclosures for tax years 2004 and later omitted this information.[635] The Form 8275 disclosures attached to the Wylys' 2005 and later tax returns (i) admitted that there were multiple trusts, (ii) added that the trusts were created in the IOM, (iii) began differentiating between the 1992 trusts and the 1994/1995 trusts, and (iv) stated that there were funding issues regarding the 1994/1995 trusts that the taxpayers had discovered in 2006.[636] The Form 8275 disclosure attached to the Wylys' 2007 tax returns described the 1999 Options Sales, pursuant to which Sam and Charles each sold options to subsidiaries of IOM trusts for cash.[637] The Form 8275 ***460** disclosure Sam attached to his 2013 tax return added brief notes about how some of his views were in opposition the SDNY Court's grantor trust determination in the SEC Action.[638]

Since all that checking the box "yes" on the tax returns would have disclosed is that Sam or Charles and Dee were the grantor of a foreign trust or had transferred property to a foreign trust in a given year, and because the Form 8275 disclosures that the Wylys attached to their tax returns in the years identified above contained that basic information, the Court agrees with the Debtors that they cured their failure to check the correct box on their tax returns, at least from tax years 2002 through 2013 as to Sam and 2003 through 2011 as to Charles and Dee.

In summary and as it relates to Sam, after examining all of the documents that were filed with the IRS that the IRS labels as false or misleading, the Court concludes that (i) Sam's tax returns were false in the years in which he underreported income (1992–2003, 2005–2006, 2010) and in the years in which no Form 8275 disclosure was attached to his tax returns (1992–2001), and (ii) the Forms 3520 and 3520–A that he filed were false and misleading, particularly in light of the Forms 3520, 3520–A, and 5471 that should have been filed and were not (1992–2013), as the IRS was never provided with an accurate portrayal of Sam's offshore system until he was forced to disclose the extent of his offshore holdings during the IRS audit. Accordingly, this badge of fraud applies to Sam.

However, this badge of fraud does not apply to Dee, as the Court is satisfied that Dee (i) did not know that the tax returns and other forms she signed that were filed with the IRS were in any way false or misleading, and (ii) did not participate in any decision to attempt to keep the extent of the offshore holdings secret through less than complete and candid reporting.

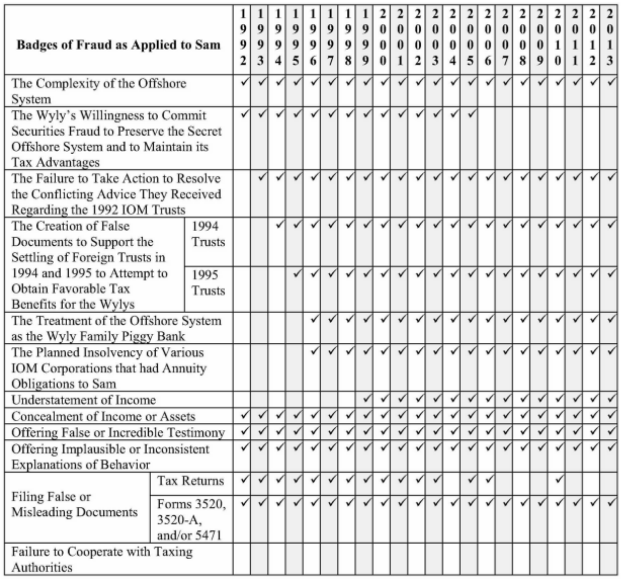
l) Failure to Cooperate with Taxing Authorities.

The evidence here is conflicting. Certainly, the IRS has pointed to instances where incomplete information was provided to them in connection with an earlier, but unrelated, audit, or where inaccurate information was provided on a tax return. Overall, however, the Court is persuaded that at least as to the 2004 audit of the offshore system, the one truly relevant here, the Wylys have cooperated with the taxing authorities.

The IRS has not established this badge of fraud by clear and convincing evidence as to either Sam or Dee.

In conclusion, the IRS has established, by clear and convincing evidence, the following badges of fraud in the following years as to Sam:

***461**



Badges of Fraud as Applied to Sam		1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
The Complexity of the Offshore System		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
The Wyly's Willingness to Commit Securities Fraud to Preserve the Secret Offshore System and to Maintain its Tax Advantages		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓								
The Failure to Take Action to Resolve the Conflicting Advice They Received Regarding the 1992 IOM Trusts			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
The Creation of False Documents to Support the Settling of Foreign Trusts in 1994 and 1995 to Attempt to Obtain Favorable Tax Benefits for the Wylys	1994 Trusts			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	1995 Trusts				✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
The Treatment of the Offshore System as the Wyly Family Piggy Bank						✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
The Planned Insolvency of Various IOM Corporations that had Annuity Obligations to Sam						✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Understatement of Income									✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Concealment of Income or Assets		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Offering False or Incredible Testimony		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Offering Implausible or Inconsistent Explanations of Behavior		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Filing False or Misleading Documents	Tax Returns	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓				✓			
	Forms 3520, 3520-A, and/or 5471	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Failure to Cooperate with Taxing Authorities																							

As the above summary demonstrates, there are numerous badges of fraud present as to Sam each year from 1992 through 2013. And, as noted previously, while the sheer number of badges is not determinative, the significance of the badges under the facts and circumstances here have convinced the Court that the IRS has carried its burden of proof regarding Sam's liability for fraud penalties under 26 U.S.C. § 6663 for each year from 1992 through 2013. However, as explained above, the IRS has not proven, by clear and convincing evidence, the existence of any badge of fraud as to Dee, which is obviously insufficient for it to carry its burden of proof as to Dee. But, the IRS has one final argument in its arsenal that it uses to attempt to prove Dee's intentional failure to pay taxes known or believed to be owing—*i.e.,* the doctrine of willful blindness, to which we now turn.

C. Was Dee Willfully Blind?

[40] **[41]** It is undisputed that the doctrine of willful blindness arose in connection with a wide range of criminal statutes. However, in *Global–Tech Appliances, Inc. v. SEB S.A.,*[639] the Supreme Court concluded that the willful blindness doctrine could be applied in civil lawsuits (there a patent infringement action). According to the Supreme Court, there are two basic

***462** requirements of the willful blindness doctrine: "(1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact."[640] If both elements are satisfied, "a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts."[641]

Although the tax court has applied the willful blindness doctrine in at least two tax fraud cases to satisfy the knowledge requirement, it is not entirely clear that its application is appropriate here.[642] In the first place, both of these tax court cases involved relatively sophisticated taxpayers. Specifically, one involved a tax lawyer[643] and the other involved a taxpayer who was "well-educated in the intricacies of the business world, and [was] deeply involved in that world for almost 40 years."[644] Thus, these taxpayers bear little resemblance to Dee. Secondly, one of these cases—*Fiore v. C.I.R.*[645]—NOtes that "[w]illful blindness is a relatively underdeveloped area of law in Tax Court jurisprudence-at least in fraud cases ... Willful-blindness fraud is more thoroughly described in criminal law."

[42] When the doctrine of willful blindness has been applied in the criminal law context, it is not always necessary to show that the defendant engaged in affirmative acts to avoid knowledge of wrongdoing to invoke the willful blindness doctrine because "in some cases the likelihood of criminal wrongdoing is so high, and the circumstance surrounding a defendant's activities and cohorts are so suspicious, that a failure to conduct further inquiry or inspection can justify the inclusion of the deliberate ignorance instruction."[646] Nevertheless, even in the criminal context, circumstances where a willful blindness instruction to a jury is appropriate are rare.[647] And, as the Fifth Circuit stated in *U.S. v. Jones,*[648] negligence, carelessness, or foolishness is not enough to establish willful blindness.

Assuming that the doctrine of willful blindness applies here, if Dee acted with willful blindness, this Court could find the knowledge requirement for fraud penalties satisfied. And, while a case could be made that Dee's conduct here falls more closely into the negligence, carelessness, or foolishness category, the Court will analyze willful blindness to see if it would change the outcome here. Thus, the Court must determine whether it is reasonable to find here—by clear and convincing evidence—that Dee (i) subjectively believed that there was a high probability that she (and Charles while he was alive) had (a) understated income on her (their) tax returns or (b) underpaid her (their) taxes, and (ii) then took deliberate actions to avoid learning ***463** of the fact of her (their) understated income or underpaid taxes.

[43] After carefully considering the evidence, this Court concludes that there is insufficient evidence from which a reasonable fact finder could find, utilizing the clear and convincing evidence standard, that Dee subjectively believed that there was a high probability that she (and Charles while he was alive) had (i) understated income on her (their) tax returns or (ii) underpaid her (their) taxes. This is certainly true from 1992 through 2003. During those years, what did Dee know such that she could form a subjective belief of a high probability of understated income or underpaid taxes? At best, the record supports a finding that Dee knew that: (i) Charles had established a series of offshore trusts and related entities in the IOM, (ii) she had signed certain documents in connection with certain of the IOM trusts, the IOM corporations, or her annuity agreements issued by an IOM corporation, (iii) they lived a lavish lifestyle purchasing expensive jewelry, art, and home furnishings, and (iv) she had signed their joint tax returns.

However, on this record, the Court cannot find that Dee: (i) understood the offshore system—complex or not, (ii) understood any of the documents she had signed in connection with the offshore system—which she had not read and the Court is satisfied that if she had read she would not have understood to any great extent, (iii) knew that the items of expensive jewelry, art and home furnishings that Charles and she had purchased had been paid for by one or more of the IOM trusts or corporations, and (iv) understood their joint tax returns—which she had not read and the Court is satisfied that if she had read she would not have understood to any great extent. In point of fact, Dee's lifestyle did not change after the offshore system was established, which could have put her on notice that something was amiss. By 1990, Charles and she were rich by anyone's standard and she had become accustomed to a lifestyle that most would consider lavish. She made purchases and someone in the Wyly family office paid the bills. Nothing changed in that regard on or after 1992.

But, even assuming that she knew and understood that Charles had established an extremely complicated offshore system; that, standing alone, is not illegal or fraudulent. Moreover, even assuming that she had read and understood the documents she had signed—nothing in them would have put her on notice of anything that should have created a subjective belief of a high probability that Charles and she had understated their income or underpaid their taxes. Their joint tax returns were extremely complicated documents that she had no role in preparing. From her perspective, they continued to be prepared as they always had—by people within the Wyly family office whom she trusted. From this Court's perspective, there is simply insufficient evidence to find—by clear and convincing evidence—that Dee knew something that should have created a subjective belief in her that there was a high probability that Charles and she had understated their income or underpaid their taxes during those years.

Now, let's analyze the later years. An IRS audit focused on the Wyly offshore system started in 2004, the Senate began investigating the Wyly offshore system in 2005, [649] the SEC began investigating Charles and Sam for alleged securities fraud about that time and, in 2010, the SEC sued Charles and Sam, among others, ***464** in the SDNY Court for alleged securities fraud. Even assuming that Dee knew all of these facts, which is not clear on this record, should knowledge of these facts have created in Dee a subjective belief of a high probability that Charles and she had understated their income or underpaid their taxes? The Court answers this question no, as to answer the question yes requires the Court to find that Dee could understand (i) the legal issues being raised by the IRS in its audit, (ii) what the Senate was investigating and what conclusions, if any, they reached, (iii) what securities fraud was, much less what Charles was alleged to have done or ultimately found to have done, and (iv) the relevance of the securities fraud allegations to the issue of understated income or underpayment of taxes.

Again, recognizing that Dee is an intelligent but financially unsophisticated woman, the Court is convinced that she has not understood the legal issues being litigated here (many of which are the same issues that were being investigated elsewhere), which strongly suggests that she would not have understood them in that context either. In short, her three years of college and her 50 plus years as a homemaker and mother did not equip her with the ability to understand the highly complicated legal issues sufficiently such that she could form a subjective belief of a high probability that Charles and she (or she after Charles' death) had understated their (her) income or underpaid their (her) taxes. And, without such a subjective belief, we do not get to the required second element of willful blindness—*i.e.,* that Dee then took deliberate actions to avoid learning of the fact of her (their) understated income or underpaid taxes.

On this record, the IRS failed to prove—by clear and convincing evidence—that Dee was willfully blind; and thus, the IRS has failed to carry its burden of proof on the required second element of its claim for fraud penalties as to Dee for any year in which there is a stipulated underpayment of tax.

D. Is Dee Entitled to the Benefits of the Innocent Spouse Defense ?

Next, the Court must decide whether Dee is entitled to innocent spouse relief pursuant to 26 U.S.C. § 6015 with respect to her liability for any income tax deficiencies that may be determined for the years 1992 through 2011. [650] Because the tax returns for the years 2012 and 2013 are not joint returns, innocent spouse relief cannot be at issue for those years.

As noted previously and as a general rule, when married persons file a joint income tax return they become jointly and severally liable for the tax due with respect to that return. However, Congress concluded that under certain circumstances, such liability could be unfair. As relevant here, Dee seeks "innocent spouse" relief pursuant to 26 U.S.C. § 6015(b) and (c).

[44] For the reasons explained below, this Court is satisfied that Dee is entitled to innocent spouse relief under § 6015(b), which provides that relief from joint and several liability is available if: (i) a joint return was filed, (ii) there is an understatement of tax attributable to the erroneous items of one individual filing the return, (iii) the spouse requesting relief did not know, and had no reason to know, of the understatement at the time of signing the return, (iv) taking into account all the ***465** facts and circumstances, it would be inequitable to hold the requesting spouse liable for the deficiency in tax resulting from the understatement, and (v) the requesting spouse asserts the innocent spouse defense within two years of the IRS commencing collection activities.[651] Dee has clearly established the first[652] and the last[653] elements for tax years 1992 through 2011. Thus, the Court's analysis will focus on the remaining elements. As discussed previously, Dee bears the burden of proof by a preponderance of the credible evidence.[654]

As just noted, § 6015(b)'s second required element is that there is an understatement of tax on the return attributable to erroneous items of the other spouse.[655] An understatement of income is defined as the excess of (i) the amount of the tax required to be shown on the return for the taxable year, over (ii) the amount of the tax that is shown on the return, reduced by any rebate.[656] An erroneous item is any item resulting in an understatement or deficiency in tax to the extent that such item is omitted from, or improperly reported (including improperly characterized) on an individual joint income tax return.[657] For example, unreported income from an investment asset resulting in an understatement or deficiency in tax is an erroneous item.[658] Similarly, ordinary income that is improperly reported as capital gain resulting in an understatement or deficiency in tax is also an erroneous item.[659] An erroneous item is also an improperly reported item that affects the liability on other returns—*i.e.,* an improper net operating loss that is carried back to a prior year's return.[660] Penalties and interest are not erroneous items.[661] Rather, relief from penalties and interest will generally be determined based on the proportion of the total erroneous items from which the requesting spouse is relieved.[662]

[45] As noted previously, the parties have stipulated that there is understated income on Dee and Charles' joint tax returns for years 1992, 1994 through 2003, 2006, 2008, and 2011.[663] After carefully ***466** considering the evidence at trial, the Court finds that all of the understated income for each of those years is attributable solely to Charles' activities.[664] Dee's uncontroverted testimony demonstrates that she had limited knowledge of, or involvement in, the establishment of the offshore trusts by Charles and Sam, had no specific knowledge of, or involvement in, the operation of the offshore trusts, and was not generally involved in the family's business and financial affairs.

Section 6015(b)'s third required element is that the requesting spouse establish that, in signing the return, she did not know and had no reason to know that there was such an understatement. A requesting spouse has knowledge or reason to know of an understatement if she actually knew of the understatement, or if a reasonable person in similar circumstances would have known of the understatement.[665] All of the facts and circumstances are considered in determining whether a spouse had knowledge or reason to know, including (i) the nature of the item relative to other items, (ii) the couple's financial position, (iii) the requesting spouse's educational background and business experience, (iv) the extent of the requesting spouse's participation in the activity at or before the time the return was signed about items that a reasonable person would question, (v) whether the requesting spouse failed to inquire, at or before the time the return was signed, about items on the return or omitted from the return that a reasonable person would question, and (vi) whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns—*e.g.,* omitted income from an investment regularly reported on prior years' returns.[666]

Courts generally agree on the knowledge test in omitted income cases. For example, in *Cheshire v. C.I.R.,*[667] the Fifth Circuit stated that the proper test is whether the taxpayer knew or had reason to know about the omitted income itself, or knew or had reason to know about the income-generating transaction, referred to as the knowledge of the transaction test.[668] In *Cheshire,* the taxpayer took a large retirement distribution, part of which was used to pay off their mortgage.[669] The money used to pay off the mortgage was improperly deducted from the taxpayer's taxable income.[670] Without deciding whether the case presented facts of an omitted income or erroneous deduction case, the court found that the taxpayer had actual knowledge of the income generating transaction, a retirement distribution, so innocent-spouse relief was not available.[671]

However, in *Braden v. C.I.R.*,[672] a husband who knew that his wife had inherited ***467** money from her father's estate, but did not know that some of the money was from withdrawals from her father's IRA accounts and some from interest income, did not know or have reason to know of the understatement.[673] According to the tax court, this case could be distinguished from *Cheshire* because there the wife had actual knowledge of the underlying transaction—a distribution from a pension plan—while the husband in its case did not know the essential facts of the transaction that defined its character for federal income tax purposes.[674] Rather, the husband thought the money emanated from his father-in-law's estate, which would not be taxable, and the tax court found no indication that the husband should have known some of the money was from IRA accounts and interest income, which are both taxable.[675]

Another example illustrating omitted income is *Pietromonaco v. C.I.R.,*[676] where the tax court erred in denying innocent-spouse relief to a spouse who had only a high school education, and who paid household expenses from a joint checking account, but otherwise had no access to her family's finances and had no knowledge of her husband's business activity.[677] The tax court's finding that she should have known of income understatements from a cursory review of joint returns, because she was aware of her expenditures, was erroneous; her husband controlled their bank accounts, and the couple had savings built up over their 40–year marriage that could have accounted for amounts by which expenditures exceeded their reported income.[678] The couple also lived the same lifestyle both before and after the underreporting, and the taxpayer received no gifts or other benefits from the income her husband failed to report.[679]

[46] If a spouse has actual knowledge of the underlying transaction that produced the omitted income, innocent-spouse relief will be denied, even when the spouse did not fully understand the tax significance of the transaction.[680] In *Penfield v. C.I.R.,*[681] an ex-husband not only knew of pension withdrawals his ex-wife made, but had been instrumental in persuading his ***468** ex-wife to make those withdrawals. Therefore, the tax court properly denied the ex-husband innocent-spouse relief.[682]

With this background in mind, we return to the facts and circumstances to be considered in determining whether a spouse had knowledge or reason to know, including (i) the nature of the item relative to other items, (ii) the couple's financial position, (iii) the requesting spouse's educational background and business experience, (iv) the extent of the requesting spouse's participation in the activity at or before the time the return was signed about items that a reasonable person would question, (v) whether the requesting spouse failed to inquire, at or before the time the return was signed, about items on the return or omitted from the return that a reasonable person would question, and (vi) whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns.[683] Many of these circumstances have been discussed in connection with the Court's fraud penalties and willful blindness analysis and will not be repeated here.[684] However, in summary and as previously found, Dee's uncontroverted, credible testimony is that she was not involved in Charles' business affairs. And, while Dee signed some documents in connection with the offshore system, the Court is satisfied that she understood very little about it or the income that was being generated offshore and not reported on their joint tax returns.

After carefully considering the record and the relevant facts and circumstances, the Court is satisfied that (i) Dee did not know about the underlying transactions that produced the unreported income from the offshore system, and (ii) a reasonable person in similar circumstances would not have known about these transactions. In short, Dee did not have the educational background or sophistication in business and tax matters to know if her tax returns contained any understatements of income. And, a reasonable person with the same educational background and lack of business sophistication as Dee would not have had a different understanding. Accordingly, Dee satisfies the third element for innocent-spouse relief under § 6015(b).

[47] **[48]** Section 6015(b)'s fourth required element is that, when considering all of the facts and circumstances, it would be inequitable to hold a requesting spouse jointly and severally liable for an understatement.[685] One relevant factor for this purpose is whether the requesting spouse significantly benefitted, directly or indirectly, from the understatement.[686] Indeed, the Fifth Circuit has characterized this factor as "the most important factor in determining inequity."[687] A significant ***469** benefit is any benefit in excess of "normal support."[688] Evidence of direct or indirect benefit may consist of transfers of property or rights to property, including transfers that may be received several years after the year of the understatement.[689] Thus, for example, if a requesting spouse receives property from the non-requesting spouse that is beyond normal support and is traceable to items omitted from gross income that are attributable to the non-requesting spouse, the requesting spouse will be considered to have received a significant benefit from those items.[690]

[49] "Normal support" is not measured absolutely; there is no dollar amount above which support is deemed out of the ordinary. Normal support is determined by comparing the couple in question's standard of living during the tax years for which there is an alleged deficiency to the years before. If a couple's standard of living during the tax years in question is beyond what the couple normally enjoyed, that can be evidence of a "significant benefit" that should have put the requesting spouse on notice. As the Fifth Circuit explained in *Sanders v. U.S.,*[691] "one person's luxury can be another's necessity, and the lavishness of an expense must be measured from each family's relative level of ordinary support." An illustrative case is *Kistner v. C.I.R.*[692] There, the tax court, citing *Sanders,* examined the lifestyle of a wealthy couple:

> During 1979 and 1980, petitioner clearly lived a very affluent lifestyle. However, prior to 1979, petitioner was already living in the McClure residence, with its pool, clubhouse and tennis court, during one half of the year, and in the furnished Florida condominium during the other half of the year. Petitioner also was already benefitting from the other domestic services of the Robichauds and the use of the A-frame cabin in Michigan. The extent of the personal use of Tem–Cole's airplanes prior to 1979 is unclear, but the evidence suggests that Tem–Cole did own airplanes prior to 1979 that were used by petitioner and by Mr. Weasel.
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> Petitioner's standard of living during 1979 and 1980 was also not unusual in light of Mr. Weasel's wealth and level of income. As mentioned, Mr. Weasel had a net worth of approximately $8.6 million in prior years, and he received in prior years annual dividend distributions and compensation totaling over $1 million.[693]

***470** The tax court concluded that because the taxpayer had enjoyed a lavish lifestyle for years, there was nothing unusual about her lifestyle that caused her to significantly benefit from the understatements of income on her tax returns.[694] The petitioner was, therefore, entitled to innocent-spouse relief.[695]

As with the petitioner in *Kistner,* Dee experienced no meaningful improvement to her lifestyle during the tax years at issue. As previously found, the Wylys were extremely wealthy before the offshore trusts were established, allowing Dee to enjoy what the IRS characterizes as an opulent lifestyle. And, she continued to enjoy that same lifestyle after the offshore system was established. While the IRS points to purchases of expensive art or jewelry as evidence of "significant benefit" to Dee, as the Treasury Regulations and case law makes clear, significant benefit means something above and beyond the lifestyle the taxpayer previously enjoyed. On this record, it is clear that Dee's lifestyle did not change in any meaningful way after the establishment of the offshore trusts and related corporations.

[50] In addition to whether the requesting spouse significantly benefitted from the understatement, the tax court has also held that a material factor in determining whether it would be inequitable to hold the requesting spouse liable is whether "the failure to report the correct tax liability on the joint return results from concealment, overreaching, or any other wrongdoing on the part of the *nonrequesting* [sic] spouse."[696] If the non-requesting spouse (here Charles) has engaged in concealment, overreaching, or wrongdoing, this factor weighs in favor of granting the requesting spouse (here Dee) innocent spouse relief.[697] For example, in *Haltom v. C.I.R.,*[698] the tax court noted that:

> [t]he second factor we look at is whether the failure to report resulted from wrongdoing on the part of the nonrequesting spouse. This factor weighs heavily in Linda's favor. It was, after all, Jerry who embezzled the money, not Linda, and we have already found that she had no reason to know of either the embezzlement or its omission from their return.

Thus, wrongdoing on the non-requesting spouse's part can weigh in favor of granting innocent spouse relief to the requesting spouse. This is because "[a] purpose of section

6015 relief 'is to protect one spouse from the overreaching or dishonesty of the other.' "[699]

This factor weighs in favor of Dee. This Court previously found that Dee (i) did not commit tax fraud, as none of the badges of fraud it carefully examined applied to Dee,[700] and (ii) was not willfully blind to the fact that Charles was committing tax fraud.[701] Conversely, Charles was involved in the formation of the offshore system and, like Sam, controlled the movement ***471** of money and assets through the offshore system. In fact, Charles' offshore system and offshore activities largely mirrored those of his brother Sam, whom the Court has found committed tax fraud by clear and convincing evidence.[702] The failure to report the correct tax liability on Charles' and Dee's joint tax returns results from concealment, overreaching, and other wrongdoing on Charles' part, not Dee's. Thus, this inequity factor—which the tax court ranks along with the significant benefit factor as the "most heavily weighted" in the inequity analysis—favors Dee greatly.[703]

The regulations interpreting § 6015(b) indicate that there are other factors that may be taken into account when determining whether it would be inequitable under all of the facts and circumstances to hold a requesting spouse liable,[704] including "the fact that the requesting spouse has been deserted by the nonrequesting spouse, the fact that the spouses have been divorced or separated, or that the requesting spouse received benefit on the return from the understatement."[705] The first factor identified in the regulations—desertion—is inapplicable to Dee,[706] as Charles did not desert her. As to the second factor identified in the regulations—divorce or separation—the tax court has held that "[a]t worst ... widowhood may be a neutral factor, but we find it completely untenable that this factor weighs against relief."[707] This is because the inequity that this factor is attempting to measure is the inequity that occurs when a requesting spouse is left to deal with the consequences of tax liability on his or her own by virtue of the absence of their partner. As the tax court in *Von Kalinowski v. C.I.R.*[708] stated:

> As things presently stand, petitioner and Mr. Von Kalinowski remain married. The two have not separated, and petitioner has not been left by her husband to "face the music". Instead, petitioner continues to enjoy the lifestyle and financial security that are largely attributable to her husband's assets and income. Simply put, petitioner has not been deserted in the sense foreseen by the legislators who enacted the predecessor to the section 6015(b)(1) relief from joint liability.

Normally, it would seem a simple matter to conclude that a widow such as Dee has been left to "face the music" regarding her tax liability on her own. Although Dee still enjoys a great deal of financial security, she has been deprived of Charles' income, and many of the assets that she previously shared with him are now entangled in his probate estate. However, IRS Revenue Procedures, which are discussed further below, state that a widow or widower will be treated as no longer married for the purposes of the inequity analysis only if he or she "is not an heir to the non-requesting spouse's estate that would have ***472** sufficient assets to pay the tax liability."[709] This makes sense, as a widow or widower whose deceased spouse's probate estate has sufficient assets from which the tax liability can be paid has not been left to deal with that tax liability on his or her own.

Here, although Dee is Charles' heir, it is unclear whether Charles' probate estate will have sufficient assets with which to pay the tax liability at issue here. Dee bears the burden of proof on the innocent spouse defense, and since it is unclear on this record whether Charles' probate estate will be sufficient to pay the tax liability at issue here, the Court cannot conclude that her status as a widow is equivalent to that of divorce or separation for the purposes of the Court's inequity analysis. Again, however, the tax court has pointed out that "[a]t worst ... widowhood may be a neutral factor" and that it would be completely untenable that this factor weighs against relief.[710] The Revenue Procedures come to a similar conclusion, and state that "[i]f the requesting spouse is still married to the nonrequesting spouse, this factor is neutral."[711] Thus, this factor is neutral as to Dee.

As to the third factor identified in the regulations —benefit on the return—a "benefit on the return" encompasses situations where the non-requesting spouse's understatement leads to a tax benefit for the requesting spouse, such as a refund that is higher than that to which the couple would have otherwise been entitled [712] or a deduction by one spouse that offsets income of the other spouse. [713] No party has argued that Dee received a benefit on her return as a result of the understatement at issue here; and thus, this factor will not be addressed further.

The regulations interpreting § 6015(b) also advise that "[f]or guidance concerning the criteria to be used in determining whether it is inequitable to hold a requesting spouse jointly and severally liable under this section," Revenue Procedure 2000–15 "or other guidance published by the Treasury and IRS" is relevant. [714] Revenue Procedure 2000–15 provides a list of seven factors to consider, including (i) whether the requesting spouse is separated or divorced from the nonrequesting spouse, (ii) whether the requesting spouse would suffer economic hardship by virtue of not being able to pay for basic living expenses, (iii) whether the requesting spouse was abused by the non-requesting spouse, (iv) whether the requesting spouse knew or had reason to know of the items giving rise to the deficiency, (v) whether the non-requesting spouse has a legal obligation pursuant to a divorce decree or agreement to pay the outstanding liability, (vi) whether the requesting spouse significantly benefitted from the items giving rise to the deficiency, and (vii) whether the liability for which relief is sought is solely attributable to the non-requesting spouse. [715] The most recent version of these Revenue Procedures, Revenue Procedure 2013–34, has added two additional factors to consider: (viii) whether the requesting spouse has made a good faith effort to comply with the income tax laws ***473** in the taxable years following the taxable year or years to which the request for relief relates, and (ix) the mental and physical health of the requesting spouse both during the years in question and at the time relief is requested (collectively, the "**Revenue Procedures Factors**"). [716]

While the tax court has considered the Revenue Procedures Factors in determining whether it would be inequitable to hold the requesting spouse liable, it has concluded that they are not controlling. [717] This Court will similarly consider them.

The Court has already considered the first Revenue Procedures Factor, and agrees with the tax court that widowhood is at worst neutral in the inequity analysis. This factor is neutral as to Dee. [718]

The second factor—economic hardship—is neutral here too. While Dee can certainly pay reasonable basic living expenses even if she is held liable for the tax at issue here given her wealth, the Revenue Procedures provide that "[i]f denying relief from the joint and several liability will not cause the requesting spouse to suffer economic hardship, this factor will be neutral." [719]

The third factor asks whether Dee was abused. Nothing in the record suggests that Charles abused Dee; in fact, that thought is laughable on this record. But, again, the absence of this factor is neutral. [720]

The fourth factor is whether Dee knew or had reason to know of the items giving rise to the deficiency at issue. As the Court has already noted in its analysis of § 6015(b)(1)(C), she did not. [721] As found previously, Dee relied entirely on Charles to handle all tax and business matters throughout their marriage, [722] and was completely unaware of the workings of the offshore system Charles established. [723] Thus, this factor weighs in Dee's favor. [724]

The fifth factor asks whether the non-requesting spouse (here Charles) has a ***474** legal obligation pursuant to a divorce decree or agreement to pay the outstanding liability. The tax court has noted in the case of a widowed spouse that "[c]ustomarily we find that this factor is neutral if it does not weigh in favor of relief." [725] Since Charles and Dee never divorced, but Dee is Charles' widow, this factor is neutral as to Dee.

The sixth factor is whether the requesting spouse significantly benefitted from the unpaid income tax liability or understatement. As previously found, this factor weighs in favor of relief for Dee. [726]

The seventh factor inquires whether the liability for which relief is sought is solely attributable to the non-requesting spouse. This factor does not appear in the most recent version of the Revenue Procedures Factors, and in any case was already analyzed by the Court in its discussion of 26 U.S.C. § 6015(b)(1)(B). As previously found, this factor weighs in favor of relief for Dee, but as this factor does not appear in the most current listing of Revenue Procedures Factors and is not analyzed as a Revenue Procedures Factor by those tax courts interpreting the most recent procedures, the Court will not weigh this factor in Dee's favor. [727]

The eighth factor weighs against relief if the requesting spouse has not made a good faith effort to comply with the income tax laws in the taxable years following the taxable years to which the request for relief relates. This factor weighs against Dee, as there is no evidence in the record indicating that she has "changed course" from the positions that Charles and she took on their joint returns since he passed away. For example, Dee's tax returns in 2012 and 2013 still continue to indicate that she is not the grantor of a foreign trust. [728]

Finally, the ninth factor asks whether Dee is in poor mental or physical health or was in poor mental or physical health at the time the returns were filed. There is no evidence that Dee is—or over the time period at issue ever was—in poor mental or physical health. Thus, according to the tax court and the Revenue Procedures, this factor is neutral as to Dee. [729]

After carefully considering all possible factors identified by the courts or the Revenue Procedures, and after carefully considering "all the facts and circumstances" as § 6015(b)(1)(D) instructs it to do, [730] the Court has only found one factor that weighs against Dee's request for innocent spouse relief. The other factors are either neutral or weigh decidedly in her favor. Significantly, the two most important factors, as identified by either the Fifth Circuit or the tax court, weigh decidedly in her favor. Dee experienced no meaningful change to her lifestyle as a result of the tax fraud at issue here, and this tax fraud ***475** was entirely attributable to Charles. These two facts go to the heart of the two factors that courts have considered to be the most important in assessing whether it is inequitable to hold the requesting spouse liable. The one lesser factor that weighs against Dee—compliance with tax laws after the years for which relief is sought—is also mitigated by the particular circumstances of her Case. Dee's credible testimony at trial was that even after Charles' death, she continued to rely on the Wyly family office to prepare her tax returns and to handle her finances, and that she has never had any reason to suspect that the Wyly family office was deficient in their duties. [731] While Dee's lack of knowledge regarding her tax responsibilities is not commendable, her lack of knowledge also means that any noncompliance with tax laws on her part is unintentional. Thus, having carefully weighed all of the facts and circumstances, the Court finds that the fourth element of § 6015(b) is satisfied, as it would be inequitable to hold Dee liable for the deficiency in tax at issue here.

While the Court does not believe that the fifth element for innocent-spouse relief under § 6015(b) is in dispute here, it concludes that it is satisfied nonetheless. To elect the application of § 6015(b), a requesting spouse must file Form 8857 (or other similar statement under penalty of perjury containing the same information required on Form 8857) with the IRS no later than two years from the date of the first collection activity against the requesting spouse with respect to the joint tax liability. [732] Collection activity can be any of the following: an 26 U.S.C. § 6330 notice, an offset of an overpayment of the requesting spouse against a liability under 26 U.S.C. § 6402, the filing of a suit by the United States against the requesting spouse for the collection of the joint tax liability, or the filing of a claim by the United States in a court proceeding in which the requesting spouse is a party or which involves property of the requesting spouse (such as a proof of claim filed in a taxpayer's bankruptcy case). [733] Dee has asserted her right to innocent spouse relief on a timely basis.

For these reasons, the Court concludes that Dee carried her burden of proof and established each of the required elements for innocent spouse relief under 26 U.S.C. § 6015(b). Because the Court has concluded that Dee is entitled to innocent spouse relief under § 6015(b), it need not reach the parties' arguments about her entitlement to such relief under § 6015(c).

E. Did Sam Establish his Reasonable Cause Defense to the Imposition of Fraud Penalties for His Income Tax Underpayments?

1. The Defense in General

Because the IRS carried its burden of proof on its claim for fraud penalties under 26 U.S.C. § 6663 as to Sam's underpayments of income tax, we must now analyze his reasonable cause defense. As noted previously, to establish this defense, Sam must prove

—by a preponderance of the ***476** credible evidence —that there was "reasonable cause" for his income tax underpayments and that he acted in "good faith with respect to [the] underpayment[s]." [734] Moreover, 26 C.F.R. § 1.6664–4 provides, in relevant part, that:

> (a) In general. No penalty may be imposed under section 6662 with respect to any portion of an underpayment upon a showing by the taxpayer that there was reasonable cause for, and the taxpayer acted in good faith with respect to, such portion. Rules for determining whether the reasonable cause and good faith exception applies are set forth in paragraphs (b) through (h) of this section.
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> (b) Facts and circumstances taken into account—(1) In general. The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.... Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer. An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith. Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reasonable cause and good faith. Similarly, reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect. Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. (See paragraph (c) of this section for certain rules relating to reliance on the advice of others.)
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> (c) Reliance on opinion or advice—(1) Facts and circumstances; minimum requirements. All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law. For example, the taxpayer's education, sophistication and business experience will be relevant in determining whether the taxpayer's reliance on tax advice was reasonable and made in good faith. In no event will a taxpayer be considered to have reasonably relied in good faith on advice (including an opinion) unless the requirements of this paragraph (c)(1) are satisfied. The fact that these requirements are satisfied, however, will not necessarily establish that the taxpayer reasonably relied on the advice (including the opinion of a tax advisor) in good faith. For example, reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.
>
> (i) All facts and circumstances considered. The advice must be based upon all pertinent facts and circumstances and the law as it relates to those facts and circumstances. For example, the advice must take into account the taxpayer's purposes (and the relative ***477** weight of such purposes) for entering into a transaction and for structuring a transaction in a particular manner. In addition, the requirements of this paragraph (c)(1) are not satisfied if the taxpayer fails to disclose a fact that it knows, or reasonably should know, to be relevant to the proper tax treatment of an item.
>
> (ii) No unreasonable assumptions. The advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any other person. For example, the advice must not be based upon a representation or assumption which the taxpayer knows, or has reason to know, is unlikely to be true, such as an inaccurate representation or assumption as to the taxpayer's purposes for entering into a transaction or for structuring a transaction in a particular manner.
>
> * * *
>
> (2) Advice defined. Advice is any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer

> relies, directly or indirectly, with respect to the imposition of the section 6662 accuracy-related penalty. Advice does not have to be in any particular form.

And, while this regulation does not expressly refer to fraud penalties under § 6663, the Court believes it has applicability here, as do the parties. Both the Debtors [735] and the IRS [736] cite to 26 C.F.R. § 1.6664–4 in connection with their reasonable cause based on reliance on the advice of counsel arguments. [737] Furthermore, tax courts have also cited to this regulation in assessing the merits of reasonable cause defenses raised by taxpayers in order to avoid fraud penalties, even though the regulation applies to "penalties imposed under section 6662"—*i.e.,* accuracy-related penalties as opposed to fraud penalties. [738]

[51] ***478** Assessing whether someone has established reasonable cause and good faith—which is what Sam must establish here in order to avoid fraud penalties—is a facts and circumstances analysis that takes into account all of the relevant variables, and that "turns on the quality and objectivity of the professional advice which they obtained." [739] The tax court has summarized the relevant considerations for establishing reasonable cause based on reliance on the advice of counsel in this way: [740]

> To establish reasonable cause through reliance on the advice of a tax adviser, the taxpayer must meet the following three-prong test, laid out in *Neonatology Assocs., P.A. v. Commissioner,* 115 T.C. at 98–99: (1) the adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer relied in good faith on the adviser's judgment.

Some of the same tax courts who use the 26 C.F.R. § 1.6664–4 framework in order to analyze reasonable cause in a fraud context also utilize the *Neonatology* test in order to assess whether a taxpayer has established reasonable cause based on the reliance on the advice of professionals. [741] Even those courts that do not explicitly cite either § 1.6664–4 or the three-pronged *Neonatology* test assess the same facts and circumstances that both the regulation and the three-prong test examine. These courts explore whether the advisor the taxpayer relied on had all of the necessary facts, [742] whether the advisor was qualified to render reliable advice by virtue of expertise ***479** and lack of conflicts of interest, [743] and whether the taxpayer in fact relied on the advice actually received from the advisor. [744]

[52] **[53]** As noted previously, the Debtors assert that their reliance on the advice of professionals not only establishes a valid reasonable cause defense, but that it also negates the Debtors' fraudulent intent and prevents the IRS from meeting its initial burden under 26 U.S.C. § 6663. [745] It is indisputable that the IRS bears the burden ***480** to prove civil tax fraud by clear and convincing evidence, and that proof of civil tax fraud includes showing that the Debtors intended to avoid taxes that they knew or believed to be owing. [746] It is also true that whether a taxpayer relied on a professional in taking a tax position has bearing on that taxpayer's intent. [747] However, many courts that are faced with taxpayers who attempt to avoid fraud penalties based on reliance on the advice of counsel nevertheless treat such reliance as a defense rather than as a matter to be considered in assessing whether the IRS has met its initial burden to prove fraudulent intent. [748] Regardless, after a careful review of the record and after considering all pertinent facts and circumstances, this Court concludes that the advice Sam received neither negates his fraudulent intent nor establishes his reasonable cause and good faith defense. [749]

[54] ***481** In answering the question of whether Sam reasonably relied in good faith on the advice he received from various lawyers as to the income tax treatment of his offshore system and the transactions undertaken through that system under Federal tax law, the Court must decide whether the advice Sam received was based upon all pertinent facts and circumstances and the law as it relates to those facts and circumstances, after: (i) considering why Sam entered into the transactions and structured them in a particular manner, and (ii) whether Sam disclosed any fact that he knew, or reasonably should have known, to be relevant to the proper tax treatment of an item. Moreover, the advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of Sam or any other person. As the regulation itself states, the advice must not be based upon a representation or assumption which Sam knew, or had reason to know, was unlikely to be true. Finally, even if all of these requirements are satisfied, that does "not necessarily establish that the taxpayer reasonably relied on the advice ... in good faith." [750]

With this background in mind, Sam's reasonable cause and good faith defense as to his income tax underpayments fails here, as to all tax years in which there was an underpayment of income tax. In explaining its determination, the Court will first examine what advice Sam received and from whom, [751] grouping that advice when appropriate, and will then analyze Sam's reasonable cause and good faith defense in light of that advice. Some of the advice upon which Sam is alleged to have relied in good faith is contained in formal written opinions issued by various lawyers, while other advice is captured in written memorandum or emails, while still other advice was allegedly received orally. Generally, each category of advice will be discussed in chronological order, followed by the Court's findings about that advice and Sam's reasonable reliance on it in good faith. [752]

*482 2. The 1992 Private Annuity Transactions

As discussed previously, Sam entered into six complicated private annuity transactions in 1992, on which he paid no income tax at the time the transactions were undertaken. Sam received a written legal opinion from Pratter, Tedder & Graves dated February 28, 1992 "concerning the 1992 federal income tax consequences that were likely to apply to the proposed sale of 'Securities' ... in exchange for a private annuity, with such sale occurring during the 1992 taxable year." [753] Like all written opinions, it was based upon certain facts, which as the opinion letter itself cautions "assumes that the program will be implemented in a manner that is unmodified from the proposed program described herein." [754] The opinion letter further cautions that "any change or deviation from the proposed plan of action described herein might produce different tax consequences than those set forth in this opinion." [755] The factual foundation underlying this opinion letter is described, in relevant part, as follows: [756]

> It is our understanding that you are considering the sale of Securities to a domestic corporation which will issue a private annuity in exchange for the Securities....
>
> It is our further understanding that the domestic corporation intending to purchase the Securities in exchange for the issuance of the private annuity is wholly owned by a foreign corporation which is wholly-owned by a foreign nongrantor trust.
>
> We also understand that the possession and/or enjoyment of the Securities being exchanged for the private annuity will reside exclusively with the acquiring corporation, and you will not preserve or reserve any control of any kind or character over such Securities or any income therefrom that would constitute a retained interest in the possession and/or enjoyment of the Securities being exchanged for the private annuity. It is thus expressly intended that you will irrevocably surrender the enjoyment, control, ownership, and all economic benefits attributable to the ownership of the Securities which are sold in exchange for the private annuity.

The opinions that were then given by Pratter, Tedder & Graves based upon this factual predicate include, among others, an opinion that: (i) the sale of the Securities in exchange for a private annuity is not a taxable event to Sam in 1992, [757] (ii) the exchange of Securities for a private annuity of equivalent actuarial value is likely to be excluded from federal gift tax, [758] (iii) the subsequent exercise of the Securities by the obligor (the domestic corporation) will likely not generate a taxable event to ***483** the annuitant (Sam), [759] and (iv) Sam's subsequent contribution of the annuity to a grantor trust of which he is the grantor-settlor will likely not cause the income tax consequences to vary from those already described. [760] The opinion letter concluded with the usual caveats that: [761]

> [s]hould there be any change in the applicable tax laws or the facts and circumstances relating to the events described herein, the opinions expressed herein necessarily require a reevaluation in the light of such changes....

> Our analysis is based on the facts and/or assumptions contained in this letter. If such facts and/or assumptions are inaccurate or incomplete, our analysis and conclusions are equally inaccurate or incomplete and might vary substantially from those contained herein.

Similarly, the six Nevada corporations acquiring the options and warrants from Sam and issuing the unsecured private annuities to him received written opinion letters dated April 2, 1992 from Pratter, Tedder & Graves. [762] These opinion letters were identical (except for the name of the entity to whom the letter is addressed). [763] For ease, only one letter—*i.e.,* the letter addressed to East Baton Rouge Limited—will be analyzed in detail. In summary, the firm concluded, "[b]ased on the information presented to us as expressed herein that it is more likely than not that the anticipated federal tax treatment ... will be as we opine herein." [764] As relevant here, the firm provided two opinions. The first described the anticipated tax treatment to East Baton Rouge Limited of its acquisition and subsequent sale of the options and warrants it was to acquire from Sam in exchange for issuing a private annuity to Sam. The second opinion explained East Baton Rouge Limited's anticipated tax treatment if it subsequently relinquished its obligation to pay the annuity to Sam by paying the assuming party assets of a value worth the equivalent of the annuity liability being relinquished. The upshot of these two opinions was that if East Baton Rouge Limited entered into a contract with a foreign corporation (that does not and will not engage in business within the United States and has no office or agent in the United States) pursuant to which the value of the cash and/or other assets exchange by it equals the value of the annuity obligation at the time of such transactions, "it is more likely than not that there should be no federal income tax consequence to [it] as [it has] incurred no economic gain or loss." [765]

So, as relevant here, taking the February and April opinion letters together, Pratter, Tedder & Graves advised Sam that it is more likely than not that: (i) Sam's sale of options and warrants to six domestic corporations that were owned by six foreign corporations that were, in turn, owned by a foreign non-grantor trust in exchange for the issuance of a private annuity of equivalent value to him will not trigger income tax or gift tax consequences to him in 1992, and (ii) the subsequent ***484** relinquishment of the options and warrants by the six domestic corporations to the six foreign corporations (who did not and will not engage in business within the United States and who had no office or agent in the United States) in exchange for the foreign corporations' assumption of the domestic corporations' annuity obligations to Sam, will not trigger income tax consequences to the domestic corporations.

There is no dispute here that (i) the domestic corporations —*i.e.,* the six Nevada corporations Sam caused to be formed—were wholly owned by the foreign corporations —*i.e.,* the six similarly named IOM corporations that Sam caused to be formed, (ii) the six similarly named IOM corporations were wholly owned by the Bulldog IOM Trust that Sam settled, (iii) the annuity Sam received was of equivalent value to the options and warrants he sold to the Nevada corporations, and/or (iv) the six IOM corporations did not and have not engaged in business within the United States and had no office or agent in the United States. However, another key factual and legal predicate to the 1992 opinion is that the Bulldog IOM Trust, which owned the six IOM corporations directly and the six Nevada corporations indirectly, be a foreign non-grantor trust. Surprisingly, there is no Pratter, Tedder & Graves opinion letter, or any other opinion letter, addressing this key predicate to the tax treatment of the 1992 annuity transactions undertaken by Sam. While Sam received opinion letters from Tedder, Chatzky & Berends [766] addressing the legal characterization of two other trusts he established in the IOM in December 1992 —*i.e.,* the Lake Providence IOM Trust and the Delhi IOM Trust—those opinion letters were not received until May 19, 1993. [767] And, while Chatzky testified that he "believes" there were opinions issued for the Bulldog IOM Trust, [768] no such opinion(s) was introduced into evidence. [769]

With this background in mind, we can now evaluate Sam's reasonable cause and good faith defense surrounding the income ***485** tax consequences of the 1992 annuity transactions he undertook. There are at least two insurmountable problems with Sam's defense as it relates to the 1992 annuity transactions as explained below.

[55] First, the law is clear that Sam cannot rely upon an opinion of a promoter of the tax scheme in question to support a reasonable cause and good faith defense. When the Court uses the term "promoter," it is invoking the concept that reliance on a professional "may be unreasonable when it is placed upon insiders, promoters, or their offering materials, or when the person relied upon has an inherent conflict of interest that the taxpayer knew or should have known about."[770] Reliance on a professional who stands to profit considerably from a taxpayer's participation in a transaction on which that professional advises—or who is not an independent professional—may not be reasonable.[771] This is because, in order to establish reasonable cause or to negate fraudulent intent, a taxpayer must rely on a professional in good faith.[772] The promoter status of a tax advisor goes to the heart of whether a taxpayer's reliance was in good faith. As one tax court has phrased it: "[t]he caselaw is clear on this point—promoters take the good-faith out of good-faith reliance."[773]

Tax courts have also noted "what exactly makes a tax adviser a promoter has been less than clear."[774] Some courts have defined a promoter as "an adviser who participated in structuring the transaction or is otherwise related to, has an interest in, or profits from the transaction."[775] However, these courts have also noted that this definition needs to be applied with caution because of its potential breadth, and tend to only apply it "when the transaction involved is the same tax shelter offered to numerous parties."[776] However, another tax court used the broad definition of "promoter" without similar caveats, applying this definition where the promoter in question "charged $120,000 ... set up the various ***486** entities and coordinated the deal from start to finish."[777]

Many definitions of "promoter" are negative—*i.e.* they define what a promoter is not as opposed to what a promoter is. One tax court noted that a tax advisor is not a promotor when the advisor (i) has a long-term and continual relationship with the client, (ii) does not give unsolicited advice regarding the tax shelter, (iii) advises only within his field of expertise (and not because of his regular involvement in the transaction being scrutinized), (iv) follows his regular course of conduct in rendering his advice, and (v) has no stake in the transaction besides what he bills at his regular hourly rate."[778] The Federal Circuit has noted that "[a]dvice hardly qualifies as disinterested or objective if it comes from parties who actively promote or implement the transactions in question."[779] According to the Fifth Circuit, "taxpayers may not rely on someone with an inherent conflict of interest," *i.e.* a promoter.[780]

The SDNY Court found Tedder to be a promoter in the SEC Action;[781] and, as noted previously, this Court gave collateral estoppel effect to that finding here. And, while the Wylys now argue that Tedder was not a "promoter," their own documents refer to him as such. For example, IRS Exhibit 96 is an internal memorandum from Hennington and Boucher to, among others, Sam and Charles, in which they state "David Tedder, the attorney who originally promoted the 1992 trusts and annuity transactions is now in jail, having been prosecuted for various offences including fraud."[782] Moreover, that Tedder promoted, sold, or pitched the complex offshore system and related annuity transactions to Sam and Charles, and that he would tell Sam and Charles anything they wanted to hear, is clear from both Sam's direct testimony and Chatzky's testimony explaining why Tedder and he ceased practicing law together, respectively. ***487** [783] As explained by Chatzky, he and Tedder are no longer law partners because Tedder "had a penchant for making statements to people that were either questionable or flatly untrue...."[784] Chatzky gave an example of a client asking Tedder if an estate planning concept had ever been tested by the IRS, has it ever been audited, and the "correct answer is 'No, it hasn't been tested ... [or] audited' [b]ut David Tedder would say, 'oh, yeah, it's been audited hundreds of time, and the IRS in each case passed it."[785] According to Chatzky, this made him uncomfortable, so their law firm dissolved and Chatzky returned to practicing law through his own firm, Chatzky & Associates.[786] Thus, this Court is satisfied that even without giving collateral estoppel effect to the SDNY Court's finding in the SEC Action, Tedder's law firm, Pratter, Tedder & Graves, promoted the offshore scheme to Sam and Charles and thus the firm's opinions cannot be relied upon by Sam in asserting his reasonable cause and good faith defense with regard to the 1992 annuity transactions.

Now, to attempt to avoid the well-settled law that he cannot rely upon the advice of a "promoter," Sam argues that Tedder did not really write the opinions that Tedder signed on behalf of Pratter, Tedder & Graves. Rather, Sam argues that Chatzky actually researched and ghost-wrote the opinions signed and issued by Tedder's firm.

Factually, that is true. Chatzky testified at trial that he wrote the opinions that Tedder's firm then issued to the Wylys. Significantly, however, when asked on direct examination why Tedder signed the opinions instead of him, Chatzky testified that "[his] understanding" was that the Wylys "engaged Pratter, Tedder & Graves to ... draft the opinions and, therefore, the opinions were submitted to David Tedder for his signature." [787] So, while Chatzky met Sam at the Malibu meeting where Tedder "pitched" [788] the offshore system and the private annuity deal to Sam and Charles, Chatzky apparently considered Tedder to be the Wylys' lawyer, not himself. Moreover, Chatzky testified that the opinion was [789]

> his [Tedder's] opinion. He can change his mind or he cannot sign it or he can make adjustments or amendments, whatever. And I'm not aware of any such changes that he made. So his [Tedder's] involvement, really, was to read the opinion and either sign it or contact me for—with questions.

Ironically, Sam's own trial testimony makes clear that he was relying on the ***488** advice of Pratter, Tedder & Graves, as he misunderstood who Chatzky was at the Malibu meeting. Sam clearly thought Chatzky was another lawyer at Pratter, Tedder & Graves, and that Chatzky was the more scholarly of the two attorneys. [790] But Sam was wrong—at least as to who Chatzky was. Chatzky was not a lawyer at Pratter, Tedder & Graves. Chatzky had his own law firm and, while he worked with Tedder from time to time, there is no evidence in the record that Chatzky was retained by the Wylys at this time to give advice to the Wylys. [791]

But, even assuming that Chatzky gave Sam advice in 1992 and 1993—*i.e.,* the advice contained in the opinion letters he ghost-wrote for Pratter, Tedder & Graves to issue to the Wylys and the offshore entities they caused to be formed in those years, there is no opinion that it is more likely than not that the Bulldog IOM Trust will be construed to be a valid non-grantor trust for United States tax purposes. As noted previously, that was a key factual assumption underlying the 1992 opinions issued by Pratter, Tedder & Graves (as ghost-written by Chatzky) to Sam.

Because Tedder's law firm promoted the offshore system to Sam and Charles, the advice Sam received from Pratter, Tedder & Graves cannot be used to establish a reasonable cause and good faith defense as a matter of law. Moreover, without evidence of the receipt of advice concerning the legal characterization of the Bulldog IOM Trust as a foreign non-grantor trust, a key factual and legal assumption underlying the advice received was not established. For either of these reasons, Sam's reasonable cause and good faith defense fails as to the 1992 annuity transactions in each tax year in dispute among the parties unless Sam received advice regarding the proper legal characterization of the Bulldog IOM Trust as a foreign non-grantor trust thereafter.

Moreover, as discussed previously, French, acting as Sam's agent, learned in 1993 that Lubar had concluded that there was a "significant risk" that the 1992 IOM trusts—*i.e.,* as relevant to Sam, Bulldog IOM Trust, Lake Providence IOM Trust, and Delhi IOM Trust—would be characterized as grantor trusts as to Sam under 26 U.S.C. § 679 because income was being accumulated for the benefit of U.S. beneficiaries. [792] Moreover, French learned that Lubar had concluded that the IOM trustee's power to add or substitute other foreign charities would cause the 1992 IOM trusts to be characterized as grantor trusts as to Sam under 26 U.S.C. § 674. For the reasons already explained, what French learned from Lubar regarding the proper ***489** legal characterization of the 1992 IOM trusts is imputed to Sam, once his agent and trusted advisor French learned it. [793] And, as previously found, Sam did nothing further to investigate Lubar's conclusions thereafter until October 2003, when the Meadows Owens firm was asked to confirm Lubar's analysis—both Lubar's original analysis from 1993 and his updated analysis from mid-2003. Thus, from 1993 through September 2003, [794] Sam could not have relied in good faith on the advice he received from Pratter, Tedder & Graves—even assuming that firm was not a tax promoter and/or that Sam somehow received informal "advice" from them or someone else that the Bulldog IOM Trust was likely a valid non-grantor trust, of which there is no evidence in the record and we know that no formal written opinion was ever signed and issued to Sam to that effect—as Sam was on notice of the fact that an international tax lawyer hired on his behalf by French, Lubar, had an alternative view of the tax attributes of the 1992 IOM trusts and related transactions, which Sam ignored.

The record is silent on any other advice actually received by Sam regarding the proper legal characterization of the Bulldog IOM Trust as a foreign non-grantor trust from 1993 to October, 2003. While Meadows Owens—specifically, Owens—began representing the Wylys on tax and estate planning matters in 1998, there is no evidence in the record that Meadows Owens ever independently investigated the proper legal characterization of any of the 1992 IOM trusts as foreign grantor or non-grantor trusts during that time period. And, while Evan testified as to the topics on which Owens gave the Wylys advice at certain Wyly family meetings during this time period, and outlines of discussion topics covered by Owens at those meetings were introduced into evidence at trial, [795] the statements attributed to Owens were not admitted for their truth, [796] but rather to establish Sam's state of mind—*i.e.,* what he understood about the trusts as it may be relevant to his fraudulent intent or lack thereof or his reasonable cause and good faith defense or lack thereof. [797]

But even considering Evan's testimony in this regard, it is not terribly helpful. For example, Evan testified regarding the topics discussed by Owens at a Wyly family meeting in approximately April 2000 as ***490** delineated in IRS Ex. 110. [798] For the most part, Evan was asked to read the topic headings contained in Owen's discussion outline, and Evan then confirmed that the topic was discussed, that advice was given by Owens on that topic and that he and his father heard the advice and to the best of Evan's knowledge, his father followed the advice given. Of course, without knowing exactly what advice, if any, was *actually* given by Owens, it is of no real consequence here that Sam heard it, as it is not possible to evaluate the relevance of the actual advice to Sam's reasonable cause and good faith defense. Moreover, that Sam followed the advice suffers from the same flaw plus another—*i.e.,* the "to the best of Evan's knowledge" caveat makes the testimony of virtually no assistance to the Court's evaluation of Sam's defense, as there is nothing in the record from which the Court can conclude that Evan would have any reason to know if his father followed some particular advice given to his father by Owens or not.

Similarly, Evan testified about IRS Exhibit 111, another Owen's discussion outline dated September 7, 2000, confirming that Owens gave advice on each topic, that Sam and he heard the advice, and to the best of Evan's knowledge, his father followed that advice. This testimony was similarly unhelpful for the reasons just explained—and another, as explained below.

The Owens' outline for the September 2000 meeting discusses "Tax Characterization of 1992 Trusts, During Charitable Interest Term" and goes on to state that "[t]he 1992 Trusts are characterized as 'foreign nongrantor trusts' ['FNGT'] for so long as the Grantor is living, *plus* two (2) years thereafter." [799] That statement is true, as far as it goes. That is certainly what the original documents say—but that statement does not reflect any independent analysis of the proper legal characterization of the 1992 IOM trusts by Owens or his firm. Moreover, we know that the status of the 1992 IOM trusts was analyzed by Meadows Owens in October 2003, which strongly suggests that such analysis had not been done before, or the earlier memoranda from Owens' files at the firm would have been relied upon instead or simply updated.

Finally, and as alluded to previously, what is missing from Evan's testimony is any detailed understanding of what Owens actually said under each discussion topic [800] and/or, more importantly, what Owens actually did in order to give the advice that Evan testified Owens gave. Did Owens ***491** independently analyze the original transactions to come to an independent opinion regarding their validity, proper legal characterization, and proper tax treatment or did he simply assume that the original Tedder and/or Chatzky opinions were correct and he then proceeded to update those opinions based upon changes in the tax laws? Did Owens ever see the earlier opinion at all? Or, did Owens just rely on French, Robertson, or later Hennington, who could have told him what had already been done and then built onto that existing structure? On this record the Court has no idea what Owens was or was not told, and/or did or did not do to independently analyze the original structures as implemented by the Wylys. And, while some Meadows Owens' memoranda were introduced into evidence at trial, those memoranda pertain to other topics, not the legal characterization of the 1992 IOM trusts or the validity of the 1992 annuity transactions and their proper tax treatment. [801]

Moreover, even assuming that Owens undertook independent research regarding the 1992 annuity transactions and their tax treatment at this time, we have no idea what facts Owens based his independent analysis and advice upon, as the IRS correctly argues. Sam did not give Owens the facts, nor did Evan. In fact, no witness could articulate the facts upon which any advice Owens gave was based. The best that anyone could do was to say that Owens appeared knowledgeable and that he was given access to anything he needed. For example, Evan testified that Owens "was very well informed on the Isle of Man trusts. We had several family meetings with him where he went into a lot of details on each of the trusts. It was very clear he had a wealth of knowledge regarding those trusts."[802] However, on cross-examination, Evan was unable to delineate what specific facts Owens' advice was based upon.[803]

From the Court's perspective, the fact that Owens appeared knowledgeable is not a sufficient predicate from which the Court can find that his opinions, assuming any relevant to these issues were actually given, were based on adequate facts to make them sound. Lawyers can often appear knowledgeable, but whether they know all the relevant facts that will enable them to give informed and reliable advice is a different question, which simply cannot be answered on this record.

That brings us to 2003. Recall that Boucher learned of Lubar's 1993 conclusions about the proper legal characterization of the 1992 IOM trusts as grantor trusts as to Sam in 2003 through a chance meeting with him in the Cayman Islands, which led to a flurry of activity as discussed *supra* at pp. 371–74. Recall that Hennington and Boucher met with Lubar in mid–2003 in London to discuss his conclusions regarding the 1992 IOM trusts and the private annuity transactions undertaken through them in 1992 and that their notes from that meeting are summarized in a memorandum[804] they prepared dated June 30, 2003 addressed to Sam, Charles, Evan and Donnie, as discussed *supra* at pp. 435–38. Finally, recall that this led to an August 2003 anonymous ***492** meeting with the IRS on the Wylys' behalf as Lubar had recommended.

When this meeting with the IRS had not resolved anything by mid to late September 2003 and Sam's deadline to file his 2002 tax return was quickly approaching (October 15, 2003), Hennington testified that she turned back to Meadows Owens, who had been advising the Wylys about various aspects of the offshore system and transactions within that offshore system for a few years, for advice on what to do. Specifically, Hennington, acting as Sam's agent, asked Meadows Owens to advise them what they should do with Sam's 2002 tax return given Lubar's conclusions that: (i) the Bulldog IOM Trust "should be classified as a grantor trust because [a] the Trust should be treated as having U.S. beneficiaries and [b] the Trustee may add beneficiaries,"[805] and (ii) that the 1992 annuities could be attacked by the IRS on various grounds as summarized in the memorandum Boucher and she had prepared dated June 30, 2003.[806] Because Owens had died earlier that year, Hennington turned to two other Meadows Owens' partners—*i.e.,* Pulman and Cousins—for this advice.

So, what advice did Pulman and Cousins give the Wylys and when was it given? First, we know that Pulman testified that they did not have a lot of time to consider the issues as Hennington came to them in late September.[807] Second, we know that Hennington met with Pulman, Cousins and two other Meadows Owens' lawyers on October 8, 2003 to discuss five options that Meadows Owens had determined could be pursued by Sam given his October 15 filing deadline for his 2002 tax return.[808] One of those options was for Sam to file a Form 8275 disclosure with his 2002 tax return, on which Sam would disclose Lubar's conclusions regarding the tax positions Sam had previously taken and was continuing to take. This was the option recommended by Meadows Owens and is the option that Sam pursued. Third, we know that in preparation for the meeting with Hennington, Pulman received a memorandum from Michelle Weinstein dated October 1, 2003, in which she stated her disagreement with Lubar's conclusions under 26 U.S.C. § 674(a).[809] Fourth, we know that on October 19, 2003, Pulman received a memorandum from David Kniffen, in which he stated his disagreement with Lubar's conclusions under 26 U.S.C. § 679, among other provisions.[810]

Based on Pulman's testimony at trial, it appears that he advised Hennington in late October 2003 that he believed the Wylys had a "reportable position"[811] that was contrary ***493** to Lubar's conclusions about the grantor trust status of the 1992 IOM trusts.[812] However, Pulman never personally advised the Wylys that the 1992 IOM trusts were properly characterized as foreign non-grantor trusts.[813] Moreover, on this record it does not appear that Meadows Owens ever gave advice confirming the validity and proper legal characterization of the 1992 IOM trusts and the tax consequences flowing from transactions undertaken through those trusts.[814]

So, where does this leave us in evaluating Sam's reasonable cause and good faith defense as to the validity and proper tax treatment of the 1992 annuity transactions? We know that (i) a key assumption underlying the original Pratter, Tedder & Graves opinion to Sam about the tax treatment of those transactions was that the Bulldog IOM Trust be a valid non-grantor trust, (ii) there is no evidence that Pratter, Tedder & Graves actually issued such an opinion to Sam in 1992, 1993, or at any other time, (iii) in 1993 Lubar advised French, acting as Sam's agent, that there was a significant risk that the 1992 IOM trusts would be characterized as foreign grantor trusts as to Sam, (iv) at least with respect to the Bulldog IOM Trust, there is no advice contrary to Lubar's from 1993 to mid–2003 when Lubar is asked by Hennington and Boucher to do further research and to reanalyze the 1992 transactions, which (a) he does, (b) confirms his original conclusions that the 1992 IOM trusts are properly characterized as foreign grantor trusts as to Sam and Charles, ***494** and (c) raises even further concerns about the validity of the 1992 annuity transactions for other reasons, and (v) Pulman advised Hennington, another of Sam's agents, that he disagreed with Lubar's conclusions or, at least, that Sam had a "reportable position" with regard to those issues.[815] So, in short and at best, by late 2003 Sam arguably had conflicting advice from experienced tax professionals he hired to give him that advice. From the Court's perspective, Sam cannot now pick the advice he prefers—*i.e.,* Pulman's advice that he has a "reportable position" that the 1992 IOM trusts are non-grantor trusts as to him—and then claim to have reasonably relied upon it in connection with his reasonable cause and good faith defense.

So, for all of these reasons, Sam has failed to carry his burden of proof to establish his reasonable cause and good faith defense as to the proper legal characterization of the Bulldog IOM Trust and the tax treatment of the 1992 annuity transactions undertaken by him through domestic and foreign corporations indirectly and directly owned by the Bulldog IOM Trust from 1992 through 2013, the years at issue in the Motions and the Claim Objections.

3. The Settlement of the Bessie IOM Trust and the La Fourche IOM Trust and their Proper Characterization

That brings us to Sam's 1994 and 1995 IOM trusts —*i.e.,* the Bessie IOM Trust and the La Fourche IOM Trust. Recall that these trusts were set up as foreign trusts settled by a non-US person—*i.e.,* King and Cairns, respectively, and that the Court has already concluded that the settling of these trusts was highly irregular, if not fraudulent, from the outset.[816] Perhaps ironically, Lubar is the tax professional who advised the Wylys on the proper structure of these trusts and their proper tax treatment assuming that structure was implemented. As is usually the case with legal advice, Lubar's advice here was predicated on certain facts that he assumed to be true for purposes of giving his advice. Unfortunately, those facts were not true as explained below, although Lubar had no reason to know of their falsity at the time he wrote his memorandum.

Specifically, by letter dated February 16, 1994, Lubar sent a memorandum to French, as Sam's agent, on the tax consequences for U.S. beneficiaries of trusts established by a non-resident alien of the United States.[817] As the memorandum itself makes clear, Lubar was asked to "prepare a memorandum regarding the U.S. federal income tax treatment of U.S. citizen beneficiaries (the 'Taxpayers') of foreign (*i.e.,* non-U.S.) 'grantor trusts' (the 'Trusts') established by an individual (the 'Grantor') who is a nonresident alien of the United States."[818] Lubar was told by French to assume the following facts:[819]

> 1. *The Grantor, although not related to the Taxpayers, has known the Taxpay* ***495** *ers for a considerable period of time and will establish the Trusts for the Taxpayers' benefit as an entirely gratuitous act.* All moneys contributed to the Trusts, now or in the future, will belong to the Grantor, and *he has not previously and will not in the future receive any consideration, reimbursement, or other benefit for, or in respect of, this act, directly or indirectly.* Further, the Taxpayers have not previously made gifts to the Grantor exceeding US $10,000 in any taxable year.
>
> 2. The Trusts have been established in the Isle of Man as typical discretionary trusts. Under their terms, the trustee (the "Trustee") has been given broad powers to manage and dispose of the Trusts' principal and income,

> subject, in most cases, to the consent of a protector (the “Protector”). Neither the Trustee nor the Protector is a beneficiary of the respective Trusts. The Trusts are irrevocable but may be modified by the Trustee in certain respects, including the naming of additional beneficiaries.
>
> 3. The Trusts will acquire a majority share interest in a non-U.S. corporation (“Newco”) organized to engage in, *inter alia*, the insurance business, exclusively outside the United States. Neither the Taxpayers nor any person related to the Taxpayers, directly, indirectly or constructively, will transfer any money or other property to Newco except on an “arm's length” basis [fn 2], and if the Taxpayers provide services to Newco as employees, independent contractors or otherwise, directly or indirectly, they will be compensated solely on an arm's length basis.
>
> [fn 2] For this purpose, a transfer is considered to be “arm's length” if undertaken on terms, including financial terms, that would be made between wholly unrelated persons in comparable circumstances.

Based upon these predicate facts, Lubar offers several opinions. As relevant here, Lubar opines that [820]

> Because of the broad discretionary powers afforded to the Trustee and the fact that the Grantor is also a beneficiary of the Trusts, *the Trusts will be ‘grantor trusts' for all U.S. federal income tax purposes pursuant to the provisions of sections 671 et seq. for so long as the Grantor lives.* As a consequence, *the Grantor will be considered to be the owner* of the portion *of the Trusts* (including the shares of Newco) attributable to the property that he transfers to the Trusts, and *all items of income, deduction or credit attributable to such portion will be included in computing the Grantor's taxable income and credits for U.S. federal income tax purposes.*
>
> *However, because the Grantor is a nonresident alien as to the United States and neither the Trusts nor Newco will have any income from U.S. sources or effectively connected with the conduct of a U.S. trade or business, the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.* In the assumed circumstances, the Grantor will be the sole transferor of property to the Trusts and will, accordingly, be treated as owner of all the interests in the Trusts. Thus, all income of the Trusts will be notionally taxed to the Grantor for U.S. federal income tax purposes, and *the Taxpayers, U.S. citizen beneficiaries of the Trusts, will not be subject to U.S. tax on any distributions received from the Trusts that are attributable to income realized by the Trusts during the Grantor's lifetime* .... Further, because ***496** the Grantor will be treated as owner of the shares of Newco held by the Trusts, the Taxpayers will not be considered to own any shares thereof for purposes of the provisions applicable to “controlled foreign corporations” (“CFC” or “foreign personal holding companies” (“FPHC”) and likely will not be considered to own any shares of Newco for purposes of the “passive foreign investment company (“PFIC”) provisions. *Thus, the Taxpayers should not have any current U.S. tax liability or reporting obligations in respect of income realized by Newco during the Grantor's lifetime* (other than compensation that the Taxpayers may receive from newco, directly or indirectly, for services performed on its behalf).

As previously found, certain of those predicate facts were simply not true. Neither King (the grantor of the Bessie IOM Trust) nor Cairns (the grantor of the La Fourche IOM Trust) had known Sam “for a considerable period of time.” Indeed, Evan testified that King was merely a stockbroker who did some business, but “not a lot,” with Maverick. [821] Moreover, we know that French prepared a letter for Cairns to sign stating that he was establishing the La Fourche IOM Trust “to show [his] gratitude for [Sam's] loyalty to our mutual ventures and [his] personal support and friendship,” all of which was untrue as Cairns testified. In fact, Cairns did not know Sam at all: [822]

> Q. Is there any language in [the letter] that was not provided to you by Mr. French?
>
> A. No, all of it was provided.
>
> Q. [The letter] says here, “This is to show my gratitude for your loyalty to our mutual ventures and your personal support and friendship.” Were you in fact a friend of Mr. Sam Wyly?
>
> A. No, but I was a friend of Ronnie Buchanan's.
>
> * *
>
> Q. You never talked to him, never met Mr. [Sam] Wyly?

A. No.

In addition, neither the Bessie IOM Trust nor the La Fourche IOM Trust was established as an entirely gratuitous act." Indeed, as a stockbroker dealing with Maverick, King had already earned commissions from dealings with Wyly entities (though not through a direct relationship with Sam).[823] And, soon after the trusts were established, Cairns' trust management company was hired to serve as trustee for some of the Wylys' IOM trusts, including the La Fourche IOM Trust he allegedly settled for Sam's benefit.[824]

Moreover, as found by the SDNY Court and as independently found here:[825]

> ***497** There were no gratuitous transfers here. *First,* I am doubtful that King provided even the factual $1 towards the trusts. In a November 26, 1995 fax to French, Buchanan writes that "Keith never produced the money." Buchanan explains that the King-related trusts "were settled with a factual dollar bill" only so that "there [was] no question of the[ ] [trusts] being voidable by reason of the absence of assets" pending the Wylys' transfer of options. Even if King had contributed the $1, the premise that an unreimbursed dollar bill is sufficient to establish a tax-free foreign grantor trust cannot be taken seriously. Second, Cairns' transfer of $100 cannot be considered gratuitous because shortly after settling these trusts, he received lucrative work from the Wylys as trustee. Finally, in light of the falsified trust deeds and supporting documentation surrounding these trusts, it would be unjust to consider anyone but the Wylys to be the true grantors of these trusts.

Indeed, it appears that King's and Cairn's failure to fund the trusts was discovered as early as November 1995.[826]

As 26 C.F.R. § 1.6664–4 itself makes clèar "the advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any other person."[827] Because Lubar's advice was based on unreasonable factual assumptions given to him by French, Sam's agent, Sam cannot have reasonably relied on Lubar's advice here.

For all of these reasons, Sam has failed to carry his burden of proof to establish his reasonable cause and good faith defense as to the proper legal characterization of the Bessie IOM Trust and the La Fourche IOM Trust and the tax consequences attributable to those trusts. In coming to this conclusion the Court has rejected the IRS' contention that Sam must have *actually* read the opinions or the memoranda containing the advice he purports to have reasonably relied upon in good faith before he is entitled to assert a reasonable cause and good faith defense. While it is true that Sam admitted that he had not read most, if not all, of those legal opinions or memoranda containing the relevant advice, he is not required to have done so. As the Debtors' Post–Trial Brief makes clear, the definition of "advice" contained in the applicable regulation allows advice to be provided "to or for the benefit of" Sam and permits Sam to rely upon that advice "directly or indirectly."[828]

However, in coming to its conclusion, the Court has also rejected Sam's argument that he did not know that the factual assumptions contained the opinions or memoranda were wrong and that somehow, his lack of understanding allows him to reasonably rely on the advice contained therein ***498** —even though it was based on erroneous facts and assumptions. The fallacy of this argument is apparent on the face of the same regulation that defines "advice" favorably to Sam—*i.e.,* 26 C.F.R. § 1.6664–4, which simply provides that "the advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any other person."[829] Nowhere does the regulation state that the taxpayer must know of the unreasonable factual assumptions. It is an objective test; the factual assumptions must be reasonable. Here they were not. Moreover, the advice itself conditions its efficacy on the accuracy of the factual assumptions expressly stated in the memorandum. Here, those assumptions were inaccurate, and therefore the advice is of no force and Sam cannot have reasonably relied upon it.

4. The 1996 Private Annuity Transactions

We next turn to the six complicated private annuity transactions Sam entered into in 1996, on which he paid no income tax at the time the transactions were undertaken. Recall that those transactions were structured differently from the 1992 annuity transactions. For example, in 1996 Sam assigned 650,000 options to purchase stock of Sterling Software to Crazy Horse IOM Trust, a foreign trust he settled in 1995, which trust immediately assigned the options to Locke Limited (IOM), an entity wholly owned by Bulldog IOM Trust, in exchange for an unsecured private annuity payable to Crazy Horse IOM Trust. Crazy Horse IOM Trust was then liquidated, the effect of which was to put the right to receive the annuity payments to Sam, who as just noted, was the grantor of the now-liquidated Crazy Horse IOM Trust. Sam undertook five more similarly structured annuity transactions in 1996.

We will group the transactions by the IOM trust that owned the IOM entity issuing the private annuity. So, that means that Sam's two assignments of options to Crazy Horse IOM Trust, which options were then assigned to Locke Limited (IOM) and Moberly Limited (IOM) in exchange for two unsecured private annuities payable to Crazy Horse IOM Trust will be analyzed together, as Locke Limited (IOM) and Moberly Limited (IOM) are both wholly owned by Bulldog IOM Trust. Then, we will analyze Sam's assignment of options to Arlington IOM Trust, which options were then assigned to Sarnia Investments Limited (IOM) in exchange for an unsecured private annuity payable to Arlington IOM Trust, as Sarnia Investments Limited (IOM) is wholly owned by Lake Providence IOM Trust. Followed by an analysis of Sam's two assignments of options to Tallulah IOM Trust, which options were then assigned to Audubon Asset Limited (IOM) and Yurta Faf Limited (IOM) in exchange for two unsecured private annuities payable to Tallulah IOM Trust, as Audubon Asset Limited (IOM) and Yurta Faf Limited (IOM) are wholly owned by Bessie IOM Trust. Finally, we will analyze Sam's assignment of options to Sitting Bull IOM Trust, which options were then assigned to Devotion Limited (IOM) in exchange for an unsecured private annuity payable to Sitting Bull IOM Trust, as it is wholly owned by La Fourche IOM Trust.

Returning to Sam's two assignments of options to the Crazy Horse IOM Trust, the ***499** Crazy Horse IOM Trust received a written opinion letter from Chatzky and Associates [830] dated February 22, 1996. [831] The opinion letter notes that

> [y]ou have requested the law firm of Chatzky and Associates, a Law Corporation to review and comment on the proposed sale of compensatory "Nonqualified Options"... in exchange for a private annuity, with such sale to occur during the 1996 taxable year for United States income tax purposes and United States income withholding tax purposes. [832]
>
> * * *
>
> Our opinions are based on the correctness of the facts and circumstances set forth herein, and our understanding that the factual scenario set forth hereinbelow is complete, accurate, true, and correct. [833]
>
> * * *
>
> It is our view based on the information presented to us as expressed herein that it is more likely than not that the anticipated federal United States tax treatment relating to the matters discussed herein will be as we opine herein. [834]

Then, Chatzky sets forth the facts that the firm is relying upon. Several of those facts are relevant here, including

> 4. Sam Wyly transferred these options to The Crazy Horse Trust, a foreign situs grantor trust that is recognized as a "grantor trust" for United States income tax purposes. [835]
>
> 5. You anticipate that The Crazy Horse Trust will transfer the non-statutory options to an underlying foreign corporation that is wholly owned by a *foreign situs non-grantor trust.* [836]
>
> 6. It is anticipated that the wholly owned underlying foreign corporation of a *foreign non-grantor trust* will issue a private annuity to The Crazy Horse Trust in exchange for the receipt of non-statutory options of an equivalent value. [837]

Based upon these facts, among others, Chatzky and Associates provides the following opinions

> A. Pursuant to the general federal income tax treatment of property exchanged for a private annuity the sale of non-statutory options to a foreign corporation in exchange for The Crazy Horse Trust's receipt of a

> deferred private annuity of equivalent value is not a taxable event in the year 1996.[838]
>
> * * *
>
> B. The private annuity is not intended to contain a gift or bargain sale element, ***500** and the exchange of non-statutory options for a private annuity of equivalent actuarial value is likely to be excluded from federal gift tax.[839]
>
> * * *
>
> C. The annuity payments must be unsecured to avoid immediate taxation of The Crazy Horse Trust in 1996 with respect to the disposition of the non-statutory options in exchange for an annuity of an equivalent value.[840]
>
> * * *
>
> E. The disposition of compensatory non-statutory options by The Crazy Horse Trust, a grantor trust, in an arm's length transaction under which non-statutory options are transferred in exchange for the receipt by The Crazy Horse Trust of a substantially nonvested private annuity of an equivalent value issued by the obligor corporation is not a taxable event in the year 1996.[841]
>
> * * *
>
> F. The subsequent exercise of the non-statutory options by the obligor will not likely generate a taxable event to The Crazy Horse Trust because the compensation element will remain opened [*sic*] until the year The Crazy Horse Trust receives its annuity payments.[842]
>
> * * *
>
> G. The private annuity contract is likely to be treated as being held by a natural person.[843]

There is no dispute here that: (i) the Crazy Horse IOM Trust is a foreign situs grantor trust (to Sam), (ii) Locke Limited (IOM) and Moberly Limited (IOM) issued private annuities to the Crazy Horse IOM Trust in exchange for their receipt of the options, and (iii) the annuity was of equivalent value to the options. However, as with the 1992 annuity transactions analyzed *supra* at pp. 482–94, a key factual predicate to Chatzky's legal opinion is that the Bulldog IOM Trust, which owned Locke Limited (IOM) and Moberly Limited (IOM), the two corporations issuing annuities to the Crazy Horse IOM Trust, be a foreign non-grantor trust. As discussed at length above, Sam never received any advice that the Bulldog IOM Trust is properly characterized as a foreign non-grantor trust on which he can reasonably rely. As a result, and for the same reasons set forth above in connection with the 1992 annuity transactions, Sam's reasonable cause and good faith defense fails with respect to these two annuity transactions throughout the tax years in question here.

Turning to Sam's assignment of options to Arlington IOM Trust, who then assigned those options to Sarnia Investments Limited (IOM) in exchange for an unsecured private annuity payable to Arlington IOM Trust, Arlington IOM Trust also received a written opinion letter from Chatzky and Associates[844] dated February 22, 1996.[845] The opinion letter issued to the Arlington IOM Trust is identical to the opinion letter received by the Crazy Horse IOM Trust quoted above except that all ***501** references to the Crazy Horse IOM Trust are changed to Arlington IOM Trust. There is no dispute here that: (i) Arlington IOM Trust is a foreign situs grantor trust (to Sam), (ii) Sarnia Investments Limited (IOM) issued a private annuity to Arlington IOM Trust in exchange for its receipt of the options, and (iii) the annuity was of equivalent value to the options.

However, a key factual predicate to Chatzky's legal opinion is that Lake Providence IOM Trust, which owned Sarnia Investments Limited (IOM), the entity issuing the annuity to Arlington IOM Trust, be a foreign non-grantor trust. And, of possible significance to his reasonable cause and good faith defense, on May 19, 1993, Sam received a written opinion letter from Tedder, Chatzky & Berends in which the firm opines that:[846]

> [w]e have reviewed this Trust Agreement [for Lake Providence Trust] and have determined that it is more likely than not that the trust will be construed to constitute a valid non-grantor trust for United States taxation purposes provided that the trust operates in accordance with the terms and

> provisions contained in the Trust Agreement.

So, if this advice is not tainted by Tedder's status as a promoter of the offshore system to the Wylys, the advice that was missing from the Court's analysis of the 1992 annuity transactions undertaken through corporations wholly owned by the Bulldog IOM Trust has been supplied. In other words, a key factual predicate in the Chatzky and Associates' 1996 opinion that the entity issuing the annuity to Arlington IOM Trust be wholly owned by a foreign non-grantor trust may now be satisfied.

But, as already found,[847] Tedder's firm, Pratter, Tedder & Graves promoted the offshore system and the annuity transactions to the Wylys in late 1991 and 1992. That the firm name changed when Chatzky joined Tedder's firm and then issued the May 19, 1993 opinion letter just discussed does not change the firm's status as the promoter of the offshore system and the annuity transactions. Accordingly, and for the reasons already explained, Sam cannot rely upon the May 19, 1993 opinion of Tedder, Chatzky & Berends as part of his reasonable cause and good faith defense.

And, without an ability to rely on the May 19, 1993 opinion of Tedder, Chatzky & Berends, the analysis of this transaction and Sam's reasonable cause and good faith defense is the same as the analysis of the 1992 annuity transactions and Sam's reasonable cause and good faith defense. As a result, and for the same reasons set forth above in connection with the 1992 annuity transactions, Sam's reasonable cause and good faith defense fails with respect to this annuity transaction throughout the tax years in question here.

As noted previously, we will analyze Sam's two assignments of options to Tallulah IOM Trust together, as those options were assigned to two IOM corporations—Audubon Asset Limited (IOM) and Yurta Faf Limited (IOM)—that are wholly owned by Bessie IOM Trust. Like the other 1996 annuity transactions just discussed, Tallulah IOM Trust received a written opinion letter from Chatzky and Associates dated February 22, 1996 that is identical to the opinion letter received by the Crazy Horse IOM Trust quoted above except that all references to the Crazy Horse IOM Trust are changed to Tallulah IOM Trust.[848] There is no dispute here ***502** that: (i) Tallulah IOM Trust is a foreign situs grantor trust (to Sam), (ii) Audubon Asset Limited (IOM) and Yurta Faf Limited (IOM) each issued a private annuity to Tallulah IOM Trust in exchange for its receipt of the options, and (iii) each annuity was of equivalent value to the options.

However, a key factual predicate to Chatzky's legal opinion is that the Bessie IOM Trust, which owned Audubon Asset Limited (IOM) and Yurta Faf Limited (IOM), the corporations issuing the annuities to Tallulah IOM Trust, be a foreign non-grantor trust. Of course, as discussed above, we know that the Bessie IOM Trust was not a foreign non-grantor trust; it was established as a foreign grantor trust (to King) under 26 U.S.C. §§ 671–679.[849] Once again, a key factual predicate to Chatzky's opinion is not satisfied, preventing Sam from relying on that opinion in good faith. Moreover, Sam offered no evidence of any other advice he received in connection with these private annuity transactions. For these reasons, Sam's reasonable cause and good faith defense fails with respect to these annuity transactions throughout the tax years in question here.

Finally, we analyze Sam's assignment of options to Sitting Bull IOM Trust, which assigned the options to Devotion Limited (IOM) in exchange for a private annuity. Devotion Limited (IOM) was wholly owned by La Fourche IOM Trust. Like the other 1996 annuity transactions just discussed, Sitting Bull IOM Trust received a written opinion letter from Chatzky and Associates dated February 22, 1996 that is identical to the opinion letter received by the Crazy Horse IOM Trust quoted above except that all references to the Crazy Horse IOM Trust are changed to Sitting Bull IOM Trust.[850] There is no dispute here that: (i) Sitting Bull IOM Trust is a foreign situs grantor trust (to Sam), (ii) Devotion Limited (IOM) issued a private annuity to Sitting Bull IOM Trust in exchange for its receipt of the options, and (iii) the annuity was of equivalent value to the options.

However, a key factual predicate to Chatzky's legal opinion is that La Fourche IOM Trust, which owned Devotion Limited (IOM), the entity issuing the annuity to Sitting Bull IOM Trust, be a foreign non-grantor trust. Of course, as discussed above, we know that La Fourche IOM Trust was not a foreign non-grantor trust; it was established as a foreign grantor trust (to Cairns) under 26 U.S.C. §§ 671–679.[851] Once again, a key factual predicate to Chatzky's opinion is not satisfied, preventing ***503** Sam from relying on that opinion in good faith. Moreover, Sam offered no evidence of any other advice he received in connection with this private annuity transaction. For these reasons, Sam's reasonable cause and good faith defense fails with respect to this annuity transaction throughout the tax years in question here.[852]

5. Alleged Reliance on French

The Debtors assert that they reasonably relied on French, their longtime attorney and advisor, for tax advice regarding the offshore system. The Court disagrees for two reasons. First, the Court finds that French—who is admittedly not a tax lawyer—was not qualified to give tax advice to the Wylys regarding the offshore system. Second, the Court finds that French did not actually give any tax advice of his own to the Wylys regarding the offshore system. Instead, at the Wylys' request, he acted as a middleman, relaying to them the tax advice of actual tax lawyers he consulted with on their behalf.

That French was acting in a dual capacity here—*i.e.,* (i) as the Wylys' lawyer on issues he was competent to advise on, and (ii) as the Wylys' trusted agent, empowered to hire other expert advisors with respect to those issues on which he was not, bears brief emphasis. As previously found, French was charged by Sam and Charles, his principals, with the responsibility to oversee the implementation of the Wyly offshore system from a legal perspective. That French was a trusted advisor to the Wylys when the offshore system was initially established and transactions began to be undertaken through it is beyond dispute on this record. However, the Wylys recognized that French did not have the required legal expertise himself to address all of the relevant legal issues that the implementation of the offshore system would require (recall that French was a securities lawyer), so French was authorized to hire, on the Wylys' behalf, whomever French believed necessary to implement the offshore system in such a way as to accomplish the Wylys' goals. And, while French obviously gave some legal advice along the way himself, he was much more than a lawyer here—he served as Sam's and Charles' agent, charged with the responsibility to implement the Wyly offshore system. It is in this middleman or agent role that French received tax advice on the Wylys' behalf from experienced international tax professional(s), but French gave Sam and Charles no tax advice of his own, as he himself acknowledged when he testified that he acted as "basically a business adviser,"[853] and not as a tax lawyer —"I'm ***504** not the tax lawyer. I'll take that disclaimer again, okay."[854]

[56] With French's middleman or agent role firmly in mind, we turn to the first reason that the Wylys' cannot rely upon French's purported tax advice—*i.e.,* French was not qualified to give tax advice on the offshore system. Whether a particular professional is qualified enough to give tax advice that a taxpayer can reasonably rely upon is a fact sensitive inquiry, but that a professional must be at least minimally qualified is beyond question. In certain situations, it will not be enough that the advisor was a lawyer or a certified public accountant.[855] Indeed, a lawyer's choice to consult with an undisputed tax expert on a matter may be an implicit acknowledgment that he is not competent to give tax advice about a particular matter.[856] While the Fifth Circuit has stated in dicta that "[i]t cannot be a requirement ... that a lawyer or accountant must be shown in fact to be a 'tax expert' before reliance on his advice is reasonable,"[857] it has also acknowledged that a taxpayer must rely on a competent professional,[858] and that "[r]eliance on the advice of a professional tax adviser does not necessarily demonstrate reasonable cause and good faith; rather, the validity of this reliance turns on the 'quality and objectivity of the professional advice.' "[859] Although there are no bright line tests regarding competence of tax professionals to which the Court can turn, an examination of the case law allows us to glean some helpful standards.

Neonatology Associates, P.A. v. C.I.R.[860] is a leading tax court case discussing when—for purposes of a reasonable cause defense—a taxpayer may reasonably rely on the advice of a professional in order to escape penalty liability. The taxpayers there argued that they should not be liable for penalties because they had established reasonable cause via their reliance on professionals.[861] The *Neonatology* court laid out the following test for establishing reasonable cause based on reliance on professional tax advice:

> for a taxpayer to rely reasonably upon advice so as possibly to negate a section 6662(a) accuracy-related penalty determined by the

> Commissioner, the taxpayer must prove by a preponderance of the evidence that the taxpayer meets each requirement of the following three-prong test: (1) the adviser was a competent professional who had sufficient expertise ***505** to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer actually relied in good faith on the adviser's judgment. [862]

The *Neonatology* court further noted that it may not be reasonable to rely on a professional's advice when the taxpayer knew, or should have known, that the professional lacked "the requisite expertise to opine on the tax treatment of the disputed item." [863] Specifically, the *Neonatology* court found that the taxpayers there had not established reasonable cause based on reliance on the advice of professionals in part because the only professional on whom the taxpayers could prove they actually relied was an insurance agent who was not, and had never held himself out as, a tax professional. [864] This insurance agent also stood to gain financially from the sale of the insurance products at issue to the taxpayers. [865] Although the taxpayers alleged that they had also relied on the advice of other, more qualified professionals, the taxpayers were ultimately unable to prove that they actually relied on the advice of any other professionals besides the insurance agent. [866]

As a lawyer French is obviously more qualified to give tax advice than an insurance agent who alleged no tax expertise and was not a lawyer. However, this does not necessarily mean that the Wylys could reasonably rely on French's tax advice, assuming he gave them any. *CNT Investors, LLC v. C.I.R.* [867] demonstrates why. *CNT Investors* involved a taxpayer who was a funeral home owner with a mortuary science degree ("**Carroll**") who "[a]lthough ... an astute and successful businessman, he understood only basic tax principles and lacked sophistication in various stock and bond type financial matters. Hence he sought counsel and assistance from professional advisers on legal and accounting issues relating to the funeral home." [868] One of these professionals was J. Roger Myers ("**Myers**"), "the funeral home's de facto general counsel." [869] Myers' tax expertise was summed up in this way:

> As of 1999 Mr. Myers had practiced law for almost 30 years, most of them spent in a business-oriented private practice involving some civil litigation. Although he did not hold himself out as a tax lawyer and typically referred clients to specialists for complicated income tax advice, Mr. Myers had taken basic Federal income and estate tax courses in law school, had previously prepared estate tax returns, and had advised Mr. Carroll on general tax law principles. [870]

Carroll ran into tax problems when he was contemplating retiring and selling his funeral home. [871] Myers and Carroll's CPA determined that it would not be possible for Carroll to sell his funeral home without triggering significant taxable gain. [872] One day, however, Myers stumbled across a potential solution to this problem:

> In 1999 Mr. Myers encountered a potential solution. Over lunch with a longtime acquaintance, local financial adviser ***506** Ross Hoffman, Mr. Myers described Mr. Carroll's problem in general terms, explaining that he had a client who needed to transfer appreciated assets out of a corporation for estate planning purposes. Mr. Hoffman advised Mr. Myers that he knew of a strategy that might work.
>
> Earlier in the year Mr. Hoffman had attended a Las Vegas conference sponsored by Fortress Financial, a New York-based tax planning firm. Erwin Mayer, an attorney with the law firm Jenkens & Gilchrist, gave a seminar at the conference on a strategy he called a "basis boost" that could allegedly increase the tax basis of low-basis assets. The basis boost strategy Mr. Mayer presented was, in substance, a Son–of–BOSS transaction. [873]

Hoffman was not a lawyer and admitted that he did not completely understand the basis boost transaction. [874] However, he put Myers in touch with another attorney who gave him a "memorandum prepared by Jenkens & Gilchrist describing and analyzing the transaction.

Myers reviewed the memorandum and consulted some of the legal authorities cited therein, albeit not in extreme detail." [875] Hoffman thereafter presented that basis boost transaction to Carroll and his wife at a meeting Myers attended. [876] Carroll decided to go forward with the basis boost. [877]

As it turned out, the basis boost transaction was not a legitimate way for Carroll to save taxes, and Carroll found himself in tax court facing significant penalties. [878] The *CNT Investors* court used the *Neonatology* court's three-part test for assessing whether Carroll had demonstrated reasonable cause based on reliance on the advice of counsel, [879] finding that the question of whether Myers' had sufficient expertise on which Carroll could justifiably rely posed a difficult question, in part because the law regarding what constitutes sufficient expertise does not lay out a bright line test:

> Rather than set a specific standard, the regulations under section 6664(c) outline certain baseline competency requirements. First, rather than mandate that the adviser possess knowledge of relevant aspects of Federal tax law, the regulations stipulate only that "reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked" such knowledge. Sec. 1.6664–4(c)(1), Income Tax Regs. Second, the adviser must base his or her advice on "all pertinent facts and circumstances and the law as it relates" to them. *Id.* subpara. (1)(i). Third, the adviser must not himself or herself "unreasonably rely on the representations, statements, findings, or agreements of the taxpayer *or any other person.*" *Id.* subpara. (1)(ii) (emphasis added).
>
> In applying these general guidelines, this Court has not articulated a uniform standard of competence that an adviser must satisfy but has instead demanded ***507** expertise commensurate with the factual circumstances of each case. [880]

In the end, the tax court concluded that Carrol could rely on Myers for two reasons. First, Carroll was unsophisticated in financial matters and "had never before invested in even garden-variety mutual funds and securities" and "understood only basic tax principles." [881] Second, the record demonstrated that Myers had independently analyzed the basis boost transaction and came to his own conclusions regarding its validity:

> Mr. Myers performed due diligence. After Mr. Hoffman pitched the Son–of–BOSS transaction to him, in an effort to better understand the proposal Mr. Myers held a conference call with Mr. Mayer. This conversation left Mr. Myers unsatisfied with his grasp of how the transaction would work, so he requested, and Mr. Mayer sent, a memorandum and an article from a tax publication describing and analyzing the transaction and citing various legal authorities. Mr. Myers reviewed Mr. Mayer's memorandum and consulted some of the legal authorities cited therein, albeit not in extreme detail. He also researched Jenkens & Gilchrist. During the implementation phase, he spoke by telephone with Mr. Mayer several times.
>
> Mr. Myers believed that he had a good grasp of how the Son–of–BOSS transaction would work and of the legal theories behind it. Although Mr. Myers did not know all of the details of the transaction, the record does not indicate that he shared this fact with Mr. Carroll. Rather, Mr. Myers formed the opinion that the transaction was "legitimate [and] proper", and he did share this opinion with Mr. Carroll. He advised Mr. Carroll that the transaction looked like a viable way to resolve CCFH's low basis dilemma. [882]

For these reasons, the *CNT Investors* court concluded that "[t]o Mr. Carroll, a tax and financial layperson, Mr. Myers would have appeared ideal, not simply competent, to advise him on the feasibility and implications of the basis boost transaction." [883]

Here, however, Sam's and Charles' purported reliance on French presents a situation entirely different from that of *CNT Investors.* French's clients, Sam and Charles, were enormously sophisticated businessmen who knew that French was not qualified to give them tax advice on their highly complex offshore system. Moreover, the evidence unquestionably establishes that French did not believe himself qualified to advise the Wylys on the complicated tax issues raised by their offshore system—that is why he chose to consult actual tax specialists on the Wylys' behalf in order to insure that the tax aspects of their offshore system were properly analyzed and competent advice was given.

As just noted, whether Sam and Charles (and Dee derivatively) could reasonably rely on French's alleged advice about the offshore system comes down to a facts and circumstances analysis of their situations. And, as found at the outset of this section of the opinion, after considering those facts and circumstances, the Court finds that Sam and Charles (and Dee derivatively) could not rely on French's alleged tax advice because: (i) French was not competent to give them such advice as he did not have sufficient tax expertise for them to ***508** reasonably rely on him, and (ii) French did not give them any tax advice of his own—his alleged tax advice was entirely derivative of the tax advice provided by Tedder, Chatzky, and/or Lubar. [884]

Returning to the issue of French's competence, the Court finds that French was not competent to give the Wylys' tax advice upon which they could reasonably rely for several reasons. First, French was not a tax lawyer; he was a securities lawyer, as Evan, Sam, and he testified. [885] In French's own words, his role in relation to the Wylys was "basically a business adviser," [886] and was certainly not that of a tax lawyer—"I'm not the tax lawyer. I'll take that disclaimer again, okay." [887] In Sam's words: "I don't recall [French] being concerned about tax things. He was a securities lawyer, basically. He was concerned about disclosures to the SEC and things like that, I think, were his primary mission." [888]

Second, the sheer complexity of the Wylys' offshore system made it necessary for French to consult with true tax experts as opposed to attempting to engage in his own tax analysis of the offshore system. That French was not competent to give the Wylys tax advice on the offshore system is corroborated by what he did when faced with uncertainties about the tax consequences associated with the 1992 IOM trusts and the annuity transactions undertaken offshore—*i.e.,* he sought a second opinion from Lubar, a highly credentialed international tax lawyer, both in 1993 and in 1997. [889] This is exactly what the Wylys ***509** expected French—who Sam described as "sort of the coordinator or the commander of the lawyers"—to do; find the best in the business in order to get the job done. [890] As the Court previously found, French's decision to seek a second opinion from Lubar confirms that: (i) French had lingering concerns about Tedder's legal opinion (ghostwritten by Chatzky) concerning the tax consequences to the Wylys of the 1992 annuity transactions undertaken by Sam and Charles through the Bulldog IOM Trust and the Pitkin IOM Trust, respectively, [891] and (ii) French had no specialized tax knowledge with which to evaluate the proper status of the offshore trusts and the tax consequences flowing from the Wylys' 1992 annuity transactions.

Third, by the time the offshore system was established, both Sam and Charles had many years of experience engaging in highly sophisticated financial transactions. The idea that businessmen as sophisticated as the Wyly brothers could think it was reasonable to rely on a securities lawyer for tax advice regarding their labyrinthine offshore system is not credible. Sam and Charles trusted French as their general counsel, but they knew he was no tax lawyer, as Sam testified: "I don't recall [French] being concerned about tax things. He was a securities lawyer, basically. He was concerned about disclosures to the SEC and things like that, I think, were his primary mission." [892] Both Sam and Charles understood that any alleged tax advice they got from French was a distillation of what actual, experienced tax lawyers had told him, and nothing more. As French described himself when asked to confirm that he was not a tax lawyer, he stated: "[t]hat's right, but I knew what the tax lawyers said we needed to do." [893]

[57] This brings us to the second reason that the Court finds that Sam and Charles (and Dee derivatively) cannot rely on French in order to establish reasonable cause or a lack of fraudulent intent—*i.e.,* the record does not show that French actually gave any independent tax advice to the Wylys regarding the tax treatment of their offshore system, or at least any independent tax advice upon which they actually relied. The evidence in the record is that most independent investigations into the offshore system French undertook were related to securities law issues, not tax law issues. [894] French's role regarding the offshore system was akin to that of a ***510** general counsel. [895] In the Wylys' eyes French took the lead on legal matters; but, the Wylys also recognized that "taking the lead" more often than not involved bringing in specialist lawyers who knew more about a given area of the law than French. [896] True to this form, French's "tax advice" about the offshore system consisted of relaying the opinions of Tedder, Chatzky, and/or Lubar to Sam and Charles. As the *CNT Investors* court pointed out, whether an advisor evaluates a transaction himself and forms his own opinion independent of representations of promoters is very important in determining whether a taxpayer can rely upon that advice.[897] Here, it is clear that (i) the initial tax analysis of the 1992 IOM trusts and annuity transactions originated with Tedder and Chatzky, not French,[898] (ii) Lubar provided a second, and very different, opinion regarding the tax consequences of the 1992 IOM trusts from that provided by Tedder and Chatzky, and (iii) Lubar was the real architect of the 1994 and 1995 generations of trusts,[899] although Lubar had no way of knowing that the facts he was told by French to assume were true for purposes of his advice were not true.

Although Evan testified that French worked "as kind of a double-check on the ***511** other attorneys that worked on the project as well and, you know, wrote trusts and wrote annuities,"[900] and that French—far from warning Sam and Evan that there were problems with the 1992 IOM trusts in fact recommended that the Wylys create them—this testimony means less than it might seem to at first glance.[901] First, Evan is not a disinterested witness.[902] Second, as already found, French's "double-checking" consisted of (i) conferring with Bean, one of his tax partners at Jackson Walker who said that while it was aggressive, Tedder's annuity scheme "might work" but that Jackson Walker would not issue such a legal opinion —obviously not a rousing endorsement of the scheme,[903] and (ii) conferring with Lubar, an expert international tax attorney who disagreed with Tedder's and Chatzky's advice, *after* the 1992 IOM trusts were already established.

Regarding the 1994 and 1995 IOM trusts, it is even clearer that French did not independently bless or double-check those structures. In fact, French's conduct with respect to the establishment of these trusts is highly suspect. French told Lubar to assume certain facts as true that he knew were not true; and then, when Lubar issued advice to the Wylys on how to structure the 1994 and 1995 IOM trusts as foreign grantor trusts to King and Cairns (non-resident aliens of the United States) rather than Sam and Charles based upon those erroneous facts, French proceeded to try to "paper" the transactions in a way that these trusts would "fit the mold" Lubar described, through the drafting of false documents and not insuring that these trusts were actually funded ***512** by the purported grantors, King and Cairns, as the trust documents required.[904]

After a close examination of the record, the Court was only able to uncover one piece of arguably independent tax advice that French gave to the Wylys regarding the offshore system—*i.e.,* that their use of the IOM trusts and corporations as their personal piggy bank could lead to grave tax consequences. French testified repeatedly during the trial in the SEC Action that he told the Wylys—and especially Sam—that controlling the offshore system, for example by using it to purchase assets for use by members of the Wyly family, could have adverse tax consequences.[905] As French testified during the SEC Action, his warnings regarding exercising control over the offshore trusts and corporations did not change Sam's or Charles' behavior at all.[906] Thus, Sam and Charles chose to not follow the one piece of arguably independent tax advice that French may have given them. In the end, however, the Court finds that even this advice was not French's independent advice, as he himself admitted:

> Q. You're not a tax lawyer, right?
>
> A. That's right, but I knew what the tax lawyers said we needed to do.[907]

As French himself admitted, he was not a tax lawyer, and the Wylys cannot credibly claim that they viewed him as such.

For all of these reasons, the Debtors cannot reasonably rely upon any alleged tax advice they claim French gave them with regard to the offshore system as part of their reasonable cause defenses.

F. Were Gifts Made to the Wylys' Children?

The parties have stipulated to the transactions that are alleged to constitute gifts here. As to Sam:[908]

> Sam Wyly and the IRS stipulate and agree that the property transferred for which the IRS claims gift, tax liability for each of the 2000 through 2005 calendar years is [1] the cash used for the purchase, maintenance, improvement and upkeep of the Cottonwood I and Cottonwood II

> real estate properties, and [2] the cash and other assets that were transferred into the Cayman LLCs.

As to Dee: [909]

> [Dee] & Charles and the IRS stipulate and agree that the property transferred for which the IRS claims gift, tax liability [1] for each of the 2001 through 2005 calendar years is cash used for the purchase, maintenance, improvement and upkeep of the Stargate Sport Horse and the Little Woody (LL Ranch) real estate properties, and [2] for the 2010 calendar year the discharge of a promissory note due to Caroline Dee Wyly from the Caroline D. Wyly Irrevocable Trust.

With these stipulations in mind, the Court will discuss the relevant standards it must ***513** use to determine whether a gift, was made, before analyzing Sam's alleged gifts and then Dee's alleged gifts.

1. The Relevant Standards

a) Defining a Gift

[58] As initial support for its gift theory, the IRS argues, and this Court agrees, that the term "gift" is to be broadly construed to cover all transactions in which property or property rights are gratuitously bestowed upon another by whatever means effected. [910] As explained in the Treasury Regulations, gifts need not be wholly gratuitous, but may also include other transfers: [911]

> Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a value in money or money's worth, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.

[59] Moreover, transactions within a family group are subject to special scrutiny, including a presumption that a transfer between family members is a gift. [912] In *Kimbell v. U.S.,* [913] the Fifth Circuit held, in the context of an intra-family asset sale, that:

> In *Wheeler*, [914] the government argued that the requirement that a sale be "bona fide" takes on heightened significance in intrafamily transfers and this court agreed. Based on this heightened scrutiny, we concluded that a court should inquire beyond the form of a transaction between family members to determine whether the substance justified the claimed tax treatment. However, we made it clear that just because a transaction takes place between family members does not impose an additional requirement not set forth in the statute to establish that it is bona fide. A transaction that is a bona fide sale between strangers must also be bona fide between members of the same family. In addition, the absence of negotiations between family members over price or terms is not a compelling factor in the determination as to whether a sale is bona fide, particularly when the exchange value is set by objective factors. In summary, the *Wheeler* case directs us to examine whether "the sale ... was, in ***514** fact a bona fide sale or was instead a disguised gift or a sham transaction."

The Court finds that the heightened scrutiny standard in *Kimbell* and *Wheeler* is applicable to the transactions at hand, as each entity and individual involved in the transactions is Wyly affiliated and/or Wyly controlled.

On the other hand, the Debtors argue that there are seven factors that must be satisfied before a gift can be found to have been made: (i) a donor is competent to make the gift, (ii) a donee is capable of accepting the gift, (iii) there is a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift in praesenti, (iv) there is an irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it, (v) there is a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it, (vi) there is acceptance of the gift by the donee, and (vii) the donor did not receive full and adequate consideration for the transfer of the property.[915] Although they will be addressed in detail below, the Debtors generally argue that (i) they lacked the legal capacity to gift assets that are owned by the various IOM or domestic entities, (ii) they did not intend to make gifts of the assets, and (iii) the children never understood the assets to be gifts.

b) Determining the Underlying Substance of the Transaction

[60] In furtherance of its argument, the IRS also relies upon the general tax principal that the incidence of taxation depends upon the substance of a transaction, rather than its form,[916] as embodied in the judicial doctrines of economic substance, substance over form, and step-transaction, which the Court will explain in turn.

(1) The Economic Substance Doctrine

In *Klamath Strategic Inv. Fund ex rel. St. Croix Ventures v. U.S.*,[917] the Fifth Circuit delineated a three-part test for determining whether a transaction has sufficient economic substance to be respected for tax purposes. Specifically, whether the transaction: (i) has economic substance compelled by business or regulatory realities, (ii) is imbued with tax-independent considerations, and (iii) is not shaped totally by tax-avoidance features.[918] As explained by the Fifth Circuit in Southgate Master Fund, L.L.C.,[919]

> **[61]** In other words, the transaction must exhibit objective economic reality, a subjectively genuine business purpose, and some motivation other than tax avoidance. While these factors are phrased in the conjunctive, meaning that the absence of any one of them will render the transaction void for tax purposes, there is near-total overlap between the latter two factors.

[62] Overall, "[t]he economic substance doctrine seeks to distinguish between ***515** structuring a real transaction in a particular way to obtain a tax benefit, which is legitimate, and creating a transaction to generate a tax benefit, which is illegitimate."[920]

[63] As to the first *Klamath* factor, transactions lack objective economic reality if they do not vary, control, or change the flow of economic benefits.[921] This is an objective inquiry into whether the transaction either caused real dollars to meaningfully change hands or created a realistic possibility that they would do so.[922] That inquiry must be conducted from the vantage point of the taxpayer at the time the transaction occurred, rather than with the benefit of hindsight.[923] As to the remaining factors, the Fifth Circuit explained in *Southgate Master Fund, L.L.C.*[924] that:

> [t]he latter two *Klamath* factors ask whether the transaction was motivated solely by tax-avoidance considerations or was imbued with some genuine business purpose. These factors undertake a subjective inquiry into whether the taxpayer was motivated by profit to participate in the transaction. Tax-avoidance considerations are not wholly prohibited; taxpayers who act with mixed motives, seeking both tax benefits and profits for their

> businesses, can satisfy the business-purpose test.

(2) The Substance Over Form Doctrine

[64] The substance over form doctrine provides that the tax consequences of a transaction are determined based on the underlying substance of the transaction rather than its legal form. As explained by the Fifth Circuit in *Southgate Master Fund, L.L.C.*:[925]

> **[65]** **[66]** **[67]** Where, as here, we confront taxpayers who have taken a circuitous route to reach an end more easily accessible by a straightforward path, we look to substance over form and tax the transactions for what realistically they are. A court is not bound to accept a taxpayer's formal characterization of a transaction, even a transaction that has economic reality and substance. The major purpose of the substance-over-form doctrine is to recharacterize transactions in accordance with their true nature.

(3) The Step Transaction Doctrine

[68] Similar to the doctrines of economic substance and substance over form, the step-transaction doctrine permits a court to collapse various steps in a transaction to determine its true purpose. As explained by the Fifth Circuit in *Security Indus. Ins. Co. v. U.S.,*[926]

> **[69]** **[70]** **[71]** Under the step transaction doctrine, the tax consequences of an interrelated series of transactions are not to be determined by viewing each of them in isolation but by considering them together as component parts of an overall plan. When considered individually, each step in the series may well escape taxation. The individual tax significance of each step is irrelevant, however, if the steps when viewed as a ***516** whole amount to a single taxable transaction. Taxpayers cannot compel a court to characterize the transaction solely upon the basis of a concentration on one facet of it when the totality of circumstances determines its tax status.

Courts in the Fifth Circuit utilize two tests when determining whether to apply the step-transaction doctrine—the "end results" test and the "interdependence" test.[927] As further explained by the Fifth Circuit in *Security Indus. Ins.*:[928]

> **[72]** **[73]** The test most often invoked in connection with the application of the step transaction doctrine is the "end result" test. Under this test, purportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result. As the Fifth Circuit has noted, when cases involve a series of transactions designed and executed as parts of a unitary plan to achieve an intended result, the plans will be viewed as a whole regardless of whether the effect of doing so is imposition of or relief from taxation.
>
> **[74]** **[75]** A second test for determining whether the step transaction doctrine applies is labeled the "interdependence" test. This test focuses on whether the steps were so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series. When it is unlikely that any one step would have been undertaken except in contemplation of the other integrating acts, step transaction treatment may be deemed appropriate.

With these standards in mind, the Court will now focus on the alleged gifts made by Sam to his children, before turning to Dee's alleged gifts.

2. Understanding the Transactions Alleged to be Gifts by Sam to His Children

An overview of the transactions that allegedly resulted in gifts from Sam to his children are discussed above, *see* pp. 396–98, 406–07, 425–28, *supra.* However, due to the complexity of the transactions, certain of those facts are discussed again below for ease of reference.

a) Formation and Funding of the Cayman LLCs

On June 1, 2001, six Cayman Island Exempted Corporations were formed and were wholly-owned by the Bessie IOM Trust—Orange L.L.C. ("**Orange**"), FloFlo L.L.C. ("**FloFlo**"), Bubba L.L.C. ("**Bubba**"), Pops L.L.C. ("**Pops**"), Balch L.L.C ("**Balch**"), and Katy L.L.C. ("**Katy**" and collectively the "**Cayman LLCs**").[929] According to Evan and Hennington, the Cayman LLCs were established so that Sam's six children could each track a portion of Bessie IOM Trust's assets for educational purposes.[930] The Cayman LLC's were funded via loans of cash and assets from ***517** Security Capital, which Security Capital had to borrow from other Wyly IOM corporations.[931] Specifically, in June 2001, East Baton Rouge Limited (IOM), East Carroll Limited (IOM), Moberly Limited (IOM), and Yurta Faf Limited (IOM),[932] transferred a number of financial assets to Greenbriar Limited (IOM),[933] which, in turn, loaned the assets it received, together with additional financial assets of its own, to Security Capital in return for a promissory note from Security Capital to pay Greenbriar Limited (IOM) $55,815,672.03.[934] Then, once it had liquidity, Security Capital immediately loaned approximately $8,300,000 to FloFlo and $9,500,000 to each of Balch, Bubba, Katy, Pops, and Orange.[935] Between June 2001 and December 2004, Security Capital made subsequent loans to each of the six Cayman LLCs such that, by the end of 2004, FloFlo owed approximately $9,700,000 to Security Capital, and each of Balch, Bubba, Katy, Pops, and Orange owed approximately $11,100,000 to Security Capital.[936] The "loans" were comprised of various assets consisting of cash, stocks, and investments.[937]

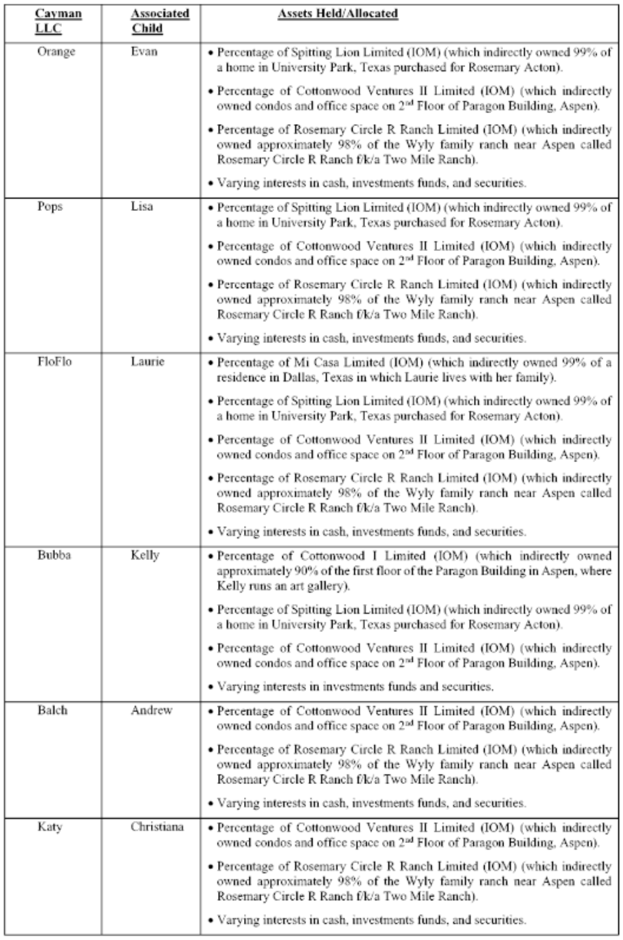
Boucher described the structure of the Cayman LLC's to Sam in a fax dated May 8, 2001:[938]

> The sub-funds will be Cayman LLC's [*sic*] as subsidiaries of the IOM Trusts. They will not be formal appointments out of the overall trust and will be revocable. They exist as a sub-fund via an informal understanding with the trustee whereby we account for these entities separately and liaise with particular family members regarding the underlying assets.
>
> * * *
>
> Note that Laurie and Kelly both end up with relatively low liquidity. On a fairly short term basis, Kelly will need liquidity to fund construction costs of their home on Two Mile Ranch [n/k/a Rosemary Circle R Ranch]. Laurie also will need near term liquidity for renovation/reconstructions of the Mi Casa property in Dallas. I suggest either reducing or eliminating allocations of particular investments to them now, or leaving the allocations as is, requiring Laurie and Kelly to decide what to sell when the liquidity needs arise. I don't see a problem with them selling assets back to the overall trust, or in the market when the need arises.

The Cayman LLCs were subsequently formed and one share of each was issued to John Dennis Hunter,[939] although the record does not reflect who Mr. Hunter is or his relationship to the Wylys. Assets were then transferred to the Cayman ***518** LLC's, but were "allocated" to Sam's children, who were ultimately in charge of managing the assets contained in the Cayman LLC associated with him or her via the procedure described by Boucher and/or direct ownership of certain entities, as will be discussed below.

A list of the Cayman LLCs, each associated child, and a general overview of the assets transferred to the applicable Cayman LLCs follows.

***519**



Cayman LLC	Associated Child	Assets Held/Allocated
Orange	Evan	• Percentage of Spitting Lion Limited (IOM) (which indirectly owned 99% of a home in University Park, Texas purchased for Rosemary Acton). • Percentage of Cottonwood Ventures II Limited (IOM) (which indirectly owned condos and office space on 2nd Floor of Paragon Building, Aspen). • Percentage of Rosemary Circle R Ranch Limited (IOM) (which indirectly owned approximately 98% of the Wyly family ranch near Aspen called Rosemary Circle R Ranch f/k/a Two Mile Ranch). • Varying interests in cash, investments funds, and securities.
Pops	Lisa	• Percentage of Spitting Lion Limited (IOM) (which indirectly owned 99% of a home in University Park, Texas purchased for Rosemary Acton). • Percentage of Cottonwood Ventures II Limited (IOM) (which indirectly owned condos and office space on 2nd Floor of Paragon Building, Aspen). • Percentage of Rosemary Circle R Ranch Limited (IOM) (which indirectly owned approximately 98% of the Wyly family ranch near Aspen called Rosemary Circle R Ranch f/k/a Two Mile Ranch). • Varying interests in cash, investments funds, and securities.
FloFlo	Laurie	• Percentage of Mi Casa Limited (IOM) (which indirectly owned 99% of a residence in Dallas, Texas in which Laurie lives with her family). • Percentage of Spitting Lion Limited (IOM) (which indirectly owned 99% of a home in University Park, Texas purchased for Rosemary Acton). • Percentage of Cottonwood Ventures II Limited (IOM) (which indirectly owned condos and office space on 2nd Floor of Paragon Building, Aspen). • Percentage of Rosemary Circle R Ranch Limited (IOM) (which indirectly owned approximately 98% of the Wyly family ranch near Aspen called Rosemary Circle R Ranch f/k/a Two Mile Ranch). • Varying interests in cash, investments funds, and securities.
Bubba	Kelly	• Percentage of Cottonwood I Limited (IOM) (which indirectly owned approximately 90% of the first floor of the Paragon Building in Aspen, where Kelly runs an art gallery). • Percentage of Spitting Lion Limited (IOM) (which indirectly owned 99% of a home in University Park, Texas purchased for Rosemary Acton). • Percentage of Cottonwood Ventures II Limited (IOM) (which indirectly owned condos and office space on 2nd Floor of Paragon Building, Aspen). • Varying interests in investments funds and securities.
Balch	Andrew	• Percentage of Cottonwood Ventures II Limited (IOM) (which indirectly owned condos and office space on 2nd Floor of Paragon Building, Aspen). • Percentage of Rosemary Circle R Ranch Limited (IOM) (which indirectly owned approximately 98% of the Wyly family ranch near Aspen called Rosemary Circle R Ranch f/k/a Two Mile Ranch). • Varying interests in cash, investments funds, and securities.
Katy	Christiana	• Percentage of Cottonwood Ventures II Limited (IOM) (which indirectly owned condos and office space on 2nd Floor of Paragon Building, Aspen). • Percentage of Rosemary Circle R Ranch Limited (IOM) (which indirectly owned approximately 98% of the Wyly family ranch near Aspen called Rosemary Circle R Ranch f/k/a Two Mile Ranch). • Varying interests in cash, investments funds, and securities.

b) The Real Estate Holdings

As shown by the above chart, ownership interests in companies that held interests in real estate were a substantial asset of ***520** each Cayman LLC.[940] These interests were generally held as follows (for property that was to be used personally by a Wyly family member): Bessie IOM Trust established and wholly owned an IOM entity. Then, the IOM entity and one or more members of the Wyly family (usually in a 97–99% to 1–3% ratio of the asset purchase price, respectively) would settle the domestic management trust. The domestic management trust would then form a domestic LLC that would (i) be managed by one or more members of the Wyly family, and (ii) purchase and hold title to the real estate.[941] In 2001, shares in the IOM entity were transferred from Bessie IOM Trust to the relevant Cayman LLC and the assets were allocated to the associated child.[942]

The structure used for investment in business use property was slightly different.[943] In that instance, the domestic management trust was replaced with a domestic corporation and an S corporation over which a Wyly family member was president. The domestic corporation would own a large percentage of a domestic LLC managed by a Wyly family member, with the remaining percentage being owned by a Texas S corporation with a Wyly family member as president.[944]

At trial, Pulman, a Meadows Owens partner involved in the structuring of the real estate transactions, explained the premise for this highly complex ownership structure.[945] As Pulman testified, a disadvantage of a foreign grantor (such as King in the case of the Bessie IOM Trust and the Tyler IOM Trust) owning property in the U.S. is that if that grantor dies, the interest in the U.S. property becomes subject to U.S. estate taxes.[946] To avoid this happening, the foreigner sets up a foreign corporation, and the foreign corporation makes the investment in U.S. real estate; therefore, when the foreigner dies, the property is not subject to U.S. estate tax.[947] This explains the involvement of the IOM entity in the real estate transactions.

According to Pulman, the issue then became, since the IOM trust does not own the property directly, but through a foreign corporation, there could be imputation ***521** of income as a constructive dividend.[948] To avoid this, a Wyly family member would become a 1% grantor in the domestic grantor trust. Pulman testified that this would make the Wyly family member and the foreign corporation joint-tenants under state law, entitling both to full use of the property without the underlying tax implications.[949] According to Pulman, the management trusts were structured to expressly permit each co-grantor the right to use the real estate.[950]

Several pieces of real estate were purchased under the personal use structure, including (i) the residence in Dallas, Texas, where Laurie and her family live, which is owned by Mi Casa LLC (Texas), (ii) the residence in University Park, Texas, where Rosemary Acton lived, which is owned by Spitting Lion LLC (Texas),[951] (iii) the home(s) on Rosemary Circle R Ranch outside Aspen occupied by Lisa, Laurie, and Kelly,[952] and (iv) the second floor of the Paragon Building in Aspen Colorado, which is owned by Cottonwood Ventures II LLC (Colorado). In each instance, the ownership and management structure resulted in a Wyly family member having control, at least initially, over how the property was occupied.

For example, Laurie wished to purchase a home in Dallas using the structure she used to build a second home on Rosemary Circle R Ranch, again utilizing offshore funds.[953] As noted previously, Laurie did not ask any IOM trustee if he thought an IOM trust would be interested in investing in a home for her family to occupy, but instead asked her Dad if it was ok to use the Colorado structure in Dallas to acquire property and then build a home for her family to live in using offshore funds.[954] Once Sam approved the concept, Laurie began communicating with the Wyly family office, but never spoke to anyone offshore.[955] Under the Meadow Owens structure, Laurie contributed $10,000 for a 1% share of the Mi Casa Management Trust (US).[956] In return, she picked a property, razed the existing structure, and hired architects ***522** and contractors to build the home her family would occupy.[957] Nearly $1 million in offshore funds were initially used on the project.[958] After FloFlo was formed in June 2001, the Mi Casa property was "allocated" to Laurie.[959] Although the testimony showed that some portion of Mi Casa Limited (IOM) was then transferred from Bessie IOM Trust to FloFlo, there is no evidence of when in 2001 the transfer occurred or what percentage was transferred.[960] Laurie serves as the trustee of the Mi Casa Management Trust (US) and as the manager of Mi Casa LLC (Texas).[961]

A similar series of events resulted when Evan, Laurie, Lisa, and Kelly wished to use offshore funds to purchase a home for their mother to live in.[962] The facts underlying this transaction are discussed in detail above, *see* pp. 425–28, *supra,* and will not be repeated here. But, in short, in return for a $9,000 contribution for a 1% share of the Spitting Lion Management Trust (US), Ms. Acton was permitted to live in the home purchased by Spitting Lion LLC (Texas) for the remainder of her life, despite the fact that she was not a beneficiary of the Bessie IOM Trust.[963] As of June 1, 2001, Spitting Lion Limited (IOM) was owned by Orange, Pops, FloFlo, and Bubba,[964] and allocated to each of Evan, Lisa, Laurie, and Kelly (Sam and Rosemary's children).[965] Ms. Acton and Lisa served as co-trustees of the Spitting Lion Management Trust (US), as well as the managers of Spitting Lion LLC.[966] Ms. Acton has since passed away.[967] On January 1, 2013, Evan's daughter McCary was added as a 1% co-grantor of the Spitting Lion Management Trust (US) and now lives in the home under the same rent-free structure her grandmother had enjoyed.[968]

This structure was also used in connection with the Rosemary Circle R Ranch ***523** property near Aspen Colorado, when Laurie, Lisa, and Kelly built homes on the Sam Wyly family ranch using offshore funds.[969] As of June 1, 2001, Rosemary Circle R Ranch Limited (IOM) was owned by Orange, Pops, FloFlo, Bubba, Balch, Katy, and Bessie IOM Trust, and allocated equally among Sam's six children.[970]

The "**Cottonwood Ventures**" properties consist of a set of condominium units on two floors of a commercial office building in downtown Aspen, Colorado, known as the Paragon Building. The first floor condominium unit (Unit 1), which is referred to by the parties as "**Cottonwood Ventures I,**" is used by Kelly to operate two art galleries. The second floor condominium units (Units 4 and 7), referred to by the parties as "**Cottonwood Ventures II,**" are used as an apartment and an office.[971] The Cottonwood Ventures properties differ from the Mi Casa, Spitting Lion, and Rosemary Circle R Ranch properties in that the record reflects substantial offshore funds were invested in the Cottonwood Ventures properties after their initial purchase.

Cottonwood I Limited (IOM) was established on July 14, 2000 and was wholly owned by the Bessie IOM Trust.[972] Cottonwood Ventures I LLC (Colorado) was formed in July 2000,[973] and it purchased the Cottonwood Ventures I property on August 14, 2000.[974] Cottonwood Ventures I LLC (Colorado) is owned by Cottonwood Gallery Inc. (Nevada) (89.3%) and Wyly Works (10.7%), a Texas S Corporation wholly-owned by Kelly.[975] As of June 1, 2002, Cottonwood I Limited (IOM) was owned by Bubba and the Bessie IOM Trust and allocated to Kelly.[976] If the Court finds that Sam made gifts of cash related to the Cottonwood Ventures I property, Sam and the IRS stipulate that the amount of the gift totals $2,855,000.[977]

Cottonwood II Limited (IOM) was established on July 14, 2000 and was wholly owned by Bessie IOM Trust.[978] Cottonwood Ventures II, LLC (Colorado) was formed in July 2000,[979] and it purchased the Cottonwood Ventures II property on August 14, 2000.[980] As of June 1, 2001, Cottonwood II Limited (IOM) was owned by Orange, Pops, FloFlo, Bubba, Balch, Katy, and Bessie IOM Trust,[981] and allocated ***524** equally to Sam's six children.[982] Sam and Kelly served as the co-managing members of Cottonwood Ventures II LLC (Colorado).[983] If the Court finds that Sam made gifts of cash related to the Cottonwood Ventures II property, Sam and the IRS stipulate that the amount of the gift, totals $10,961,000.[984]

c) Liquidation of the Cayman LLCs

Moving forward, the Cayman LLC's were placed into voluntary liquidation in 2006. Sam's children (Evan, Lisa, Laurie, Kelly, Andrew, and Christiana) did not receive any proceeds from the liquidation of the Cayman LLCs,[985] and it appears that the only substantive effect liquidation had on the ownership structure for the domestic real estate was that the shares of the various IOM corporations that were formerly owned by the Cayman LLCs were returned to the Bessie IOM Trust.[986] Sam's children, however, retained full use and enjoyment of the real estate both pre-and post-liquidation of the Cayman LLCs, as they continued to own interests in the domestic entities each acquired with personal funds. The only evidence in the record regarding the other assets in the Cayman LLCs (cash, stocks, and investments) is that they were used to repay the loan to the applicable Cayman LLC from Security Capital.[987]

3. Analysis of Alleged Gifts Made by Sam

The IRS' arguments regarding the nature of the alleged gifts from Sam to his children are set forth in §§ 2–3 of its Pre–Trial Brief. From this briefing, the Court had difficulty understanding precisely what the gifts were. And, once the Computation Stipulations were filed shortly before closing argument, it became clear that the IRS was very troubled by the transfers of offshore (i) cash that was used to purchase, improve, and maintain the Cottonwood Ventures I and II properties, and (ii) cash and other assets into the Cayman LLCs. However, the precise legal theory or theories through which the IRS was attacking these transfers as "gifts" from Sam to one or more of his children was not crisply delineated.

Because the Court was unsure that it fully understood the IRS' theories as to Sam's alleged gifts, and it obviously felt the need to understand those theories before attempting to decide the legal issue of whether Sam made any "gift" on which he would owe gift, tax, it pressed the IRS for more precision during closing arguments. At that time, the IRS clarified that, with respect to the transfers of cash used for the purchase, maintenance, improvement, and upkeep of the Cottonwood Ventures I property, gifts from Sam to Kelly allegedly occurred when funds were transferred to Cottonwood Ventures I, LLC.[988] For the ***525** Cottonwood Ventures II property, gifts from Sam to all six of his children allegedly occurred when the funds were transferred to Cottonwood Ventures II LLC.[989] With respect to Sam's alleged gifts to the Cayman LLCs, the IRS clarified during closing argument that the "gift" occurred when the Cayman LLCs were funded in June 2001.[990]

The Court will now analyze the "gifts" as clarified at closing by the IRS.

a) Cash Used to Purchase, Improve, and Maintain the Cottonwood Ventures I and II Properties

[76] As shown by the parties' stipulations, multiple millions of dollars were transferred from various IOM corporations to purchase, improve, and maintain the Cottonwood Ventures I and II properties.[991] The issue the Court must decide is if the transfers of cash from offshore for these purposes constitutes a "gift" from Sam to Kelly, in the case of the Cottonwood Ventures I property, or from Sam to each of his children, in the case of the Cottonwood Ventures II property.

In response to the IRS' gift arguments, Sam directs the Court to the factors it is to consider to determine if a gift occurred, including whether: (i) a donor is competent to make the gift, (ii) a donee is capable of accepting the gift, (iii) there is a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift in praesenti, (iv) there is an irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it, (v) there is a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it, (vi) there is acceptance of the gift by the donee, and (vii) the donor did not receive full and adequate consideration for the transfer of the property.[992]

In this regard, Sam argues that factors (i), (iii), and (iv), which require Sam to be a "donor" who intended to and did irrevocably transfer present legal title, cannot be met because Sam did not own the assets he purportedly gifted.[993] In support of this argument, Sam cites to *Short v. C.I.R.,*[994] in which the tax court faced the issue of whether Short had made a charitable contribution of land to the State of ***526** Delaware.[995] Citing to the general requirements for a gift detailed above, the tax court found that "[a]n objective inquiry must be made into the nature of the transaction to determine whether that which is labeled as a gift is in substance a gift."[996] Ultimately, the tax court found that Short was not entitled to a charitable contribution deduction because he failed to satisfy his burden of proving he possessed good legal title to the land he purportedly gifted.[997]

Using this rationale, Sam argues that he could not make a gift of the funds transferred from the IOM corporations because he never held legal title to the funds, as he had divested himself of dominion and control. Instead, according to Sam, the funds were held by various IOM corporations and domestic entities, which were, in turn, wholly owned or almost wholly owned, directly or indirectly, by the Bessie IOM Trust, over which the IOM trustee exercised dominion and control.

Thus, to determine whether Sam made a gift to his children, we must first examine whether Sam retained sufficient "dominion and control" over the offshore cash, and ultimately the property purchased, improved, and maintained with that cash; and, if so, did he sufficiently relinquish that dominion and control in order to make a gift, before moving on to the other factors (if necessary). As explained in the Treasury Regulations:[998]

> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

As this Court previously found in analyzing the various badges of fraud related to Sam's underpayment of income taxes,[999] Sam never really gave up dominion and control over the assets held in the offshore system. Although IOM trustees were in place and held legal title to the offshore assets, those trustees never exercised independent judgment in administering the trust assets, instead taking every "wish" Sam expressed to heart and faithfully executing it as directed. Indeed, the real estate transactions detailed above are but a few examples of Sam exercising effective control over the offshore funds in such a way that he and his children could use and enjoy real property, and improvements to that real property, paid for with offshore funds on a rent-free basis to them and a tax-free basis to him.

As we have discussed previously, when Laurie wanted to purchase a home for her family to occupy in Dallas using offshore funds, she did not contact an IOM trustee, she asked Sam. Once Sam approved the transaction, the Meadows Owens structure was put in place with Hennington's and ***527** Boucher's assistance, and apparently without a whimper from the trustee of the Bessie IOM Trust. The same is true when Evan, Laurie, Lisa, and Kelly wanted to purchase a home for their mother, Sam's first wife, using offshore funds. Everyone simply assumed that the trustee of the Bessie IOM Trust would go along once Sam's approval was received. And, of course, the IOM trustee did go along. For these reasons and those set forth on pp. 423–31, *supra,* the Court finds Sam's argument that he did not have sufficient dominion and control over the cash in the offshore system to gift it to his children wholly unpersuasive.

However, based on our record, and largely for the same reason, the Court cannot find that Sam made a gift of the cash used for the purchase, maintenance, improvement, and upkeep of the (i) Cottonwood Ventures I property to Kelly, or (ii) Cottonwood Ventures II property to each of his children. In short, while Sam may have let go of the cash from the offshore system so that the Cottonwood Ventures I and II properties could be purchased, improved, and maintained, he received an asset worth equivalent value back through (i) his control over the Bessie IOM Trust, which indirectly owns the majority interest in those properties, (ii) his control over Cottonwood I Limited (IOM), which is the sole shareholder of Cottonwood Gallery Inc. (Nevada), as it relates to the Cottonwood Ventures I property, and (iii) his status as Co–Manager of Cottonwood Ventures II, LLC (Colorado) as it relates to the Cottonwood Ventures II property, all of which will be explained more fully below.

[77] According to Treasury Regulation § 25.2511–2(b), a gift is complete only when the donor has "parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another." [1000] And, as explained above, a gift occurs only where, among other things, there is "a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift in praesenti" and an "irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it." [1001]

It is undisputed that cash from offshore was used to purchase the overwhelming majority interests in the Cottonwood Ventures I and II properties, along with the cash and other assets Kelly and Sam contributed. [1002] And, while Kelly and her siblings may have rent-free access to the Cottonwood Ventures properties, the simple truth is that they do not hold legal title to those properties and do not have the right to sell them and retain the proceeds upon a sale, except in accordance with the various LLC and trust agreements, which would entitle Kelly to a recovery of her investment upon liquidation and her percentage share of any profit. [1003]

***528** First, the Court will examine the relevant governing documents as they relate to each of the Cottonwood Ventures I and II properties to determine whether Sam remains in control of those properties, starting with the Cottonwood Ventures I property owned by Cottonwood Ventures I LLC (Colorado). [1004] Cottonwood Ventures I LLC (Colorado) is managed by Kelly, [1005] and has Wyly Works (a Texas S corporation owned by Kelly) and Cottonwood Gallery Inc. (Nevada) as members. [1006] As manager of Cottonwood Ventures I LLC (Colorado), Kelly has the power to sell property of Cottonwood Ventures I LLC (Colorado), [1007] but needs the approval "of two-thirds (2/3)-in interest of the Members" in order to sell "all or substantially all of the Company's business, property and assets (with or without good will), other than in the usual and regular course of the Company's business." [1008] Importantly, Kelly can be replaced as manager by "Members holding a majority of the issued and outstanding Membership Interests entitled to vote." [1009] Wyly Works has a 10.7% membership interest in Cottonwood Ventures I LLC (Colorado) and Cottonwood Gallery Inc. (Nevada) has an 89.3% membership interest in Cottonwood Ventures I LLC (Colorado). [1010] Thus, by virtue of the size of its membership interest, Kelly cannot sell all or substantially all of Cottonwood Ventures I LLC (Colorado)'s assets outside of the normal course of business without the consent of Cottonwood Gallery Inc. (Nevada) and can be replaced as manager with or without cause by Cottonwood Gallery Inc. (Nevada). [1011] And, although Kelly is the president of Cottonwood Gallery Inc. (Nevada), she can be removed and replaced as president at any time by the board of directors. [1012] In turn, the directors can be removed and replaced at any time by the shareholders of Cottonwood Gallery Inc. (Nevada). [1013] The sole shareholder of Cottonwood Gallery Inc. (Nevada) is Cottonwood I Limited (IOM). [1014] Although there are no regulations or bylaws for Cottonwood I

Limited (IOM) in the record, what the record does show is that Cottonwood I Limited (IOM) is wholly owned by the Bessie IOM Trust, which is of course completely ***529** controlled by Sam.[1015] Thus, in the end, Sam has total control over Cottonwood I Limited (IOM), which has total control over the directors of Cottonwood Gallery Inc. (Nevada), who in turn have total control over the management of Cottonwood Gallery Inc. (Nevada), which in turn has total control over the management of Cottonwood Ventures I LLC (Colorado), which owns the Cottonwood Ventures I property.

An even simpler analysis demonstrates Sam's continuing control over the Cottonwood Ventures II property after his alleged gift of cash was made to Cottonwood Ventures II LLC (Colorado), which used the cash (in conjunction with other funds) to buy the Cottonwood Ventures II property.[1016] Cottonwood Ventures II LLC (Colorado) is managed by Kelly and Sam, as co-managers,[1017] and has the Cottonwood II Management Trust (US) as its sole member.[1018] As co-managers, Sam and Kelly have the power to sell the property of Cottonwood Ventures II LLC (Colorado),[1019] but need the approval of its Member—Cottonwood II Management Trust (US)—to sell "all or substantially all the Company's property and assets (with or without good will), other than in the usual and regular course of the Company's business, without complying with the applicable procedures set forth in the [Colorado Limited Liability Company] Act."[1020] Sam and/or Kelly could be replaced as managers by Cottonwood II Management Trust (US).[1021] The initial trustee of Cottonwood Management Trust (US) was the Highland Trust Company.[1022] However, "SAM and/or KELLY if either is living and competent, and the Corporation" could remove and replace the Trustee.[1023] The "Corporation" in question was Cottonwood II Limited (IOM).[1024] Although there are no regulations or bylaws for Cottonwood II Limited (IOM) in the record, what the record does show is that Cottonwood II Limited (IOM) is wholly owned by the Bessie IOM Trust, which is of course completely controlled by Sam.[1025] Thus, Sam, ***530** together with Cottonwood II Limited (IOM) (which he controls via Bessie IOM Trust), can unilaterally replace Highland Trust Company with a new trustee.[1026] This means that, in the end, Sam has total control over Cottonwood II Limited (IOM), which in turn has total control over who the trustee of the Cottonwood II Management Trust (US) is, and that trustee has total control over the management of Cottonwood Ventures II LLC (Colorado), which in turn has control over the Cottonwood Ventures II property.

Under these facts, the Court cannot find that Sam made a gift of cash to his children here. While the Cottonwood Ventures I and II properties were purchased using mostly offshore funds, Sam has never given up control over those properties after their purchase. While Kelly has been permitted by Sam to exercise control over those properties day-to-day, Sam can remove her at any time. Moreover, the fact that Kelly and her siblings may use the properties does not make them, or the cash used to purchase, improve, and maintain them, a gift. The Bessie IOM Trust still owns the overwhelming majority of the Cottonwood Ventures I and II properties, albeit indirectly.

[78] **[79]** The various judicial doctrines espoused by the IRS do not change this determination. As explained by the Fifth Circuit in *Klamath,*[1027] this Court must consider whether these transactions: (i) had economic substance compelled by business or regulatory realities, (ii) are imbued with tax-independent considerations, and (iii) are not shaped totally by tax-avoidance features. These factors are phrased in the conjunctive, meaning that the absence of any one of them will render the transaction disregarded for tax purposes.[1028] "Thus, if a transaction lacks economic substance compelled by business or regulatory realities, the transaction must be disregarded even if the taxpayers profess a genuine business purpose without tax-avoidance motivations."[1029]

[80] As to the first factor, the Court must make an objective inquiry from the taxpayer's vantage point at the time the transaction occurred as to whether the transaction either caused real dollars to meaningfully change hands or created a realistic possibility they would do so.[1030] Here, real money changed hands when the real estate was purchased from third parties. Although the record clearly reflects that Sam used the offshore system as his personal piggy bank, and the Court questions whether the various "loans" among the IOM corporations related to the Cottonwood Ventures I and II properties will ***531** be repaid; in the end, these transactions resulted in the

Bessie IOM Trust investing, albeit indirectly, in U.S. real estate, a transaction that has economic substance.

The remaining *Klamath* factors, which are a subjective inquiry into whether the parties to the transaction were motivated by any legitimate, non-tax business purpose,[1031] are met for similar reasons. Here, the motivation behind the transaction was to purchase real estate chosen and to be used by certain of Sam's children, which occurred through a structure devised by Meadows Owens.[1032] Granted, investing in U.S. real estate via the Meadows Owens structure may not be the most profitable of its investments, but in the end, the Bessie IOM Trust indirectly owns valuable real estate, controls the ultimate disposition of that real estate, and the direct and indirect owners of that real estate will share proportionally in the gains or losses in accordance with the governing documents. Although the Meadows Owens structure may have been implemented to minimize taxes to the beneficiaries or avoid taxation should the foreign grantor die, there is simply nothing in the record indicating that the investment lacked a business motivation or was made solely for tax avoidance purposes.

Despite this, the IRS asks the Court to sham the transaction on the general allegation that Sam's children were allowed to use the properties so they must have received a gift. The Court is simply not willing to so find based on the record before it. From this Court's perspective, the issue returns to whether Sam exercised sufficient dominion and control over the offshore system and its funds to make a gift, which he did, and whether he completed such a gift, which he did not.

The Court further finds that, in substance, the transactions were not Sam making a gift of cash to Kelly (or any other child). As explained above, while Sam may have given up control over the funds long enough that they could be used to purchase the Cottonwood Ventures I and II properties, he did not give those funds to his children nor did he give up control over the properties purchased, improved and maintained with those funds —*i.e.,* the Cottonwood Ventures I and II properties. In essence, the funds were used to purchase a substitute asset still owned today by the Bessie IOM Trust, albeit indirectly. And, although Sam permits Kelly to use and manage the Cottonwood Ventures I and II properties day-to-day, and all of his children to use the Cottonwood Ventures II property, there is simply no evidence in the record supporting an inference that he gave his children the cash so they could buy the properties and hold legal title to them (indeed, no child has ever held legal property to either property). In short, none of Sam's children may individually or collectively dispose of the properties or direct the Bessie IOM Trust to dispose of the properties, and if the properties were sold, only Kelly would be entitled to a portion of the sale proceeds commensurate with her ownership interests. And, while offshore funds were also used to improve and maintain ***532** the Cottonwood Ventures I and II properties, that does not make those funds a gift either, as the Bessie IOM Trust remains the overwhelming majority owner of the Cottonwood Ventures I and II properties, albeit indirectly, and owners normally spend money to improve and maintain their property.

A step-transaction analysis leads to a similar result. When the transactions are considered together as component parts of an overall plan, the non-gratuitous nature of the transaction becomes apparent. Sam controlled the offshore funds and, at his direction, those funds were used, along with monies contributed by Kelly in accordance with her percentage of ownership, to purchase the Cottonwood Ventures I and II properties, which properties Kelly (predominately) uses rent-free. But, even if the transactions were collapsed to a direct purchase of real estate by the Bessie IOM Trust and Kelly (as to the Cottonwood Ventures I property on a roughly 90% to 10% ratio and as to the Cottonwood Ventures II property on a roughly 98% to 2% ratio), the record still does not reflect that Sam parted with his ability to exercise dominion and control over the assets largely purchased with the offshore cash. In fact, it demonstrates that Sam still maintains control over the assets.

Accordingly, for the reasons set forth above, the Court finds and concludes that the cash used for the purchase, maintenance, improvement, and upkeep of the Cottonwood Ventures I and II properties was not a gift, by Sam to Kelly or any other of his children.

b) Cash and Other Assets that were Transferred Into the Cayman LLCs

[81] The second category of alleged gifts, "cash and other assets transferred into the Cayman LLCs," are comprised of transfers of (i) ownership interests in the

IOM corporations that indirectly own U.S. real estate—Mi Casa Limited (IOM), Spitting Lion Limited (IOM), Rosemary Circle R Ranch Limited (IOM), Cottonwood I Limited (IOM), and Cottonwood II Limited (IOM) (collectively, the "**IOM Real Estate Companies**")—from Bessie IOM Trust to one or more of the Cayman LLCs, and (ii) cash, investments, and other financial assets to the Cayman LLCs. As alleged by the IRS, these gifts occurred when the "cash and other assets" were transferred into the Cayman LLCs in 2001.

(1) The Interests in IOM Real Estate Companies

Before June 2001, the Bessie IOM Trust owned 100% of the interests in the IOM Real Estate Companies, other than Rosemary Circle R Ranch (IOM) that was owned by both Bessie IOM Trust and Orange. [1033] In June 2001, the Cayman LLCs were formed and were wholly owned by the Bessie IOM Trust. [1034] Thereafter, but still in 2001, Bessie IOM Trust transferred some or all of its ownership interests in the IOM Real Estate Companies to one or more of the Cayman LLCs. Specifically, Bessie IOM Trust transferred: (i) its ownership of Spitting Lion Limited (IOM) to four of the Cayman LLCs —Orange, ***533** Pops, FloFlo, and Bubba, [1035] (ii) a portion of its ownership of Cottonwood I Limited (IOM) to one Cayman LLC—Bubba, while retaining an ownership interest, [1036] (iii) a portion of its ownership of Cottonwood II Limited (IOM) to all six of the Cayman LLCs, while retaining an ownership interest, [1037] (iv) a portion of its ownership interests in Rosemary Circle R Ranch Limited (IOM) to all six of the Cayman LLCs, while retaining an ownership interest, [1038] and (v) an unknown portion of its ownership of Mi Casa Limited (IOM) to one Cayman LLC—FloFlo. [1039]

According to the IRS, Bessie IOM Trust's transfer of these ownership interests in the IOM Real Estate Companies to the Cayman LLCs identified above resulted in a gift from Sam, as grantor of the Bessie IOM Trust, [1040] to his children, for whose benefit the Cayman LLCs were established. The IRS argues that donative intent is shown because (i) although the Cayman LLC's were liquidated in 2006 and ownership of the IOM Real Estate Companies was returned to the Bessie IOM Trust, Sam's children still enjoy unfettered access to the underlying real estate, and (ii) both the interests in the IOM Real Estate Companies and the loans underlying those interests were transferred to the Cayman LLCs (in effect, cancelling each other out).

As an initial matter, the Court notes that the transfer of interests in the IOM Real Estate Companies did not involve multiple steps or loans among the various IOM corporations, but was instead a transfer directly from the Bessie IOM Trust to one or more of the Cayman LLCs. [1041] As a result, the step-transaction doctrine does not apply. The Court will, however, consider whether the transfers had economic substance or were, in substance, a gift. The Court answers both these inquiries in the negative, as it will now explain.

***534** The Court finds that the transfers of ownership interests in the IOM Real Estate Companies from the Bessie IOM Trust to one or more of the Cayman LLCs lacked economic substance. It appears that the interests were merely moved from the Bessie IOM Trust to one or more of the Cayman LLCs in 2001, and then back to the Bessie IOM Trust in 2006 when the Cayman LLCs were liquidated, with no real discernable effect on anyone—business, tax, or otherwise. Simply put, the Court is unable to tell why this transfer occurred and what material effect, if any, it had on anyone or anything.

But, it is also true that there was no gift here to any of Sam's children. Even if this Court steps back and considers the overall substance of the 2001 ownership interest transfers in the IOM Real Estate Companies, the IOM Real Estate Companies were still owned by the Bessie IOM Trust at all times—either directly in part and indirectly in part or entirely indirectly. [1042] And, although Sam's children had unfettered access to the underlying real estate both before and after the Cayman LLCs were liquidated, this access was a result of the indirect ownership interests purchased by the respective Wyly family member(s), which was unaffected by the existence of the Cayman LLCs.

The Court is also not persuaded by the IRS' argument that Sam's donative intent is shown by the Cayman LLCs allegedly receiving both the ownership interests in the IOM Real Estate Companies and the account receivable related to the transfer of those interests. [1043] Although the IRS' argument is difficult to follow, the Court interprets the argument to be that, because the Cayman LLCs received both the ownership interests in the IOM Real Estate Companies and the alleged loan incurred to obtain the ownership interests, the transactions cancel each other out, resulting in a gift. The Court, however, disagrees. As explained above, the record simply does not support a finding that the Cayman LLCs received their ownership interests in the IOM Real Estate Companies via a loan from Security Capital. To the contrary, the interests were via a direct transfer from the Bessie IOM Trust. Thus, the IRS' argument on this point fails.

As alleged by the IRS, the gift here is the transfer of ownership interests in the IOM Real Estate Companies from Bessie IOM Trust to one or more of the Cayman LLCs in 2001. While those transfers occurred, the transfers were not a gift to one or more of Sam's children. As was the ***535** case with the Cottonwood Ventures I and II properties, while Sam's children may have unfettered use of the real estate "allocated" to them, they (i) did not own an interest in any Cayman LLC (all of which were liquidated in 2006), and (ii) do not hold legal title to the underlying real property that they use and enjoy. The Bessie IOM Trust always owned the Cayman LLCs and has always owned the IOM Real Estate Companies since their formation, either directly or indirectly.[1044] On this record, the IRS has failed in its proof.

(2) Cash and Other Financial Assets Transferred to the Cayman LLCs

The second type of alleged gift is the cash and other financial assets that were transferred into the Cayman LLCs in 2001. As stipulated by the parties, it appears that the scope of these alleged gifts is comprised primarily, if not exclusively, of the assets loaned by Security Capital to the Cayman LLCs in June 2001.[1045] As stipulated by the parties, if the Court determines that Sam made gifts of the cash and other assets transferred in 2001, the amount of such gifts to each of the Cayman LLCs is as follows: (i) Orange, $10,753,278; (ii) Pops, $10,756,981; (iii) FloFlo, $9,045,676; (iv) Bubba, $7,944,666; (v) Balch, $10,758,263; and (vi) Katy, $10,758,217.[1046]

With respect to these transfers, the IRS urges this Court to find that the various "loans" among the IOM corporations, as well as the formation of the Cayman LLCs and the foreign and domestic trusts, were all sham transactions in furtherance of Sam's scheme to avoid taxes.[1047] With respect to the loans, the IRS cites to *Miller v. C.I.R.,*[1048] which held that the determination of whether a transfer was made with a real expectation of repayment or was a sham depends on all the facts and circumstances surrounding the transaction, including whether: (i) there was a promissory note or other evidence of indebtedness, (ii) interest was charged, (iii) there was any security or collateral, (iv) there was a fixed maturity date, (v) a demand for repayment was made, (vi) any actual repayment was made, (vii) the transferee had the ability to repay, (viii) any records maintained by the transferor and/or the transferee reflected the transaction as a loan, and (ix) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.[1049] Unfortunately, after identifying the relevant facts to be considered, the IRS does not analyze them to any extent, but merely states:[1050]

> Here, there is no evidence to show that any of the obligations were paid and the notes have open maturity dates. There ***536** is no indication that any interest was charged or paid. No demand for repayment was ever made. Finally, the ability to repay the loans is also questionable because the majority of the alleged loans were used to develop and maintain real estate, and therefore, there is no cash readily available to make payments on these alleged obligations. Instead, these appear to be nothing more than entries listed on the family financials balance sheet that served to paper over the gifts.

This quote was taken from the IRS' Amended Proposed Findings of Fact and Conclusions of Law, which the Court directed be filed after the evidentiary record was closed so that all relevant record cites could be included for the Court's review. However, no supporting record cites were provided by the IRS for these proposed findings. The lack of record cites may be because there is nothing to cite to, as no testimony, promissory notes, or other documents detailing the alleged terms of the loans are found in the record. As noted previously, the IRS bears the burden to prove that Sam made a gift. If the record is deficient, it is the IRS' problem, not Sam's.

However, even assuming its proposed findings are supported by the evidence, the IRS still failed to show that the cash and other assets loaned to the Cayman LLCs by Security Capital were gifts by Sam to his children. In fact, there is nothing in the record indicating that Sam relinquished his dominion and control over the assets transferred to the Cayman LLCs, which is particularly apparent with Sam's two youngest children, Andrew (Balch) and Christiana (Katy). These children did not use offshore funds from the IOM corporations, the Cayman LLCs, or otherwise to purchase homes or other assets, and they are only mentioned in passing in the IRS' arguments. Overall, there is no credible evidence in the record demonstrating that any child exercised any control over the Cayman LLC "allocated" to him/her or the cash and other assets held by the Cayman LLCs.

While the Court is cognizant of the IRS' argument that the Cayman LLCs were only liquidated and their assets returned because Sam was under investigation by the SEC and audit by the IRS and had no other choice, the legal impact of that argument makes little sense here. As it relates to the Cayman LLCs, there was nothing for the children "to return" to the offshore system, as they never owned anything and nothing ever "left" the offshore system. The Bessie IOM Trust always owned the Cayman LLCs and it always owned the cash and other assets held in the Cayman LLCs, albeit indirectly.

For all of these reasons, the IRS has failed in its proof that any of the transfers they alleged constituted gifts were actually gifts from Sam to one or more of his children. Because the Court determines that Sam made no gifts as alleged by the IRS, the IRS' argument that Sam fraudulently failed to file gift tax returns related to these "gifts" is unavailing.

4. Understanding the Transactions Alleged to be Gifts by Dee to Her Children

With respect to Dee, the parties have stipulated that the alleged gifts are: (i) for each of the 2001 through 2005 calendar years, the cash used for the purchase, maintenance, improvement, and upkeep of the Stargate Horse Farm and Little Woody (LL Ranch) real estate properties, and (ii) for the 2010 calendar year, the discharge of a promissory note due to Dee from the Caroline D. Wyly Irrevocable ***537** Trust."[1051] The Court will address these in turn.

c) Stargate Horse Farm

"**Stargate Horse Farm**" is a 95–acre property located in a rural area of Denton County, Texas, near the Dallas–Fort Worth metroplex, on which a state-of-the-art equestrian facility was built and operated to import, breed, train, and show internationally competitive sport horses.[1052] The background underlying Stargate Horse Farm is described in an October 16, 2000 memo from Boucher to Robertson and French:[1053]

> Charles is looking at establishing a breeding and equestrian training facility with Emily's involvement. A business plan has been presented, involving the acquisition of approximately 140 acres of land just north of DFW airport. Only 50 acres will be used for the business venture and it is likely that the remaining land will be subsequently sold. Keeley [Hennington] and I are consulting Rodney [Owens] to see if we can use a structure similar to that which was used for the gallery in Aspen, thus utilizing foreign assets for the cash injection and contributing Emily's horses in the same way Kelly contributed the gallery's inventory stocks. * * * I have not seen it yet, but understand the business plan indicates the business will not likely cash flow for the first few years, and will need ongoing capital. The anticipated initial commitment will be a minimum of $3 Million.

Meadows Owens set up the following ownership structure for Stargate Horse Farm.[1054] Tyler IOM Trust established and owned 100% of Stargate Farms Limited

(IOM), [1055] which in turn established and owned 100% of Stargate Horse Properties, Inc. (Nevada). [1056] According to the Joint Stipulations, Stargate Sport Horses, LP (Texas) was then owned by two partners: (i) Stargate Horse Properties, Inc. (Nevada), as the 98% limited partner, and (ii) Stargate Sport Horses Management LLC (Texas), which was wholly-owned by Emily, as the 2% general partner. [1057] Stargate Sport Horses, LP (Texas) purchased the underlying real estate, [1058] was the owner of record for the real estate and improvements, and also operated the equestrian facility located on the property. [1059]

As stipulated by the parties, from 2001 through 2005 Stargate Horse Properties, Inc. (Nevada) contributed approximately 98% of the funds required to acquire, construct, and operate Stargate Horse Farm, while Stargate Sport Horse Management LLC (Texas) contributed the remaining ***538** 2%. [1060] The funds contributed by Stargate Horse Properties, Inc. (Nevada) were transferred from Elysium Limited (IOM) and Soulieana Limited (IOM) to Stargate Horse Properties, Inc. (Nevada), which then transferred the funds to Stargate Sport Horses, LP (Texas). [1061] If the Court determines that Dee (and Charles) made gifts of cash related to the purchase, maintenance, improvement, and upkeep of Stargate Horse Farm, the aggregate value of those gifts is $12,715,000, as the parties stipulated. [1062]

When additional funds were needed to operate Stargate Horse Farm, the partners of Stargate Sport Horses, LP (Texas) contributed funds in accordance with the operating agreement. [1063] After the Senate investigation began, however, Stargate Horse Properties, Inc. (Nevada) failed to fund ongoing operations, which resulted in Emily making loans to Stargate Sport Horses, LP (Texas). [1064] When Stargate Horse Farm was sold in 2009, the sale proceeds were distributed in accordance with the operating agreement—creditors were paid in full, including the loans made by Emily, then the proceeds were split between the partners. [1065] In the end, the bulk of the net proceeds, approximately 91%, were returned to Stargate Farms Limited (IOM) through its ownership of Stargate Horse Properties, Inc. (Nevada). [1066]

As noted previously, the IRS alleges that Dee (and Charles) made gifts to Emily of all the cash used for the purchase, maintenance, improvement, and upkeep of Stargate Horse Farm, with the gift being complete when the funds were transferred to Stargate Sport Horses, LP (Texas), the entity controlled by Emily. [1067]

d) Little Woody (LL Ranch)

"**LL Ranch,**" also known as Little Woody, is a 26–acre property with a residence near Aspen, Colorado that was initially acquired and owned by Little Woody, Ltd., a Texas limited partnership ("**Little Woody, Ltd. (Texas)**"). [1068] Little Woody, LLC (Colorado) was formed on October 22, 1999 [1069] and was initially wholly owned by Little Woody Creek Road Limited (IOM). [1070] In November 1999, the Little ***539** Woody Management Trust (US) was established, with Emily contributing assets equating to a 1% share, Jennifer contributing assets equating to a 1% share, and Little Woody Creek Road Limited (IOM) contributing assets equating to a 98% share. [1071] In November 1999, Little Woody Creek Road Limited (IOM) contributed 100% of the membership interests in Little Woody, LLC (Colorado) to Little Woody Management Trust (US). [1072] Then, in March 2001, Little Woody, Ltd. (Texas) sold LL Ranch to Little Woody LLC (Colorado). [1073] Emily and Jennifer share a home built on the LL Ranch property. [1074]

From 2001 through 2004, Little Woody Creek Road Limited (IOM) contributed 98% of the funds transferred to Little Woody Management Trust (US), while Emily and Jennifer contributed 1% each of the funds transferred to Little Wood Management Trust (US). [1075] As stipulated by the parties, between 2001 and 2004, approximately $6.2 million was transferred from Little Woody Creek Road Limited (IOM) to Little Woody Management Trust (US), and then from Little Woody Management Trust (US) to Little Woody LLC (Colorado). [1076]

The IRS alleges that Dee (and Charles) made gifts to Emily and Jennifer of all the cash used for the purchase, maintenance, improvement, and upkeep of LL Ranch, with the gifts being complete when the funds were transferred to Little Woody LLC (Colorado).[1077] The aggregate value of those alleged gifts is $6,205,000.[1078]

5. Analysis of the Alleged Gifts Made by Dee

a) Cash Used for the Purchase, Maintenance, Improvement, and Upkeep of the Stargate Horse Farm and Little Woody (LL Ranch) Real Estate Properties

[82] As did Sam, Dee argues that the IRS failed to prove the necessary elements of a gift,[1079] including factors (i), (iii), and (iv), which require Dee to be a "donor" who intended to and did irrevocably transfer present legal title to the cash or the real property purchased, improved, and maintained with that cash. Pointing to the IOM trustees, Dee argues that she did not have legal title over the cash and assets held in the offshore system and, as such, did not have the legal capacity to make a gift of the funds to her daughters. The Court finds this argument far more persuasive coming from Dee than it did coming from Sam.

***540** Although the record is replete with instances where Charles exercised dominion and control over the funds in the offshore system through his control over the IOM trustees[1080] that is simply not the case with Dee. The record is clear that, even though Dee purchased items that were paid for with offshore funds, she did not know that was happening. Charles had always provided very well for her and their family, and Highland Stargate generally paid the bills. As explained above, pp. 368, 407–08, 446 n. 573, *supra,* Dee did not discuss business with Charles, much less the complex offshore system he and Sam established in the IOM. Although Dee may have known there were offshore entities involved in the Wyly holdings, this Court is convinced that she never exercised control over those entities or would even know how to exercise control if she had wanted to do so. While Charles clearly had the ability to control the flow of funds and assets via "wishes" that were obeyed by the IOM trustees without question, there is nothing in the record to indicate that Dee held a similar power or even knew such a power existed. Based upon the record before it, the Court cannot find that Dee exercised sufficient dominion and control over the offshore funds so that she could gift them to her children.

Further, even if Dee could have gifted the assets, the record clearly shows that she did not, as the assets (whether in the form of cash or real estate) remained within the Wyly offshore system. It is undisputed that offshore cash was used to purchase the overwhelming majority interest in Stargate Horse Farm and the LL Ranch property, along with the cash and other assets that Emily contributed in the case of Stargate Horse Farm and the cash that Jennifer and Emily contributed in the case of LL Ranch. And, while Emily may have enjoyed day-to-day control over Stargate Horse Farm, the record clearly establishes that Charles retained control over the farm as a legal matter from the day it was purchased until it was sold[1081] and, upon its sale, the overwhelming majority of the net sale proceeds (approximately 91%) were distributed to Stargate Farms Limited (IOM).[1082] Moreover, while Jennifer and Emily may have rent-free access to the LL Ranch property and the home they built on that property, the simple truth is that they do not hold legal title to it and do not have the right to sell it and retain the proceeds upon a sale, except in accordance ***541** with the Little Woody Management Trust (US) agreement.[1083]

Granted, while investing in U.S. real estate using the structure set up by Meadows Owens may not be the best business decision of the trustee of the Tyler IOM Trust (as controlled by Charles), it does not change the fact that, in the end, the trust owned the overwhelming majority of Stargate Horse Farm until it was sold and still owns the overwhelming majority of the LL Ranch property and the improvements made to it, albeit indirectly.

That the alleged recipients of the gifts did not/do not hold legal title to the real estate and did not/do not have the right to retain the proceeds upon a sale (except in accordance with their written agreements) is amply demonstrated by the sale of Stargate Horse Farm in 2009, which, as noted previously, resulted in the distribution of net sale proceeds in accordance with the various operating agreements, with approximately 91% of the funds returning to the IOM offshore system. Under these facts, the Court is hard-pressed to see how Dee could have made a gift to Emily, when the funds were returned to the IOM system in proportion to the parties' respective investments when Stargate Horse Farm was sold.[1084]

This same reasoning applies to Charles. Although the record shows that Charles exercised sufficient dominion and control over the offshore funds and assets to gift them, the Court finds that no such gift occurred. Simply put, there is nothing in the record showing that Charles parted with his dominion and control over the offshore funds and assets to make a gift of them to Emily, in the case of Stargate Horse Farm, and Jennifer and Emily, in the case of LL Ranch. In fact, as previously found with regard to Stargate Horse Farm, Charles retained control over the farm through his ability to control Stargate Horse Farms Limited (IOM) through his control over the trustee of the Tyler IOM Trust, which had total control over the appointment of directors of Stargate Horse Properties Inc. (Nevada), and these directors in turn had total control over the management of Stargate Horse Properties Inc. (Nevada), which in turn had total control over the management of Stargate Sport Horses LP (Texas), which in turn had control over the management of Stargate Horse Farm.[1085]

Similarly, Charles exercised total control over the LL Ranch property when the gift of cash, as alleged by the IRS, was made. To reiterate, according to the IRS, the gift here was the transfer of approximately $6.2 million of offshore funds to Little Woody LLC (Colorado), which used the cash to purchase, improve, and maintain the LL Ranch property. Little Woody Creek Road Limited (IOM) contributed that cash to Little Woody Management Trust (US) beginning in March 2001 and concluding in November 2004, which then transferred the cash, plus amounts contributed by Emily and Jennifer, to Little Woody LLC (Colorado).[1086] Little Woody Management Trust (US) owned 100% of Little Woody LLC (Colorado)[1087] and, ***542** throughout that time period, Charles was the Manager of Little Woody LLC (Colorado),[1088] which owned the LL Ranch property.[1089] Moreover, Robertson and French were the initial Trustees of Little Woody Management Trust (US) when it was formed in March 1999[1090] and the Court reasonably infers that Robertson remained as Trustee when French's relationship with the Wylys ended in early 2001.[1091] So, throughout the period of time that the IRS' alleged gift was made by Charles to Emily and Jennifer, Charles remained in complete control of the cash initially and then the LL Ranch property and improvements made to that property by virtue of his complete control over the trustee of the Tyler IOM Trust, which controlled Little Woody Creek Road Limited (IOM), which in turn was the 98% grantor of the Little Woody Management Trust (US), whose trustee, Robertson, Charles controlled.

As noted previously, according to Treasury Regulation § 25.2511–2(b), a gift is complete only when the donor has "parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another."[1092] And, as explained above, a gift occurs only where, among other things, there is "a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift in praesenti" and an "irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it."[1093] That never occurred here with respect to either Stargate Horse Farm or the LL Ranch property.

Further, as was the case with Sam, the various judicial doctrines espoused by the IRS do not change these findings—as to either Dee or Charles. Even with the application of the substance over form, economic substance, and step-transaction doctrines, this Court must still make an independent assessment of whether the legal elements of a gift exist, which they do not. Because Dee did not have the legal capacity to make a gift of the offshore funds to her daughters, the Court need not consider whether the transaction had economic substance because, fundamentally, a person cannot gift what they do not own (whether via legal title or, in the case of Sam and Charles, de facto control).

Thus, for the foregoing reasons, the Court finds and concludes that Dee did not make a gift to (i) Emily of the funds used for the purchase, maintenance, improvement, and upkeep of Stargate Horse Farm, and (ii) Emily and Jennifer of the ***543** funds used for the purchase, maintenance, improvement, and upkeep of the LL Ranch property. The IRS has failed in its proof.

b) The Promissory Note Due to Dee from the Caroline D. Wyly Irrevocable Trust

(1) Overview of the Transaction

Stargate, Ltd. ("**SGL**"), a Texas limited partnership, was formed effective as of December 15, 1992 under the name Brush Creek, Ltd.[1094] Bush Creek, Ltd.'s Partnership Agreement was subsequently amended to (i) change the entity's name from Brush Creek, Ltd. to SGL, and (ii) reflect Dee's and Charles' additional contributions of various assets, including options in Michaels Stores and Sterling Software and a life insurance policy.[1095] The new contributions were valued at $44,343,615.[1096] Prior to September 30, 1999, SGL's general partners were Dee and Charles (1.02668%), and its limited partners were Dee (47.37276%), Charles (46.16672%), and Dee and Charles' children and grandchildren and trusts set up for their respective benefits (aggregating 5.43384%).[1097]

Between 1993 and 2007, varying amounts were loaned by SGL to Dee and Charles on an unsecured basis.[1098] As reflected on Dee's bankruptcy schedules (Schedule F), $28,080,127.92 was outstanding on this loan to Charles and her as of the date she filed her Case (the "**Unsecured Loan**").[1099] The note receivable related to the Unsecured Loan was reflected in SGL's financial statements, and the note payable was reflected on Dee and Charles' personal balance sheet.[1100]

Near the end of 1999, Dee and Charles implemented a multi-step estate planning program involving their limited partnership interests in SGL (the "**Estate Planning Transactions**"). On October 21, 1999, Dee and Charles executed a Marital Agreement dated effective September 30, 1999, pursuant to which they partitioned the community ownership of their limited partnership interests in SGL.[1101] Also effective September 30, 1999, Dee sold her now-separate property limited partnership interests in SGL to a newly created trust—The Caroline D. Wyly Irrevocable Trust (the "**CDW Irrevocable Trust**").[1102] ***544** In return, the CDW Irrevocable Trust issued to Dee a Secured and Partially Guaranteed Promissory Note in the amount of $26,054,111.00 (the "**CDW Irrevocable Note**").[1103] Also in connection with this transaction, Dee's children executed a Specific Guarantee Agreement,[1104] pursuant to which they guaranteed repayment of specified amounts of the CDW Irrevocable Note in exchange for a yearly fee, and the CDW Irrevocable Trust executed a Pledge Agreement whereby it pledged to Dee its newly-acquired limited partnership interest in SGL.[1105]

At this same time, Charles entered into substantially similar transactions, transferring his now-separate property limited partnership interests in SGL to The Charles J. Wyly Irrevocable Trust (the "**CJW Irrevocable Trust**" and, together with the CDW Irrevocable Trust, the "**Irrevocable Trusts**") in exchange for a promissory note in the amount of $25,487,656 (the "**CJW Irrevocable Note**" and, together with the CDW Irrevocable Note, the "**Irrevocable Notes**").[1106] After the sale, Dee and Charles remained SGL's general partners (1.01854%) and the CDW Irrevocable Trust (46.99734%), the CJW Irrevocable Trust (45.97945%), and Dee and Charles' children and grandchildren and various trust established for their benefit (6.00467%) were the limited partners.[1107]

Stargate Investments (Texas) was formed on October 15, 1999.[1108] The Charles J. Wyly, Jr. Family Trust and The Caroline D. Wyly Family Trust (together, the "**Revocable Trusts**") served as both general partners (each holding 1%) and limited partners (each holding 49%) of Stargate Investments (Texas).[1109] As reflected in the partnership agreement for Stargate Investments (Texas), Dee and Charles contributed assets valued at $98,424,589[1110] to it, including their right to receive future payments under (i) all annuity agreements[1111] between each of them ***545** and the various IOM corporations, (ii) the CDW Irrevocable Note, and (iii) the CJW Irrevocable Note.[1112]

Generally under this structure, Dee and Charles would make payments to SGL on account of the Unsecured Loan.[1113] SGL would use those funds to make a distribution to its partners, including the Irrevocable Trusts.[1114] The Irrevocable Trusts would then use those funds to make payments to Stargate Investments (Texas) on account of the Irrevocable Notes.[1115] In turn, Stargate Investments (Texas) would make distributions to Dee and Charles via a deposit into their community property bank account.[1116]

According to the Debtors, the Irrevocable Notes were paid in full on October 25, 2010 utilizing the above payment structure, as indicated by the hand-written notation on each note.[1117] In this regard, Hennington testified that payments on the Irrevocable Notes were made either in cash or by book entries that tracked the payables and receivables of each individual and entity.[1118] Wyly Exhibit PA is a letter composed by Hennington and sent to Christina Pfiffner, the internal revenue agent auditing certain aspects of the Wyly offshore structure and transactions. According to Hennington, the letter provides all documents necessary to show payment in full of the Irrevocable Notes, including a schedule tracking all cash and book entry payments made on the Irrevocable Notes and supporting bank statements and record entries.[1119]

The IRS is not convinced that the Irrevocable Notes were repaid, arguing instead that the circular nature of the payments merely masked the fact that no actual value changed hands, resulting in a gift by Dee to the CDW Irrevocable Trust on October 25, 2010 when the CDW Irrevocable Note was allegedly discharged, but not really repaid.[1120] According to the IRS, the Irrevocable Trusts' ability to repay the Irrevocable Notes was wholly dependent upon Dee and Charles making payments on the Unsecured Loan, which payments would then circulate to the Irrevocable Trusts and be used to pay the Irrevocable Notes, ultimately returning to Dee and Charles. According to the IRS, the true nature of this transaction is driven home by the fact that Dee is unable to show an increase in her assets corresponding to the amounts allegedly repaid on the CDW Irrevocable Note. The IRS does not challenge the Estate Planning Transactions generally, just the fact that there ***546** was no true repayment of the CDW Irrevocable Note.

A chart prepared by the parties depicting the ownership structure and the Charles and Dee Wyly Estate Planning Transactions, is attached to this Memorandum Opinion as Exhibit K.

(2) Analysis of the Alleged Gift Made by Dee

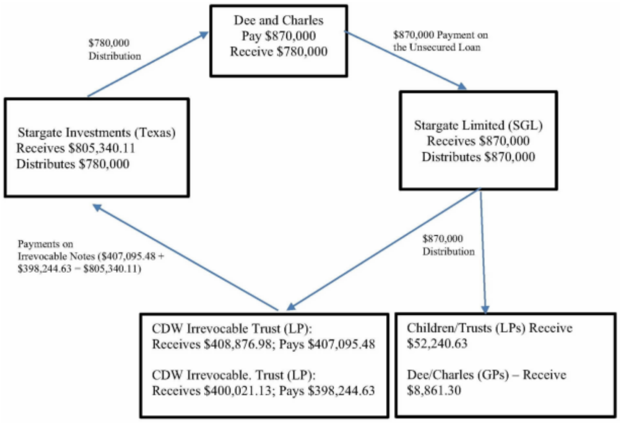
The Court initially struggled to understand the true implications of the circular transactions, as each step facially appears proper. Indeed, the IRS does not allege that (i) the Unsecured Loan was not owed by Dee and Charles to SGL, (ii) Dee sold her limited partnership interests in SGL for insufficient value, or (iii) the CDW Irrevocable Note was not a valid promissory note. Thus, the circular flow of funds seems appropriate, until one steps back to consider the overall effect.

Normally, when a person sells an asset, as Dee purported to do here—*i.e.,* her limited partnership interests in SGL —the purchaser pays for what it bought with its own assets. But, that did not happen here. As the record shows (and as described below), the funds used to pay the CDW Irrevocable Note, which Dee received in exchange for her limited partnership interests in SGL, were funds Dee was entitled to receive from other sources *prior* to the Estate Planning Transactions. Thus, in repayment, Dee received no new value and the res of the CDW Irrevocable Trust was untouched. What did occur was that Dee "sold" her valuable limited partnership interests in SGL to the CDW Irrevocable Trust, which was established for the benefit of her children and grandchildren, without any corresponding benefit to her or tax being paid. These overriding facts must be kept in mind as we wade through the complexity of these transactions and whether they had economic substance as judged under the *Klamath* factors.

As to the first *Klamath* factor, the Court must make an objective inquiry from the taxpayer's vantage point at the time the transaction occurred as to whether the transaction either caused real dollars to meaningfully change hands or created a realistic possibility they would do so.[1121] Here, the record clearly reflects that the CDW Irrevocable Trust's ability to repay the CDW Irrevocable Note was wholly dependent on Dee and Charles making a payment on the Unsecured Loan, which was owed by them well before they undertook the Estate Planning Transactions. In fact, the CDW Irrevocable Trust bank account that was used to repay the CDW Irrevocable Note had a zero balance prior to the trust receiving its first distribution from SGL in January 2000.[1122] And, once a distribution was made, it flowed through the system, both paying down the Unsecured Loan and paying off the CDW Irrevocable Note.

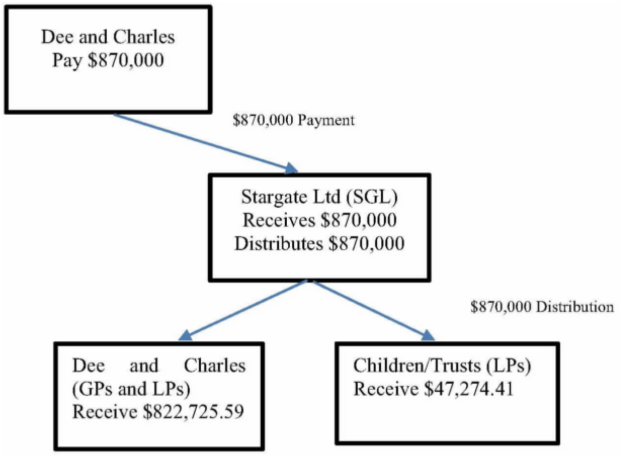
To illustrate, the Court will trace the first payment made on the Irrevocable Notes through the record. Sometime on or before January 11, 2000, Dee and Charles made an $870,000 payment to SGL on the Unsecured Loan.[1123] SGL then allocated all of those funds among its partners,[1124] and on January 11, 2000, distributed $408,876.98 to the CDW Irrevocable Trust and $400,021.13 to the CJW Irrevocable ***547**

Trust[1125] (each account having a prior zero balance). That same day, the CDW Irrevocable Trust made a $407,095.48 payment to Stargate Investments (Texas) on the CDW Irrevocable Note, retaining $1,781.50,[1126] and the CJW Irrevocable Trust made a $398,244.63 payment to Stargate Investments (Texas) on the CJW Irrevocable Note, retaining $1,777.05.[1127] Then, on January 25, 2000, Stargate Investments (Texas) made a $780,000 distribution to Dee and Charles via a deposit into their community property bank account.[1128] Of the $81,138.70 that was not returned to Dee and Charles, $52,240.63 was distributed to the other limited partners of SGL, who are comprised mainly of the beneficiaries of the Irrevocable Trusts—*i.e.,* Dee and Charles' children and grandchildren. The chart below depicts this flow of funds:


Dee and Charles
Pay $870,000
Receive $780,000
$780,000 Distribution
$870,000 Payment on the Unsecured Loan
Stargate Investments (Texas)
Receives $805,340.11
Distributes $780,000
Stargate Limited (SGL)
Receives $870,000
Distributes $870,000
Payments on Irrevocable Notes ($407,095.48 + $398,244.63 – $805,340.11)
$870,000 Distribution
CDW Irrevocable Trust (LP):
Receives $408,876.98; Pays $407,095.48
CDW Irrevocable. Trust (LP):
Receives $400,021.13; Pays $398,244.63
Children/Trusts (LPs) Receive $52,240.63
Dee/Charles (GPs) – Receive $8,861.30

This circular payment arrangement, with all funds used to repay the Irrevocable Notes originating with Dee and Charles (and mostly returning to Dee and Charles), can be traced consistently through the remaining 17 payments made on the CDW Irrevocable Note.[1129] Thus, ***548** although the CDW Irrevocable Trust "repaid" a $26,054,111 note (through the circulation of funds originating from Dee and Charles), the corpus of the trust was unaffected and all value was preserved for its beneficiaries.

It bears noting how the $870,000 payment on the Unsecured Loan would have flowed before the Estate Planning Transactions. In that instance, Dee and Charles would make a payment to SGL on account of the Unsecured Loan. In turn, SGL would allocate the funds among its partners and make a distribution, with the bulk of the funds returning to Dee and Charles as SGL's general partners and majority limited partners.[1130]


Dee and Charles
Pay $870,000
$870,000 Payment
Stargate Ltd (SGL)
Receives $870,000
Distributes $870,000
$870,000 Distribution
Dee and Charles
(GPs and LPs)
Receive $822,725.59
Children/Trusts (LPs)
Receive $47,274.41

The ultimate outcome (money returning to Dee and Charles) is unchanged under either scenario (although more money is returned to Dee and Charles under the pre-Estate Planning Transaction structure), with the difference being ownership of Dee's (now former) limited partnership interests in SGL having been "sold" to the CDW Irrevocable Trust for the benefit of her children and grandchildren.

The Court understands that, due to Dee's and Charles' affiliation with all of these entities, these are "captive" transactions where money flows back and forth. That, standing alone, does not trouble the Court. What troubles the Court is that the captive system was gamed to get the best of both worlds—Dee's limited partnership interests were "sold" to the CDW Irrevocable Trust in exchange for the CDW Irrevocable Note; however, the CDW Irrevocable Trust's assets were not diminished in repayment of that note. Tellingly, the record shows that, after the Irrevocable Notes were marked paid in full on October 25, 2010, Dee and Charles did not make any further payments on the Unsecured Loan through at least December ***549** 31, 2011 (the last date shown on Wyly Exhibit PD, tracking the Unsecured Loan).[1131] Indeed the only post-October 2010 payment reflected in the record is a $20,000 payment on September 4, 2014.[1132]

[83] Simply put, there is nothing in the record objectively indicating that the payment transactions had any economic substance. The transactions did not materially vary control or change the flow of economic benefits[1133]—money merely took a more circuitous route when coming to/from Dee and Charles so that the CDW Irrevocable Note could be "repaid" without affecting the corpus of the CDW Irrevocable Trust.[1134] The Court finds that this outcome was a goal of the Estate Planning Transactions from the outset.

The remaining *Klamath* factors, which are a subjective inquiry into whether the parties to the transaction were motivated by any legitimate, non-tax business purpose,[1135] are also not met. Indeed, the Court cannot divine (nor does the record reflect), the business purpose behind Dee selling her limited partnership interests in SGL in return for funds she was already entitled to receive. Although parties are free to engage in estate planning, Dee's estate planning took the form of a sale for value,[1136] but that value was never truly paid by the purchaser.

Accordingly, the Court finds that the alleged payment of the CDW Irrevocable Note lacked economic substance and should be disregarded for tax purposes, resulting in a gift by Dee in an amount not greater than $50,756,841[1137] when the CDW Irrevocable Note was "discharged" on October 25, 2010.

Alternatively, the Court finds that the alleged repayment of the CDW Irrevocable Note should be recharacterized as a gift for tax purposes under the substance over form doctrine. Although Dee "sold" her limited partnership interests in SGL in exchange for the CDW Irrevocable Note; as detailed above, that note was never actually repaid by the purchaser. Instead, the CDW Irrevocable Note was simply marked paid in full when a sufficient number of circular "payments" were passed through the system. In accordance with the parties' stipulation, Dee's gift was in an amount not greater than $50,756,841.[1138]

(3) Is Dee Liable for Fraud Penalties on her Gift?

[84] Because the Court finds that Dee made a gift when the CDW Irrevocable ***550** Note was "discharged," the Court must now address the IRS' allegation that Dee is liable for fraud penalties for her failure to file a related gift tax return.[1139] Since it is undisputed that Dee did not file a gift tax return for the 2010 tax year,[1140] 26 U.S.C. § 6651, not § 6663, is the applicable provision. The two statutes, however, share the same standard.[1141]

The IRS alleges that Dee deliberately chose not to file gift tax returns because she did not wish to disclose the existence of the offshore corporations and trusts.[1142] According to the IRS, the following badges of fraud support a finding of fraud against Dee here: (i) understatement of income by failing to report the transfers on income or gift tax returns, (ii) inadequate maintenance of records, and (iii) failure to file gift tax returns.[1143] Notably, these are several of the same badges of fraud that the IRS alleged in support of its argument that Dee should be held liable for § 6663 fraud penalties on income tax underpayments. And, for the reasons these badges fail to support a finding of fraud against Dee under § 6663, *see* pp. 389–462, *supra,* they similarly fail to support a finding of fraud against Dee under § 6651.

While Dee certainly signed the relevant documents, there is simply no persuasive evidence in the record that Dee understood how these very complicated Estate Planning Transactions worked, or was aware that they would result in her making a gift for which a gift tax return would be required. During trial, Dee credibly testified that she (i) was not involved in Charles' business affairs, (ii) never discussed business with him, and (iii) trusted him such that when he asked her to sign a document she would, without question. Although she did sign documents involved in the Estate Planning Transactions, she did so without reading them and in full reliance on Charles. To be clear, even if Dee had read them, the Court is satisfied that she would not have understood them or the gift tax consequences flowing from them.

Further, the Court is hard pressed to see how inadequate records were maintained for the Estate Planning Transactions. To the contrary, it appears that the IRS was provided with ample explanation and documentation regarding the Estate Planning Transactions. For example, Wyly Exhibit PA is a letter from Hennington to an internal revenue agent that lays ***551** out how the alleged payments on the Irrevocable Notes were made and how funds flowed between the various entities, which was followed by the correspondence at Wyly Exhibit PB providing even more information. And, although the IRS has alleged specific instances where they had difficulty obtaining records related to the IOM trusts and corporations, the Estate Planning Transactions involved domestic entities for which no similar allegation was made.

Thus, for the reasons set forth above, as well as those set forth on pp. 389–462, *supra,* the Court finds that

Dee: (i) made a gift in the 2010 calendar year from the "discharge" of the CDW Irrevocable Note due to her by the CDW Irrevocable Trust in an amount not greater than $50,756,841,[1144] and (ii) is not liable for fraud penalties under 26 U.S.C. § 6651 related to her failure to file a gift tax return for the tax year 2010.

G. Are Penalties Owing for the Failure to File Forms 3520, 3520–A, and 5471?

1. Introduction

In addition to asserting that the Debtors are liable for income tax, gift tax, interest, and fraud penalties, the IRS argues that the Debtors are liable for what are described alternately as international penalties and failure to file penalties (collectively, the "**International Penalties**"). Although the Court will use the term International Penalties, both descriptions are correct. The International Penalties arise because of the Debtors' alleged failures to file with the IRS information about the various foreign trusts and corporations that comprise the Wyly offshore system. If applicable here, this information must be filed with the IRS pursuant to 26 U.S.C. §§ 6038 and 6048.

The Debtors make three primary arguments in opposition to the IRS' assertion that it is entitled to recover the International Penalties: (i) that, in many instances, the reporting obligations underlying the International Penalties are not applicable to them because the actions pointed to by the IRS as giving rise to the International Penalties were not violations of §§ 6038 and 6048, (ii) that they have reasonable cause defenses for any violations of §§ 6038 and 6048 they may have committed, and (iii) that the International Penalties are excessive fines under the Eighth Amendment of the Constitution, which should be declared unconstitutional as applied to them if they are both liable for the International Penalties and their reasonable cause defenses fail.

For the reasons explained below, the Court concludes that the Debtors did, in some instances, violate §§ 6038 and 6048, although annuity payments, loans, and real estate transactions originating from the Wyly offshore system did not need to be reported as trust distributions under § 6048(c) and cash sales of options did not need to be reported as transfers into foreign trusts under § 6048(a). The Debtors' reasonable cause defense and Eight Amendment arguments are addressed in separate sections of this Memorandum Opinion.

2. Statutory Overview

Before addressing the parties' particular arguments, an overview of the statutes that govern the International Penalties, 26 U.S.C. §§ 6038, 6048, and 6677, will be helpful. Section 6038 is a statutory mechanism for monitoring the dealings between a United States person and any foreign corporation, foreign partnership, or other ***552** form of foreign business entity that such person controls.[1145] It mandates that "[e]very United States person shall furnish, with respect to any foreign business entity which such person controls, such information as the Secretary may prescribe ..." related to the nature of these controlled foreign business entities, their structure, and the transactions they undertake.[1146] This information is normally filed on an IRS Form 5471.[1147] If a taxpayer fails to file information about foreign business entities that he or she controls on Form 5471, § 6038(b) provides that "such person shall pay a penalty of $10,000 for each annual accounting period with respect to which such failure exists."[1148]

In slight contrast, § 6048 is concerned with monitoring the dealings between a United States person and foreign trusts.[1149] Under §§ 6048(a) and (c) a United States person must report: (i) his creation of a foreign trust,[1150] (ii) transfers of money or property to a foreign trust,[1151] or (iii) when he "receives (directly or indirectly) ... any distribution from a foreign trust."[1152] Information about these types of events is generally filed on an IRS Form 3520.[1153] Failure to report these types of events on a Form 3520 can result in International Penalties of $10,000 or 35% of the value of the property involved in the unreported transfer or distribution, whichever is greater,[1154] as provided in 26 U.S.C. § 6677(a).

Section 6048(b) also requires anyone who is treated as the owner of a foreign trust under the rules of subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code (better known as the grantor trust rules of 26 U.S.C. §§ 671–679) (the "**Grantor Trust Rules**") to annually submit "such information as the Secretary may prescribe with respect to such trust for such year." [1155] It also requires anyone treated as the owner of a foreign trust under the Grantor Trust Rules to provide all required information to the IRS, to United States owners of the trusts, and to United States persons receiving distributions from the trusts. [1156] The annual information required to be filed by grantors of grantor trusts under § 6048(b) is usually provided on an IRS Form 3520–A. [1157] Failure to file a Form 3520–A can result in International Penalties of $10,000 or 5% of the gross value of the relevant trust's assets, whichever is greater, [1158] as provided in 26 U.S.C. § 6677(b). [1159]

***553** As noted previously, the SDNY Court determined in the SEC Action that, as to Sam, the Bulldog IOM Trust, the Lake Providence IOM Trust, the Delhi IOM Trust, the Bessie IOM Trust, and the La Fourche IOM Trust are grantor trusts under the applicable Grantor Trust Rules, and this Court has accorded collateral estoppel effect to that determination. These trusts will be collectively referred to in this section of the opinion as the "**Sam International Penalty Trusts**." Similarly, the SDNY Court determined in the SEC Action that, as to Charles, the Pitkin IOM Trust, the Castle Creek IOM Trust, the Tyler IOM Trust, and the Red Mountain IOM Trust are grantor trusts under the applicable Grantor Trust Rules and this Court has accorded collateral estoppel effect to that determination. [1160] These trusts will be collectively referred to in this section of the opinion as the "**Charles and Dee International Penalty Trusts**."

With this background in mind, we turn to the International Penalties at issue here.

a) § 6038 and Failures to File Form 5471

For the reasons explained more fully below, the Court concludes that Sam, Charles, and Dee violated § 6038 by failing to file Forms 5471 with respect to the various IOM corporations and/or Cayman LLCs owned by the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts. In fact, the Debtors do not seem to dispute the effect of the SDNY Court's determination that these trusts were Wyly grantor trusts on their respective obligations to have filed Forms 5471 under § 6038. But, even if they do, an analysis of the relevant statutes and regulations confirms their respective obligations to file Forms 5471 with respect to the foreign corporations the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts owned (collectively, the "Foreign Corporations"). [1161] According to 26 U.S.C. § 6038(a), a Form 5471 must be filed annually by every United States taxpayer "with respect to any foreign business entity which such person controls." [1162] It is undisputed that Sam, Charles, and Dee are United States taxpayers. Moreover, the parties have stipulated that the Foreign Corporations for which the IRS asserts that Forms 5471 should have been filed are all IOM corporations or Cayman LLCs that are wholly-owned subsidiaries of one of the Sam International Penalty Trusts or one of the Charles and Dee International Penalty Trusts. [1163] Thus, all that is left for this Court to decide relating to the Debtors' liability for International Penalties under § 6038(a) is whether the SDNY Court's determination that the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts are grantor trusts necessarily means that the Debtors controlled the ***554** Foreign Corporations for purposes of § 6038. The Court concludes that it does, as explained below.

Section 6038 defines "[c]ontrol of corporation" for the purpose of Form 5471 filings:

> A person is in control of a corporation if such person owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock, of a corporation.... For purposes of this paragraph, the rules prescribed by section 318(a) for determining ownership of stock shall apply. [1164]

Turning to 26 U.S.C. § 318(a)(2)(B)(ii), we see why the SDNY Court's grantor trust determinations lead to a finding of control under § 6038. Section 318(a)(2)(B)(ii) states that "[s]tock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under [the Grantor Trust Rules] shall be considered as owned by such person." [1165] The SDNY

Court determined that the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts are grantor trusts to Sam and/or Charles through application of the Grantor Trust Rules.[1166] Thus, taken together, these statutes dictate that Sam and Charles owned and thus controlled the Foreign Corporations for the purposes of § 6038 and reporting on Form 5471 because they are the grantors of the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts, respectively, one of which trusts owns each of the Foreign Corporations.

That leaves only Dee, who is also considered to "control" the Foreign Corporations for the purpose of § 6038. Under 26 U.S.C. § 318(a)(1)(A), "[a]n individual shall be considered as owning the stock owned, directly or indirectly, by or for ... his spouse."[1167] Thus, Dee is considered to own and control the Foreign Corporations because she was Charles' spouse, at least until the time of his death, when Charles' ownership interest passed to his probate estate. Under § 318(a)(2), "[s]tock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries"[1168] and "[s]tock owned, directly or indirectly, by or for a trust ... shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust."[1169] Although ***555** it has been represented to this Court in earlier proceedings in her Case that Dee is "the primary beneficiary" of Charles' probate estate, there is insufficient evidence in this record for the Court to determine whether Dee controls the Foreign Corporations by virtue of her status as a beneficiary of Charles' probate estate. Thus, § 318(a)(1)(A) and the evidence requires the Court to find that Dee controlled the Foreign Corporations at all times up until Charles' death, but not after Charles' death.

However, if Dee is considered a grantor of the Charles and Dee International Penalty Trusts, she "controls" the Foreign Corporations through her status as grantor.[1170] And, from this Court's perspective, Dee is also a grantor of the Charles and Dee International Penalty Trusts because those trusts were funded with community property. Under Texas law, property possessed by either spouse during marriage is presumed to be community property unless clear and convincing evidence establishes otherwise.[1171] No party has presented evidence that Charles funded the Charles and Dee International Penalty Trusts with anything other than community property. And, since the Charles and Dee International Penalty Trusts were presumably funded with community property, Dee is the grantor of these trusts to the same extent as Charles.

Dee does not argue otherwise. Rather, Dee's arguments focus solely on her defenses to her liability for the International Penalties—*i.e.,* reasonable cause and excessive fines under the Eighth Amendment. In fact, Debtors' counsel waived any argument that Dee was not a grantor of the Charles and Dee International Penalty Trusts during closing argument.[1172] At that time, the Court asked Debtors' counsel to elaborate on the Debtors' side of the argument regarding contested issue of law D from the Joint Pre–Trial Order.[1173] Contested issue of law D reads as follows:

> Whether the District Court's finding in *SEC v. Wyly* that the IOM Trusts are "grantor trusts" applies to years after those in the SEC litigation, *i.e.,* 2005–2013, if, as the United State alleges, the Debtors cannot identify material factual or legal changes relating to the IOM Trusts beyond 2004 (the final year addressed in the District Court's findings)?[1174]

Debtors' counsel answered the Court's question by stating that "... this ties into ***556** a later question as well ... but—the only thing that happened after 2004 that could—could impact this is that Mr. Wyly passed away. That could have an impact on whether Dee Wyly is a grantor, but I don't think we're going to pursue that, so I don't think that's a live issue." The Court then replied by sating "Okay. So it's moot. Okay."[1175] Closing arguments then proceeded on to other questions on the Court's list, including one about contested issue of law CC from the Joint Pre–Trial Order and whether the parties had briefed it.[1176] Contested issue of law CC reads as follows:

> Whether Dee has any grantor tax liability for 2011, 2012, and 2013 since she was never a grantor and they ceased to be grantor trusts on Charles' death.[1177]

Debtors' counsel responded to the Court's question regarding this contested issue of law by stating "[t]hat's the one we just talked about." [1178]

[85] Thus, it is clear based on the statements of Dee's counsel in open court that Dee was no longer attempting to argue that she should not be treated as a grantor of the Charles and Dee International Penalty Trusts. As the Fifth Circuit has held, "a district judge must be able to winnow the issues for trial. This includes reliance on statements made by counsel in open court disavowing specific claims." [1179]

[86] For these reasons, the Court concludes that Sam, Charles, and Dee controlled the Foreign Corporations and were required to file Forms 5471 in accordance with 26 U.S.C. § 6038, which they did not do. This means that, absent a viable reasonable cause defense or relief under the Eighth Amendment, the Debtors are liable for International Penalties under § 6038(b) for their respective failures to file Forms 5471. [1180]

b) § 6048(b) and Failures to File Form 3520–A

[87] The Court next examines whether the Wylys violated § 6048(b) by failing to file Forms 3520–A regarding the Sam International Penalty Trusts and the Charles ***557** and Dee International Penalty Trusts. As explained below, the SDNY Court's grantor trust determinations necessarily lead to the conclusion that § 6048(b) violations occurred when Forms 3520–A were not filed regarding the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts.

26 U.S.C. § 6048(b) provides that "[i]f, at any time during any taxable year of a United States person, such person is treated as the owner of any portion of a foreign trust under the [Grantor Trust Rules], such person shall submit such information as the Secretary may prescribe." [1181] Given the SDNY Court's determination in the SEC Action, to which this Court has given collateral estoppel effect, Sam and Charles are treated as the owners of the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts, respectively. Accordingly, Sam and Charles were required to file Forms 3520–A throughout the life of the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts, respectively. [1182] And, as just explained above, Dee is also treated as a grantor of the Charles and Dee International Penalty Trusts by virtue of the fact that community property was used to create those trusts and by virtue of the fact that her counsel conceded this issue during closing arguments.

Accordingly, under 26 U.S.C. §§ 6048(b) and 6677, Sam, Charles, and Dee are liable for penalties equal to the greater of $10,000 or 5% of the gross value of the Sam International Penalty Trusts' assets and the Charles and Dee International Penalty Trusts' assets, respectively, for each year that they failed to file a Form 3520–A unless they can establish a right to relief under the reasonable cause provisions of § 6677 or the Eighth Amendment. [1183] Since the value of the trust assets at issue here was enormous, the penalty in all instances will be equal to 5% of the gross value of the trusts' assets. [1184]

c.) § 6048(c) and Failures to File Form 3520

(1) In General

The Court now turns to the issue of whether the Debtors violated § 6048(c) by failing to report certain trust distributions, which analysis is more complicated. The IRS asserts that the Debtors are liable for International Penalties because they failed to file Form 3520 when they were required to do so under 26 U.S.C. § 6048(c). As noted above, § 6048(c) requires a Form 3520 to be filed "[i]f any United States person receives (directly or indirectly) during any taxable year of such person any distribution from a foreign trust." [1185] "Distribution" is not defined for the purposes of 26 U.S.C. § 6048(c). Black's Law Dictionary defines a trust distribution as "[t]he cash or other property paid or credited to a trust beneficiary." [1186] IRS Notice 97–34, the only existing and still valid regulatory authority that interprets § 6048 in any depth, states that "[e]xcept as otherwise provided below, a distribution from a foreign trust includes any gratuitous ***558** transfer of money or property from a foreign trust, whether or not the trust is owned by another person." [1187]

Here, there are three different types of transactions that the IRS asserts should have been reported as "distributions" on Form 3520 for the purposes of 26 U.S.C. § 6048(c): (i) certain annuity payments received by Sam, Charles, and Dee; (ii) offshore funds used to purchase domestic real estate, and (iii) certain loans made to Sam, Charles, and certain Wyly-related entities.[1188] For the reasons explained more fully below, the Court concludes that (i) Sam, Charles, and Dee did not violate § 6048(c) by failing to report annuity payments as distributions, (ii) Sam, Charles, and Dee did not violate § 6048(c) by failing to report the use of offshore funds to purchase domestic real estate as distributions, and (iii) Sam, Charles, and Dee did not violate § 6048(c) by failing to report certain loans made to them and to Wyly-related entities as distributions. The Court reaches these conclusions in part based on its rejection of the IRS' invitation to apply the doctrines of substance over form, economic substance, and step transaction to these alleged distributions, as explained below.

(2) Annuity Payments

The IRS argues that Sam, Charles, and Dee should have reported the annuity payments they received from certain of the Foreign Corporations that had issued annuities to them on Forms 3520. According to the IRS, this is because the Foreign Corporations with the annuity obligations to them are wholly owned by one of the Sam International Penalty Trusts or the Charles and Dee International Penalty Trusts, and that by not reporting the annuity payments Sam, Charles, and Dee violated § 6048(c).[1189] The Court disagrees, as explained below.

Normally, income received as a result of an annuity transaction entered into between a foreign corporation and a United States taxpayer would not need to be reported on Form 3520 in order to satisfy § 6048(c). This is because such a transaction would not involve a gratuitous transfer from a foreign trust.[1190] Here, however, the IRS argues that the Wylys needed to report the annuity payments they received through the offshore system on Form 3520 for three reasons. First, the IRS argues that the text of § 6048(c) makes it clear that the Court may treat these annuity payments as if they came directly from foreign trusts despite the ***559** fact that they actually issued from various of the Foreign Corporations that were wholly owned by one of the Sam International Penalty Trusts or one of the Charles and Dee International Penalty Trusts. Second, the IRS argues that IRS regulations indicate that the non-gratuitous nature of the annuities can be disregarded under § 6048(c). Third, the IRS argues that the application of the substance over form doctrine, the economic substance doctrine, or the step transaction doctrine[1191] make it clear that the private annuity transactions entered into by the Wylys were both (i) not true annuity transactions, meaning that the annuity "payments" were in fact gratuitous transfers to the Wylys, and (ii) were actually transactions entered into directly between Sam, Charles, and Dee on the one hand and the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts, respectively, on the other hand.

Conversely, the Debtors argue that the annuity payments cannot be reportable distributions under the statutory language for three reasons. First, the annuity payments received from the offshore system were not made by trusts, but rather by subsidiary IOM corporations owned by the applicable trust—*i.e.,* one of the Foreign Corporations, and so the payments are not distributions "from a foreign trust" that are reportable under § 6048(c).[1192] Second, the Debtors argue that the annuity payments are not gratuitous, and that they therefore do not need to be reported as distributions.[1193] Third, the Debtors argue that they met any reporting obligation under § 6048(c) that does exist by reporting these annuity payments on their annual income tax returns. Each of the Debtors' arguments will be addressed in turn.

Returning to the Debtors' first argument—*i.e.,* that the annuity payments were not made by a foreign trust but were rather made by a wholly owned corporation of a foreign trust—it is fair to say that the IRS and the Debtors read § 6048(c) differently. Pointing to the statute, the IRS notes that it requires reporting "[i]f any United States person receives (*directly or indirectly*) ... any distribution from a foreign trust."[1194] The IRS then argues that the Debtors misread § 6048(c)'s "directly or indirectly" language as modifying only "receives" and not "from a foreign trust;" and as encompassing only situations where a distribution "starts" in a foreign trust, travels through one or more intermediaries, and then ends up in the hands of a United States person. According to the IRS, the statutory language, "directly or indirectly," modifies both "receives" and "from a foreign trust," a reading that captures situations like this one where an entity that is wholly owned by a foreign trust makes a distribution to a United States person.

In order to decide which of these two readings of the statute is better, the Court must construe the language of § 6048(c). In 2015, the Fifth Circuit laid out the following "roadmap" for the type of statutory construction in which the Court must now engage:

> ***560** The starting point in discerning congressional intent is the existing statutory text. When faced with questions of statutory construction, we must first determine whether the statutory text is plain and unambiguous and, if it is, we must apply the statute according to its terms. The parties disagree on whether the plain text of the statute needs to be found ambiguous before a canon of construction, such as ejusdem generis, can be applied.... In any case, there is no doubt that legislative history can only be a guide after the application of canons of construction. Only after application of principles of statutory construction, including the canons of construction, and after a conclusion that the statute is ambiguous may the court turn to the legislative history. For the language to be considered ambiguous, however, it must be susceptible to more than one reasonable interpretation or more than one accepted meaning.[1195]

[88] **[89]** As the Fifth Circuit has held, for statutory language to be ambiguous, "it must be susceptible to more than one reasonable interpretation or more than one accepted meaning."[1196] When a statute is not ambiguous, "the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms."[1197]

[90] **[91]** **[92]** **[93]** Moreover, while rules of grammar are helpful in interpreting statutes, "we should not be guided by a single sentence or member of a sentence; rather, we must look to the provisions of the whole law, and to its object and policy."[1198] Statutes should be interpreted as a whole rather than by just reading one isolated clause.[1199] Courts should "consider the text holistically, accounting for the 'full text, language as well as punctuation, structure, and subject matter.' "[1200] Courts do not review statutes "as a panel of grammarians," but neither do they "regard ordinary principles of English prose as irrelevant to a construction of those enactments."[1201]

With these principles of statutory construction firmly in mind, the Court turns to the text of the statute, which provides:

> If any United States person receives (directly or indirectly) during any taxable year of such person any distribution from a foreign trust, such person shall make a return with respect to such trust for such year which includes...[1202]

Again, the Debtors argue that the parenthetical phrase "directly or indirectly" modifies only the word "receives" in § 6048(c). The IRS argues that the parenthetical phrase "directly or indirectly" also modifies "from a foreign trust."

Initially, the Court notes that for the IRS' interpretation of § 6048(c) to be correct, ***561** it seems that the statute should read as follows:

> 6048(c)—If any United States person receives (directly or indirectly) during any taxable year of such person any distribution from a foreign trust *(directly or indirectly),* such person shall make a return with respect to such trust for such year which includes.[1203]

The addition of a second "(directly or indirectly)" immediately after "from a foreign trust," if it appeared in the statute, would unquestionably support the IRS' interpretation. However, the statute does not contain this additional phrase. The phrase "directly or indirectly" is contained within a parenthetical in only one location in the statute. Placing modifying words within parentheses indicates a limiting or cabining effect. It would be at least somewhat unnatural to read a parenthetical phrase as expansively modifying multiple clauses in a sentence as opposed to only the clause that the parenthetical phrase follows.

Thus, it seems that a plain language reading of § 6048(c) unambiguously favors the Debtors' interpretation that "directly or indirectly" modifies only "receives" in § 6048(c). However, even if § 6048(c) is "susceptible to more than one reasonable interpretation or more than one accepted meaning" such that we need to apply canons of statutory interpretation, the IRS' reading is further weakened by application of these canons.[1204]

The canon of statutory construction called the last antecedent rule (the "**Last Antecedent Rule**") is relevant here. The Last Antecedent Rule is described in the following way by a widely cited treatise on statutory construction:

> Referential and qualifying words and phrases, where no contrary intention appears, refer solely to the last antecedent. The last antecedent is the last word, phrase, or clause that can be made an antecedent without impairing the meaning of the sentence. Thus a proviso usually applies to the provision or clause immediately preceding it. A qualifying phrase separated from antecedents by a comma is evidence that the qualifier is supposed to apply to all the antecedents instead of only to the immediately preceding one. As with all the rules of interpretation, the last antecedent rule is merely another aid to discover legislative intent or statutory meaning, and is not inflexible and uniformly binding. In general, then, where the sense of an entire act requires that a qualifying word or phrase apply to several preceding or even succeeding sections, the qualifying word or phrase is not restricted to its immediate antecedent.[1205]

An illustration of the Last Antecedent Rule in action is helpful. If, in order to get a pilot's license, a statute requires that an applicant "undergo a physical examination, obtain a passing score on a certification test, and complete forty hours of in-flight training within six months prior to submitting an application," there is an arguable ambiguity. Does "six months prior to submitting an application" modify all of the requirements, or only the in-flight training requirement? According to the Last Antecedent Rule, the answer is that it only modifies the in-flight training requirement. An applicant could obtain a passing score on a certification test eight months prior to submitting an application and still be eligible for a pilot's license, as long as she completed her forty hours of ***562** in-flight training within six months prior to submitting her application.

Although the Last Antecedent Rule is not absolute, "and can assuredly be overcome by other indicia of meaning," it is nevertheless widely used.[1206] The Supreme Court has endorsed the Last Antecedent Rule, and reversed the Third Circuit's refusal to apply the rule because to do so would lead to what was viewed by the circuit court as an undesirable result in a case.[1207] The Fifth Circuit has also cited the Last Antecedent Rule as a canon of statutory construction,[1208] and has stated that the doctrine requires that "qualifying words, phrases, and clauses are to be applied to the words or phrases immediately preceding, and are not to be construed as extending to or including others more remote."[1209]

Achieving the IRS' reading of § 6048(c) requires us to ignore the Last Antecedent Rule. The Last Antecedent Rule counsels that "directly or indirectly" should modify only the word "receives" in § 6048(c) because this is the antecedent that immediately precedes "directly or indirectly." In contrast, the IRS wants to read the qualifying words "directly or indirectly" as modifying a *postcedent* that appears later on in the statutory text. Such a reading runs counter to the Last Antecedent Rule.

Another principle of statutory construction supports the Debtors' reading of § 6048(c)—*i.e.,* the canon of resolving ambiguities in tax statutes, and especially tax statutes imposing penalties, in the taxpayers' favor. As the Supreme Court stated:

> **[94]** In the interpretation of statutes levying taxes it is the established rule not to extend their provisions by implication, beyond the clear import of the language used, or to enlarge their operation so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor to the citizen.[1210]

[95] **[96]** This maxim holds particularly true in the context of tax penalties, where the Supreme Court notes "one 'is not to be subjected to a penalty unless the words of the statute plainly impose it.' "[1211] The Fifth Circuit agrees that tax penalties should "be interpreted liberally in favor of the taxpayer and strictly against the Government."[1212] Although many of the ***563** strongest pronouncements that tax statutes should be construed strictly in favor of the taxpayer come from older cases, the Fifth Circuit has also very recently stated that "if the words of a tax statute are doubtful, the doubt must be resolved against the government and in favor of the taxpayer."[1213] More recent tax court decisions also confirm that the doctrine of construing tax penalties strictly in favor of the taxpayer is alive and well.[1214]

The IRS' reading of § 6048(c) violates the canon of resolving ambiguity in tax penalty statutes in favor of the taxpayer and against the government. As the Court indicated in its analysis of the grammatical structure of § 6048(c), the IRS' reading of the statute is a strained one. Imposing penalties on the Debtors in the face of such a strained reading runs counter to the canon of statutory interpretation that resolves any such ambiguities in the taxpayer's favor.

[97] Thus, the Court concludes that the Wylys did not violate § 6048(c) by not reporting annuity payments they received from certain of the Foreign Corporations on Form 3520 because these annuity payments were not distributions "from a foreign trust" within the meaning of § 6048(c). But, there is another reason why the annuity payments did not need to be reported on Form 3520—they were not gratuitous transfers, as explained below.

The Wylys argue that private annuity payments are not reportable distributions under § 6048(c) because they are payments made pursuant to a contract as opposed to gratuitous transfers.[1215] Conversely, the IRS argues that the non-gratuitous nature of the annuity transactions should be ignored under 26 C.F.R. § 1.679–4(c).[1216]

The Court disagrees[1217] with the IRS because 26 C.F.R. § 1.679–4(c) applies "[s]olely for the purposes of this section."[1218] 26 C.F.R. § 1.679–4 and the statute it interprets, 26 U.S.C. § 679, discuss when a United States person who transfers property to a foreign trust will be treated as the owner of the portion of such trust attributable to such property.[1219] Specifically, § 1.679–4(b) discusses an exception to this rule for transfers for fair market value.[1220] Section 1.679–4(c) in turn discusses exceptions to this § 1.679–4(b) exception, *i.e.* certain supposedly fair market value transfers that will be ignored ***564** for the purposes of 26 U.S.C. § 679.[1221] The function of these overlapping statutes and regulations is to ignore certain transactions for the limited purpose of determining whether a transferor of property to a foreign trust should be treated as an owner of any part of that trust. The IRS seeks to invalidate the annuity transactions on a much broader level than the one envisioned by 26 U.S.C. § 679 and 26 C.F.R. § 1.679–4.[1222]

The Court agrees with the Debtors' argument that the annuity payments here were not gratuitous transfers. In exchange for their indirect transfers of options and warrants to one of the Foreign Corporations, Sam, Charles, and Dee received a private annuity of equivalent value, a fact that the IRS did not contest at trial. The annuity obligations are documented in private annuity agreements. The applicable Foreign Corporation was/is contractually obligated to make the annuity payments at issue here. When payments were made to Sam, Charles, and Dee, it was pursuant to those agreements. On this record, there is no basis upon which to conclude that the annuity payments were gratuitous transfers, let alone gratuitous transfers from a foreign trust.

This brings us to the IRS' last argument—*i.e.,* that the application of one of the various judicial doctrines

—substance over form, economic substance, or step transaction—can transmute the Wyly annuity payments into a different, reportable type of transaction that is both (i) gratuitous, and (ii) ignores the role of the Foreign Corporations. The Court rejects the IRS' attempts to apply these doctrines in this context for the reasons explained below.

As the Court has noted in its gift analysis, the IRS has invoked the doctrines of substance over form, economic substance, and step transaction in a haphazard manner. The IRS raised the novel argument that both the annuities and the Foreign Corporations should be disregarded under these doctrines as it relates to the imposition of International Penalties for the first time in posttrial briefing. This is troubling, because the IRS' post-trial argument that the Foreign Corporations and annuities should be disregarded runs directly counter to positions taken by the IRS in (i) its Proofs of Claim, (ii) the Computation Stipulations, and (iii) statements made by its counsel in open court. For the reasons explained below, the IRS is foreclosed from arguing that either the Foreign Corporations or the annuities should be disregarded under the doctrines of substance over form, economic substance, or step transaction as it relates to the imposition of International Penalties.

After an enormous amount of work by both parties, the IRS and the Debtors entered into the Computation Stipulations, which resolved almost all issues regarding how to calculate the Debtors' income tax, gift tax, and penalty liability. The Computation Stipulations resolved the amount that the Debtors would owe to the IRS if this Court determined that they were liable for gift taxes or penalties; and definitively resolved the question of how much income tax the Debtors owe but for a few ***565** ancillary issues.[1223] For example, the Computation Stipulations state:

> The Parties agree that, due to the Memorandum Opinion and Order issued in this Section 505 proceeding (docket numbers 789 and 791) relating to collateral estoppel and the classification of the Isle of Man trusts at issue in this proceeding, the IRS is not pursuing its alternative income tax position set forth in the POC that the IOM entities are shams or its alternative gift tax position that Debtors made gifts during the 1992 and 1996 calendar years. However, should that Memorandum Opinion and Order be reversed or otherwise overturned, the United States reserves its rights to pursue any and all alternative theories in the Debtors' 505 motions, including but not limited to the tax treatment of the offshore Isle of Man trusts, and any gift tax transactions involving the Isle of Man trusts.[1224]

As the language quoted above indicates, the parties' Computation Stipulations are based on calculations in the IRS' Proofs of Claim.[1225] These calculations, in turn, are based on the premise that income from the offshore system needed to be reported as "ordinary income under Subpart F of the Internal Revenue Code."[1226] Income under Subpart F of the Internal Revenue Code is income from a controlled foreign corporation.[1227] The IRS' alternative theory, upon which the Computation Stipulations were not based, was that

> [t]he foreign entities (the foreign trusts and the foreign corporations owned by foreign trusts), have been determined to be shams. The income from these sham foreign entities was required to be reported on the Debtor's individual income tax returns (Form 1040). The character of the unreported income is ordinary income, short term capital gains and long term capital gains.[1228]

The IRS' main and alternative theories are mutually exclusive. The main theory, which is embodied in the Computation Stipulations, expressly relies on the existence of the Foreign Corporations to support the existence of Subpart F income. The alternative theory, a theory that the IRS expressly disclaims in the Computation Stipulations, relies on the non-existence of the Foreign Corporations.

Now, in the context of their attempt to recover International Penalties, the IRS argues—without using the word "sham"—that the Foreign Corporations should be disregarded. As the Debtors point out in their own post-trial briefing, in asserting that the Foreign Corporations should be disregarded for the purposes of reporting distributions under § 6048(c), the IRS fails to mention that disregarding these entities would make any § 6038 penalties inapplicable (because there would be no controlled foreign corporations for which the Debtors failed to file Forms 5471) and would result in a much lower income tax ***566** liability for the Debtors.[1229] The Debtors also point out—in the context of conflicting IRS arguments regarding the nature of real estate transactions the Wylys entered into utilizing offshore system monies—that the positions taken by the IRS in its post-trial briefing directly contradict those it takes in the Computation Stipulations.[1230]

The Court notes that the Fifth Circuit has opined that, as a general rule, "parties entering into stipulations during the course of a judicial proceeding are estopped to take positions inconsistent therewith."[1231] In addition, the Fifth Circuit held in *Ergo Science, Inc. v. Martin*[1232] that a district court did not abuse its discretion when it prevented a party from arguing a position that its counsel had expressly disavowed at an earlier point in the proceeding. The Fifth Circuit's reasoning for this conclusion was that "faced with a burgeoning docket and with a complex commercial lawsuit at hand, a district judge must be able to winnow the issues for trial. This includes reliance on statements made by counsel in open court disavowing specific claims."[1233] The reasoning of *Ergo Science* is very much applicable here.

On January 6, 2016, the Court was advised by the IRS' counsel that the IRS had been authorized to enter into the Computation Stipulations by the Associate Attorney General of the United States. While it took the parties time to "tweak" the language of the Computation Stipulations, it was finalized and filed with the Court on January 26.[1234] The Computation Stipulations were based on adjustments to figures in the IRS' Proofs of Claim, which calculated income tax liability specifically on the basis that the Foreign Corporations are not shams. Moreover, the Computation Stipulations provide that "the IRS is not pursuing its alternative income tax position set forth in the POC that the IOM entities are shams."[1235] Finally, IRS counsel also stated—in open court—that it agreed that "the Isle of Man trusts are grantor trusts, and if they're grantor trusts, the corporations are controlled foreign corporations."[1236]

Now the IRS has raised—for the first time in its post-trial briefing—arguments that the Debtors have failed to report transactions under § 6048(c) that specifically rely on the Court disregarding and/or shamming the Foreign Corporations. The Court does not see how it can disregard and/or sham the Foreign Corporations for International Penalties purposes without doing so for income tax purposes, which cannot be done consistent with the Computation Stipulations. Thus, the Court concludes that the IRS is estopped from arguing that the Foreign Corporations should be disregarded.[1237]

***567** The Court also refuses to apply the substance over form, economic substance, or step transaction doctrines to find that annuity payments received by the Wylys were reportable under § 6048(c) for a different reason. This is because the use of these doctrines seems particularly inappropriate in the context of the International Penalties. The parties have not cited, nor has the Court been able to locate through its own research, a single case where the IRS successfully used, or even attempted to use, one of the doctrines the IRS relies on here for the purpose of creating a reporting requirement and then assessing penalties for the taxpayer's violation of that newly-created requirement. This makes sense, as the Court believes that these doctrines were not created for this purpose.

[98] **[99]** **[100]** **[101]** The purpose of the economic substance doctrine is to prevent taxpayers "from reaping tax benefits from transactions lacking in economic reality."[1238] Likewise, the purpose of the substance over form doctrine—of which the step transaction doctrine is a corollary[1239]—is to ensure that "the tax consequences of a transaction are determined based on the underlying substance of the transaction rather than its legal form."[1240] These doctrines are designed to make sure that transactions are taxed properly; they are "judicial anti-abuse doctrines, which prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit."[1241] In essence, they are judge-created doctrines that provide some common sense boundaries on the idea that it is "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits." [1242]

In this regard, the Debtors have already lost the tax benefits of their offshore system by virtue of the SDNY Court's grantor trust determinations. Now the IRS wants to go further. The IRS wants to apply the doctrines of substance over form, economic substance, and step transaction in order to make the Debtors liable for reporting penalties—after the proper tax treatment of the Debtors' transactions has already been determined and in ways that are counter to the IRS' previous positions. Applying the substance over form, economic substance, or step transaction doctrines solely to create reportable transactions ***568** and to then impose failure to file penalties runs counter to the Supreme Court's mandate that "one 'is not to be subjected to a penalty unless the words of the statute plainly impose it.' " [1243] Thus, this Court declines the IRS' invitation to use these doctrines purely for the purpose of conjuring up reporting requirements for which it can then recover penalties for the Wylys' failure to report.

While no longer necessary, in the interests of completeness, the Court will rule on the Wyly's third argument as to why their annuity payments did not need to be reported on Form 3520—*i.e.,* they did not need to report the annuity payments because those payments were reported on their tax returns as income. [1244] The Court rejects this argument. Throughout trial, the IRS has pointed to the manner in which the Wylys reported annuity income from the offshore system—on Schedule C attached to their tax return as opposed to on Line 1 or on the face of the return—as deceptive and misleading. [1245] The Debtors have explained that this reporting method was necessary in order to make sure that these annuity payments were properly subject to self-employment tax. [1246] The IRS, in turn, has countered that "[t]here is no provision under the Internal Revenue Code that imposes the self-employment tax under 26 U.S.C. § 1401(a) to annuity income, even though all or a part of the annuity income may be subject to income tax." [1247]

Regardless of whether the Wylys needed to subject their annuity payments to self-employment tax, § 6048(c)(1)(A) settles the debate as to whether reporting these annuity payments on Form 1040 also satisfied Form 3520 reporting obligations. It did not. Section 6048(c)(1)(A) requires that the name of the trust from which a distribution is received be reported in order to satisfy Form 3520 reporting requirements. This is no mere technicality, as the entire point of § 6048 is to allow the IRS to monitor the movement of funds through offshore trusts, a task that is not ***569** possible without knowing which trusts are involved in particular transactions. There is no evidence in the record that the Wylys identified the trusts from which the annuity payments arguably came on their tax returns, as would be required in order to satisfy § 6048(c)(1)(A). In fact, the Wylys simply listed these payments as "ANNUITIES" without further elaboration on their tax returns. [1248] Thus, the Wylys reporting of their receipt of annuity payments on their tax returns would not relieve them of liability under § 6048(c) if there was such liability.

Nevertheless, for the reasons stated above, the Court concludes that the Wylys did not violate § 6048(c) by failing to report annuity payments received from the Wyly offshore system as distributions on Form 3520 because the annuity payments were not: (i) distributions from a foreign trust, or (ii) gratuitous.

(3) Real Estate Transactions

The second category of "distributions" that the IRS argues the Wylys were required to report pursuant to § 6048(c) are real estate transactions indirectly involving one or more of the Sam International Penalty Trusts or the Charles and Dee International Penalty Trusts. Specifically, the IRS argues that Sam should have reported on Form 3520 transfers of offshore funds involving the acquisition of (i) the Cottonwood Ventures I property, (ii) the Cottonwood Ventures II property, and (iii) the Rosemary's Circle R Ranch property. [1249] The IRS also argues that Charles and Dee should have reported on Form 3520 transfers of offshore funds involving the acquisition of (i) the LL Ranch property, and (ii) Stargate Horse Farm. [1250] Conversely, the Debtors argue that the real estate transactions at issue:

> were merely investments by subsidiaries of the IOM trusts in U.S. entities that themselves invested in U.S. real estate. In exchange for their investment

> in the U.S. entities, the IOM subsidiaries received a pro rata interest in those entities. Accordingly, these transactions were simply investments by subsidiaries of the trusts. They were not distributions by the trusts because the trusts did not part with legal title to any trust asset.
>
> The IRS's inability to articulate a coherent position as to why these real estate transactions constituted gifts further illustrates that they were not reportable transactions. Furthermore, the IRS's gift theory was that the purported gift was made either to an entity or to a family member of the Debtors. Accordingly, those transactions would not be reportable by the Debtors in any event. [1251]

[102] The Court largely agrees with the Debtors. From the Court's perspective, the IRS' arguments here suffer from the same flaw in statutory construction as did its initial argument regarding the annuity payments that Sam, Charles, and Dee received from one or more of the Foreign Corporations. While it is true ***570** that offshore funds were largely used to purchase domestic real estate, and the domestic entities holding title to that real estate are or were largely owned by a Foreign Corporation, albeit indirectly, none of the transfers of offshore funds that occurred here was a transfer "from a foreign trust" within the meaning of § 6048(c).

Moreover, the IRS identifies no statutory, regulatory, or case law authorities that would allow the Court to ignore the non-gratuitous nature of the real estate investments that it identifies as distributions reportable under § 6048(c). In exchange for the transfers of offshore funds, the applicable Foreign Corporation received an equivalent ownership interest in the domestic entities that hold legal title to the real estate. Under any circumstance that makes the transfers not gratuitous.

Finally, even if the prior two reasons are incorrect, the IRS seeks to recover from the wrong "recipient." Sam, Charles, and Dee did not receive the offshore funds. Rather, the applicable domestic entity did; and thus, it is the "United States person" who was obligated to report to the IRS. For all of these reasons, the Court concludes that the Debtors are not liable for violations of § 6048(c) by virtue of not reporting the transfers of offshore funds used to purchase domestic real estate as distributions on Form 3520.

Although the IRS argues that these real estate transactions can be treated as gratuitous distributions directly from the IOM trusts by ignoring (i) the existence of the Foreign Corporations and the domestic entities, and (ii) the non-gratuitous nature of the transfers via application of the doctrine of substance over form, the Court declines to do so here because, as discussed above in the context of the annuity payments: (a) the IRS is estopped from arguing that the Foreign Corporations should be disregarded, and (b) it is inappropriate to apply the doctrines of substance over form, economic substance, or step transaction purely for the purpose of creating a reportable transaction through which penalties can then be extracted from the Wylys.

(4) Security Capital Loans

The last form of "distribution" that the IRS asserts the Wylys were required to report on Form 3520 under § 6048(c) are loans received by Sam, Charles, and certain Wyly-related entities from Security Capital, who obtained the money it loaned out from one or more of the Foreign Corporations. As explained below, there are actually three sets of loans at issue. With respect to each loan, the IRS argues that it should have been reported on Form 3520 as distributions under § 6048(c) both because the text of the statute requires it and because the loans were gratuitous transfers as opposed to true loans under IRS regulations and the doctrine of substance over form. [1252]

As just noted, three sets of loans are at issue here. The first set of loans was made to Charles. These loans included a $6,000,000 loan from Security Capital to Charles made in October 2002 and an additional $25,000,000 loan from Security Capital to Charles made in March 2003. [1253] In order to make these two loans to Charles, Security Capital borrowed the money from Gorsemoor Limited (IOM), which is wholly owned by the Tyler IOM Trust. [1254] Charles is the grantor of the Tyler IOM ***571** Trust by operation of the SDNY Court's grantor trust determination. [1255]

The second set of loans was made to Sam. These loans included a $10,000,000 loan to Sam from Security Capital made in July 2003. [1256] In order to make this loan to Sam, Security Capital borrowed the money from Newgale Limited (IOM), [1257] which is wholly owned by the Bessie IOM Trust.[1258] Sam is the grantor of the Bessie IOM Trust by operation of the SDNY Court's grantor trust determination.[1259] This second set of loans also included a $15,000,000 loan that Security Capital made to Sam with money borrowed from Greenbriar Limited (IOM) and Newgale Limited (IOM) in January 2002.[1260] Greenbriar Limited (IOM) is wholly owned by the Delhi International IOM Trust.[1261] Sam is the grantor of the Delhi International IOM Trust by operation of the SDNY Court's grantor trust determination.[1262]

The third set of loans was made to what are characterized by the IRS as various Wyly-related entities. These loans include $11,500,000 loaned from Security Capital to Green Mountain Energy Resources, LLC ("**Green Mountain Energy**") in 1998.[1263] Security Capital borrowed the money it needed to make this loan from Richland Limited (IOM), Morehouse Limited (IOM), and East Carroll Limited (IOM),[1264] each of which are wholly owned by the Bulldog IOM Trust.[1265] These loans also include a $3,000,000 loan from Security Capital to the Chief Executive Officer of Green Mountain Energy in January 1999.[1266] Security Capital borrowed the money it needed to make this loan from East Carroll Limited (IOM), another entity that is wholly owned by the Bulldog IOM Trust.[1267] These loans further include an $8,000,000 loan from Security Capital to The Sam Wyly 1978 Malibu Revocable Trust in 1999.[1268] Security Capital borrowed the money it needed to make this loan from Locke Limited (IOM) and Moberly Limited (IOM), which are each wholly owned by the Bulldog IOM Trust.[1269] This set of loans also includes a loan of financial assets valued at $55,815,672.03 from Security Capital to the various Cayman LLCs in 2001.[1270] Security ***572** Capital obtained the financial assets it loaned to the Cayman LLCs from East Baton Rouge Limited (IOM), East Carroll Limited (IOM), and Moberly Limited (IOM), each of which are wholly owned by the Bulldog IOM Trust,[1271] and Yurta Faf Limited (IOM), which is wholly owned by the Bessie IOM Trust.[1272] Finally, this set of loans includes a $5,000,000 loan from Security Capital to Wrangler Trust (US).[1273] Security Capital borrowed the money it needed to make this loan from Locke Limited (IOM), which is wholly owned by the Bulldog IOM Trust.[1274] Sam is the grantor of the Bulldog IOM Trust and the Bessie IOM Trust by virtue of the SDNY Court's grantor trust determination.[1275]

[103] The Court rejects the IRS' argument that these loans are reportable distributions under § 6048(c) for three reasons. First, § 6048(c) does not require a United States person to report a loan that they receive from a foreign grantor trust; it only requires that loans from a foreign non-grantor trust be reported. That makes sense because reporting a loan from a foreign grantor trust would be like reporting a loan to yourself—completely unnecessary. But, further explanation may be helpful. Section 6048(c) does not discuss loan transactions as distributions.[1276] Although IRS Notice 97–34 discusses reporting loans from foreign trusts as distributions under § 6048(c), this discussion appears in the context of an explanation of reporting obligations under 26 U.S.C. § 643(i).[1277] 26 C.F.R. § 1.641(a)–0 indicates that § 643 has "no application to any portion of the corpus or income of a trust which is to be regarded, within the meaning of the Code, as that of the grantor or others treated as its substantial owners."[1278] In other words, § 643 and its accompanying regulations are not applicable to grantor trusts, which the trusts at issue here are.[1279] Furthermore, § 643(i) is, by its own terms, a definition that applies "[f]or purposes of subparts B, C, and D."[1280] The rules governing grantor trusts such as the ones at issue here are located in subpart E. Thus, IRS Notice 97–34's requirement to report loans from foreign trusts on Form 3520 in order to comply with § 6048(c) only applies to loans from foreign non-grantor trusts. Because the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts are all foreign grantor trusts, § 6048(c) is not applicable.[1281]

***573** Second, there are no grounds on which the Court could conclude that these loans were in fact gratuitous transfers to Sam or Charles. This is especially true regarding loans made to the alleged Wyly-related entities as opposed to Sam and Charles, as the IRS offers almost no evidence from which the Court could draw the conclusion that these loans were, in substance, gratuitous transfers to Sam and Charles. But even as it relates to loans to Sam and Charles themselves, and although the loans bordered on sweetheart deals, the loans to Sam and Charles were nonetheless genuine loans complete with interest rates, repayment terms, and documentation.[1282]

On this record, the Court cannot find that they were gratuitous transfers.[1283]

For example, Charles signed a note payable to Security Capital in connection with his $6,000,000 October 2002 loan.[1284] According to the note, Charles' $6,000,000 loan had a ten year term and called for annual, interest-only payments (at a rate of 4.90%) with unpaid interest and principal due on the tenth anniversary of the loan in October 2012.[1285] As the Court noted previously, Charles died in 2011 before the loan matured. Hennington testified that although interest payments were made on Charles' loans from Security Capital, that after Charles' death they "continued to be kind of hung up in the probate estate."[1286] Similarly, Charles signed a note payable to Security Capital in connection with his $25,000,000 March 2003 loan.[1287] This $25, 000,000 loan also calls for annual, interest-only payments, but has a fifteen year maturity and an interest rate of 4.80%.[1288] Thus, according to the note, all principal and unpaid interest is due on February 28, 2018.[1289] Again, Hennington's testimony suggests that Charles made interest payments on this loan until his death.[1290] Security Capital has filed a proof of claim against Dee, seeking to collect both of these loans.[1291]

Sam also signed a note payable to Security Capital in connection with his $10,000,000 July 2003 loan.[1292] This $10,000,000 loan calls for annual, interest-only payments at 4.17% per annum and matures on July 14, 2018.[1293] Hennington testified that Sam "made all annual interest ***574** payments" on his Security Capital loans.[1294] Security Capital has filed a proof of claim against Sam, seeking to collect this loan.[1295]

Moreover, Sam signed a note payable to Security Capital in connection with his $15,000,000 January 2002 loan. This $15,000,000 loan[1296] calls for annual, interest-only payments at 5.5% per annum and matured on February 15, 2012.[1297] Although Sam defaulted on this loan by not repaying it then, Security Capital agreed to amend the note in 2013 and a new maturity date of July 14, 2018 was agreed upon.[1298] In exchange for this new maturity date, Sam (i) paid $1,500,000 to Security Capital, reducing his total indebtedness to $13,500,000; (ii) paid his single overdue annual interest payment, and (iii) agreed to continue paying interest at the rate of 5.5%.[1299]

The evidence in the record—as well as Security Capital's proofs of claim, of which this Court takes judicial notice —indicates that the loans that Security Capital made to Sam and Charles were in fact treated as loans by all of the parties involved. The IRS has the burden of showing that penalties such as the International Penalties are applicable in the first instance under 26 U.S.C. § 7491(c). In the absence of sufficient evidence that the loans to Sam and Charles were in fact gratuitous transfers, the Court cannot conclude that the Debtors needed to report these loans on Form 3520 under § 6048(c).

Third, as the Court has explained before in the context of its analysis of the annuity payments and the real estate transactions, the IRS misinterprets the language of § 6048(c) to attempt to capture these loans as "distributions" to Sam and Charles "from a foreign trust." All of the loans at issue here were loans from Security Capital, a Cayman Islands company setup in order to administer loan transactions made at the Wylys' direction.[1300] To facilitate its loans to Sam and Charles, Security Capital borrowed money from certain of the Foreign Corporations that were wholly owned by the Sam International Penalty Trusts or the Charles and Dee International Penalty Trusts.[1301] But, the loans at issue here were not made by any foreign trust.[1302] Thus, these loans were not "from a foreign trust" within the meaning of 26 U.S.C. § 6048(c).

Once again, the IRS argues that, in spite of the Court's conclusion that the text of § 6048(c) does not require reporting of these loans on Form 3520, these loans were in actuality gratuitous transfers directly from a Sam International Penalty Trust and a Charles and Dee International Penalty Trust to Sam and Charles, respectively. For the reasons explained in the context of analyzing the annuity payments and the real estate transactions, the Court ***575** rejects this argument for two reasons. First, this argument relies on the Court disregarding the Foreign Corporations (along with Security Capital), and the Court has determined that the IRS may not make an argument that relies on this step based on its position in the Computation Stipulations, its Proofs of Claim, and in statements made by its counsel in open court. Second, utilizing judge-made doctrines

—substance over form, economic substance, or step transaction—in order to create reporting obligations that are not clearly imposed by § 6048(c) in order to impose penalty liability on the Debtors here is improper.

(5) Sales of Options to IOM Corporations

[104] Finally, the Court must determine whether the Debtors violated § 6048(a) by failing to report the sale of options to certain of the Foreign Corporations. Section 6048(a)(3)(A)(ii) requires a United States person who transfers money or property to a foreign trust to file a Form 3520 alerting the IRS that one of these events has occurred. [1303]

As relevant here, in 1999, Charles sold stock options to Quayle Limited (IOM) and Elegance Limited (IOM) and Sam sold stock options to Greenbriar Limited (IOM) and East Carroll Limited (IOM) (collectively, the "**1999 Option Sales**"). [1304] Each of these entities are wholly owned by Castle Creek IOM Trust, Red Mountain IOM Trust, Delhi IOM Trust, and Bulldog IOM Trust, respectively, of which Charles or Sam is the grantor by virtue of the SDNY Court's grantor trust determination. [1305] The IRS argues that the 1999 Option Sales needed to be reported on Form 3520 under § 6048(a)(3)(A)(ii). [1306] The Court disagrees, as explained below.

The relevant text of 26 U.S.C. § 6048(a)(3)(A)(ii) reads as follows:

> The term "reportable event" means ... the transfer of any money or property (directly or indirectly) to a foreign trust by a United States person ...

Notably, the structure of § 6048(a)(3)(A)(ii) mirrors that of § 6048(c). Although in its briefing the IRS does not appear to argue that the 1999 Option Sales are reportable events under the text of § 6048(a)(3)(A)(ii) and instead relies exclusively on the doctrine of substance over form, the Court notes that the same statutory analysis that it applied to § 6048(c) applies here. The 1999 Option Sales were not sales to foreign trusts; rather, they were sales to certain of the Foreign Corporations, which are wholly owned by one of the Sam International Penalty Trusts or the Charles and Dee International Penalty Trusts. [1307] And, for the reasons stated above in its statutory construction of § 6048(c), the Court concludes that the 1999 Option Sales are not reportable events within the meaning of § 6048(a)(3)(A)(ii). [1308] The Court also concludes that, for the reasons stated above, it is inappropriate to apply the doctrines of substance over form, economic substance, or step transaction to attempt to create reportable events for which penalties can then be recovered from the Debtors.

For these reasons, the Debtors are liable for the following: (i) International Penalties under 26 U.S.C. § 6038(b) because ***576** they failed to file Forms 5471 as required by 26 U.S.C. § 6038(a), and (ii) International Penalties under 26 U.S.C. § 6677 because they failed to file Forms 3520–A as required by 26 U.S.C. § 6048(b). The Debtors are not liable for any other International Penalty.

H. Did the Debtors Establish Their Reasonable Cause Defenses to the Imposition of International Penalties?

1. Introduction

Because the Court has concluded that the Debtors are liable for certain of the International Penalties, the Court must now evaluate their respective reasonable cause defenses to this liability. For the reasons explained more fully below, the Court concludes that Sam has not established his reasonable cause defenses by a preponderance of the credible evidence, but that Dee has established her reasonable cause defenses and thus, will not be held liable for the International Penalties.

a) Review of Provisions of § 6038

As just discussed, 26 U.S.C. § 6038(a)(1) requires every United States person who controls a foreign business entity to file a Form 5471. Under § 6038(a)(2) and its accompanying regulations, Forms 5471 are due at the same time as the United States person's tax return. [1309] As previously found, the Debtors failed to file Forms 5471 for the Foreign Corporations throughout the life of the offshore system, and are thus liable for penalties under 26 U.S.C. § 6038(b). The parties have stipulated to the amount of these penalties. [1310]

However, § 6038's reasonable cause provision may provide the Debtors with an avenue of relief from this liability. Specifically, § 6038(c)(4)(B) provides that "the time prescribed under paragraph (2) of subsection (a) to furnish information ... shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary) reasonable cause existed for failure to furnish such information."[1311] Thus, if either Sam or Dee can establish that they had "reasonable cause" for not filing Forms 5471 for the Foreign Corporations, then they will not be liable for penalties under § 6038(b). The meaning of the phrase "reasonable cause" is discussed in greater detail below.

b) Review of Provisions of §§ 6048(b) and 6677

As just discussed, § 6048(b) requires every United States person who is treated as the owner of any portion of a foreign trust under the Grantor Trust Rules to submit ***577** an annual Form 3520–A.[1312] According to the instructions to Form 3520–A, the form must be filed "by the 15th day of the 3rd month after the end of the trust's tax year."[1313] Section 6677 imposes penalties for violations of § 6048(b).[1314] As previously found, the Debtors failed to file Forms 3520–A throughout the life of the offshore system and are thus liable for penalties under § 6677. The parties have stipulated to the amount of these penalties.[1315]

However, penalties under § 6677 will not be imposed "on any failure which is shown to be due to reasonable cause and not due to willful neglect."[1316] Thus, if either Sam or Dee is able to establish that they had reasonable cause for not filing Forms 3520–A and that their failures to file Forms 3520–A were not due to willful neglect, then they will not be liable for penalties under § 6677. The meaning of the phrases "reasonable cause" and "willful neglect" are discussed in greater detail below.

2. Reasonable Cause and Lack of Willful Neglect

a) In General

[105] [106] [107] [108] Reasonable cause is determined on a case-by-case basis, taking into account all of the facts and circumstances.[1317] According to Fifth Circuit precedent, "the plaintiff bears the burden of proof on a reasonable cause defense."[1318] As the Fifth Circuit has stated in the context of avoiding accuracy-related or fraud penalties, the most important factor in evaluating a taxpayer's reasonable cause defense is "the extent of the taxpayer's effort to assess his proper liability in light of all the circumstances."[1319] A taxpayer's experience, knowledge, and education are relevant in determining whether reasonable cause has been established.[1320] In defining reasonable cause in general, many courts rely on 26 C.F.R. § 1.6664–4(b), which interprets the meaning of "reasonable cause" and "good faith" (though good faith is not a part of the Court's consideration in connection with the Debtors' liability for International Penalties) for the purposes of avoiding penalties under §§ 6662 and 6663. Treasury Regulation § 1.6664–4(b) provides:[1321]

> (b) Facts and circumstances taken into account—(1) In general. The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. (See paragraph (e) of this section for certain rules relating to a substantial understatement penalty attributable to tax shelter items of corporations.) ***578** Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer. An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith. Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not

> necessarily demonstrate reasonable cause and good faith. Similarly, reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect. Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith ...

The Court must stress that, as in its analysis of the Debtors' attempted use of reliance on the advice of counsel to negate fraudulent intent under § 6663 and to establish reasonable cause for avoidance of fraud penalties under § 6664, this regulation is a helpful guide but is not controlling. This is because this regulation does not expressly apply to penalties under §§ 6663, 6038(c)(4)(B), or 6677(d), and—unlike under § 6664—the Court need not evaluate whether the Debtors here have displayed "good faith" in order to relieve them of liability for International Penalties. Rather, as relevant here, the Debtors need only establish "reasonable cause" under § 6038(c)(4)(B) and both "reasonable cause" and lack of "willful neglect" under § 6677(d).

In the context of establishing reasonable cause for failing to file a return on time, the Supreme Court stated in *U.S. v. Boyle*[1322] that " 'reasonable cause' is not defined in the Code, but the relevant Treasury Regulation calls on the taxpayer to demonstrate that he exercised 'ordinary business care and prudence' but nevertheless was 'unable to file the return within the prescribed time.' " Courts have adopted the Supreme Court's definition of reasonable cause in *Boyle —i.e.,* "ordinary business care and prudence"—as the proper definition of reasonable cause throughout the Internal Revenue Code and especially in failure to file situations.[1323] The *Boyle* Court also defined the term "willful neglect," stating that it should be understood as "a conscious, intentional failure or reckless indifference."[1324] Again, courts have adopted *Boyle's* definition of willful neglect as the proper definition of the phrase as it is used throughout the Internal Revenue Code.[1325]

***579** Although there are very few cases and no regulations defining "reasonable cause" or "willful neglect" within the specific contexts of §§ 6038(c)(4)(B) and 6677(d), those few cases that do exist tend to adopt *Boyle's* definitions of these phrases, assuming that the meanings of the phrases "reasonable cause" and "willful neglect" are the same throughout the penalty provisions of the Internal Revenue Code.[1326] This Court agrees with this approach, especially in light of the fact that there are no regulations that specifically interpret the meaning of the phrases "reasonable cause" and "willful neglect" in §§ 6038(c)(4)(B) and 6677(d).

b) Reliance on the Advice of Professionals

The Debtors rely almost exclusively on the fact that they relied on the advice of professionals in order to establish their reasonable cause defenses to their liability for International Penalties. The Court discussed the legal standards relevant to establishing reasonable cause by relying on the advice of tax professionals earlier in this opinion in its discussion of Sam's attempt to use his purported reliance on the advice of counsel to negate fraudulent intent under § 6663 and to establish reasonable cause for avoidance of fraud penalties under § 6664.[1327] The Court will briefly review these legal standards here for the sake of clarity.

[109] [110] [111] [112] To reiterate, when a professional advises a taxpayer on a matter of tax law, such as whether a liability exists or whether a return must be filed, it is reasonable for the taxpayer to rely on that advice without seeking a second opinion, even if that advice turns out to be wrong.[1328] This is because "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney."[1329] However, "reliance on the advice of a professional tax adviser does not necessarily demonstrate reasonable cause and good faith; rather, the validity of this reliance turns on the quality and objectivity of the professional advice which they obtained."[1330] To establish reasonable cause based on a professional's advice, the professional's advice must: (i) be reasonable and made in good faith, (ii) not be based on unreasonable factual or legal assumptions, and (iii) not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any ***580** other person.[1331] According to the Fifth Circuit, "[i]f a tax advisor's opinion is shown to be based on unreasonable factual or legal assumptions, that is, upon a representation or assumption which the taxpayer knows, or has reason to know, is unlikely to be true, then the taxpayer's reliance on that opinion does not constitute reasonable cause."[1332] Furthermore, if a taxpayer does not actually follow the advice that he or she receives from a tax professional, reliance on that advice cannot establish reasonable cause.[1333] The tax court has summarized the relevant considerations for establishing reasonable cause based on reliance on the advice of counsel in this way:

> To establish reasonable cause through reliance on the advice of a tax adviser, the taxpayer must meet the following three-prong test, laid out in *Neonatology Assocs., P.A. v. Commissioner,* 115 T.C. at 98–99: (1) the adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer relied in good faith on the adviser's judgment.[1334]

Before proceeding to analyze whether the Debtors have met their burden of establishing their reasonable cause defenses here, one final set of legal principles must be analyzed. Specifically, can a taxpayer establish his reasonable cause defense based on an "honest difference of opinion?"

c) Honest Difference of Opinion

The Debtors assert what they characterize as a separate reasonable cause argument from their reliance on the advice of professionals argument. Specifically, the Debtors argue that there was an honest difference of opinion as to whether the Sam International Penalty Trusts and the Charles and Dee International Penalty Trusts were non-grantor trusts, and that this honest difference of opinion establishes reasonable cause for the Debtors' failure to file Forms 3520–A and 5471.

Throughout their Pre–Trial Brief, the Debtors maintain that reasonable cause can be established when there is an honest difference of opinion on the law.[1335] They also argue that an honest difference of opinion on the law can negate fraudulent intent.[1336] Authority does exist that supports the Debtors' argument. For example, the Debtors cite *Robinson v. U.S.,*[1337] a decision where "[t]he credibility of the Plaintiff's testimony regarding his belief that he was not required to file a return, the uncertainty of the existing statutory and regulatory definition of a broker, and the lack of legal force of the proposed amendments to Treasury Regulation[s]" were sufficient to establish reasonable cause, despite the fact that the taxpayer had not consulted his accountant regarding the matter at issue. The Debtors also cite *Rice v. C.I.R.*[1338] for the proposition that ***581** "some difference of opinion" regarding a legal position is sufficient to establish reasonable cause and/or a lack of fraudulent intent. Finally, the Debtors cite *Carter v. C.I.R.,*[1339] a case where the court held that where there was a "complex legal issue on which there can be an honest difference of opinion," the failure of a taxpayer to reach the right conclusion on that issue was insufficient to establish negligence.

However, as applied here, this Court sees little, if any, difference between the Debtors' "honest difference of opinion" argument and their reliance on the advice of counsel argument. Indeed, the Debtors meld the two arguments in their own pleadings. For example, in the Debtors' Amended Proposed Findings of Fact and Conclusions of Law dedicated to their honest difference of opinion argument, the Debtors ask the Court to find that:

> When the law is unsettled or unclear, a belief based on a review of the existing authorities establishes reasonable cause for failure to file a form ... Given the complexity and uncertainty of the law during the years at issue, it was entirely reasonable for the Wylys to rely on their professional advisors and believe their advice that the IOM trusts were indeed not grantor trusts to Sam and Charles and that they had filed all required tax returns and forms.[1340]

As this proposed finding makes clear, the Debtors' “honest difference of opinion” argument is identical to their “reliance on the advice of professionals” argument. In fact, the argument has to be the same because there is no evidence in the record that the Debtors had any “honest difference of opinion” about how to interpret the relevant tax law independent of the analyses provided to them by their tax advisors. Neither Sam nor Dee ever read any of the legal opinions that form the basis of their reliance on the advice of counsel argument, [1341] and both admitted that they did not independently analyze the relevant tax issues. [1342] As such, the Debtors' “honest ***582** difference of opinion” argument and their “reliance on the advice of counsel” argument will be analyzed together as they are one and the same.

This Court's conclusion that these are not separate bases upon which to establish a reasonable cause defense here is bolstered by examining cases where courts have found that a taxpayer had reasonable cause based on an honest difference of opinion. Generally, the “honest difference of opinion” argument is used by courts to provide relief to taxpayers who did not rely on counsel or other professional advisors but made a legal mistake when confronted with a confusing provision of the tax law that they interpreted on their own. [1343] The difference here, however, is that none of the cases cited by the Debtors, and almost none of the additional cases the Court found discussing this kind of “honest difference of opinion” basis for a reasonable cause defense, involved taxpayers who relied on counsel or other advisors at all. [1344] Indeed, where taxpayers have attempted to rely on an “honest difference of opinion” argument while at the same time relying on the professional advice of a tax advisor, their “honest difference of opinion” argument has not resonated with the courts. [1345] In the few cases where taxpayers establish reasonable cause both because they relied on advisors and because they had an honest difference of opinion regarding the law, the courts tend to analyze the taxpayer's honest difference ***583** of opinion as a component of his reliance on the advice of counsel, defaulting to a reliance on the advice of counsel framework in order to evaluate the taxpayer's reasonable cause. [1346]

Here, the Wylys did not analyze the law independently. They relied on their advisors to analyze the law for them. As such, the Court will treat the Debtors' “honest difference of opinion” and “reliance on counsel” reasonable cause arguments as one and the same.

d) Application to Both Debtors

In their pre-trial briefing, the Debtors sum up their reasonable cause defenses to International Penalties in this way: [1347]

> As already described above, the Wylys were continually told by their advisors that the 1992 IOM trusts were non-grantor trusts and that the 1994 and 1995 IOM trusts were grantor trusts to Messrs. King and Cairns, respectively. Consistent with this advice, the Wylys properly filed Forms 3520 for the IOM trusts for the years they created and funded such trusts, and filed the Forms 3520–A (required for grantor trusts owned by a U.S. person) annually for the IOM grantor trusts they created until they were terminated in 1996.
>
> No further Forms 3520 or 3520–A were filed, and no Forms 5471 were filed, because the Wylys' advisors did not tell them to make any additional filings. *Based on the conclusions reached by these advisors regarding the characterization of the trusts and the nature of certain other transactions, no such additional information returns should have been filed.*
>
> Furthermore, even after the Wylys were told in 2003 that Morgan Lewis thought there was a risk that the 1992 trusts could be treated as grantor trusts to Sam and Charles, they were not advised of any potential need to file these forms. Although the IRS continues to focus on the views of Morgan Lewis to support these penalties, Debtors reiterate that (i) other advisors (principally Messrs. Chatzky, Tedder, and French, and Meadows Owens) interpreted the same statutory provisions differently, (ii) Morgan Lewis could not (and did not) point to conclusive authority supporting its views because such authority did not exist, (iii) when the Wylys learned about Morgan Lewis' contrary views, they began disclosing the issues on their federal income tax returns, and (iv) even after being informed of Morgan Lewis' concerns, the Debtors were not advised to file these information reports. The contrary views were not resolved until the Disgorgement Opinion was issued in 2014. This is further evidence that the state of the law was unclear.

> On their advisors' counsel, the Wylys properly filed all of the tax forms their advisors told them to file, including Forms 3520 for the IOM trusts they settled and funded, Forms 3520–A each year for the trusts those advisors told them were grantor trusts to them, and other obscure forms when advised to file them, such as FBARs and Forms 8938.
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> * * *
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> At no point during the 22–year period at issue in these Cases were Sam and Charles Wyly ever advised by any of their lawyers they engaged to file the Forms 5471, 3520 or 3520–A at issue. And, furthermore, for the first 12 years of this period (until 2003), the Wylys were not advised that there was even a meaningful risk that the trusts were ***584** grantor trusts—the prerequisite finding necessary to trigger the Form 3520–A and 5471 filing requirements.

Moreover, the Debtors rely upon the Supreme Court's decision in *U.S. v. Boyle*[1348] for the proposition that taxpayers are not required to seek second opinions or monitor whether their counsel is giving correct advice in order to rely on that advice for reasonable cause purposes. The Debtors acknowledge that any advice they received regarding the need to file Forms 3520, 3520–A, or Form 5471 was "implicit,"[1349] and that this advice was linked to their advisors' understanding that "the 1992 IOM trusts were non-grantor trusts and that the 1994 and 1995 IOM trusts were grantor trusts to Messrs. King and Cairns, respectively."[1350] Finally, the Debtors argue that while there are IRS procedures for filing protective or conditional forms in certain instances, no such procedures exist for Forms 3520, 3520–A, or 5471.[1351]

The IRS objects to the Debtors' reasonable cause defenses on multiple grounds; specifically that: (i) Tedder and Chatzky (and at times Meadows Owens' attorneys) are promoters of the Wyly offshore system on whose advice the Wylys may not rely, (ii) the advice that Sam and Charles was given regarding the offshore system was based on facts that Sam and Charles knew to be false, (iii) the Debtors never actually heard any of the advice on which they purport to rely firsthand, and (iv) the Debtors cannot actually produce any of the advice that was supposedly given to them by Meadows Owens or substantiate what facts were given to Meadows Owens to produce that advice.[1352] Finally, the IRS argues that the Debtors' advisors gave them a great deal of advice about reporting requirements, as follows:[1353]

> In 1991, the memorandum to the Wylys included advice from Tedder stating that (1) Form 3520 must be filed when a foreign trust is formed; (2) attach a copy of the Trust Agreement to the Form 3520 for safety; and (3) file Form 3520–A annually to keep confirming that the Trust is in existence. Tedder specifically advised "Always over disclose to the IRS." Throughout the time that the Offshore System was operating, the Wylys also received additional advice as to these forms. In December 2002, Keeley Hennington, the Wylys agent, acknowledged the Form 3520 filing requirement and awareness of the same. In August 2003, Lubar, another Wyly agent, informed Keeley Hennington and Boucher, two additional Wyly agents, that Form 5471s must be filed. In October 2003, Todd Welty, then with the Meadows firm, also discussed the penalties associated with not filing a Form 3520 and 5471 with Keeley Hennington. While silence of advisors is not sufficient to establish a reasonable cause defense, the record here is clear that the Wylys were actually advised to file these forms and received this advice as early as 1991 in advance of their implementing the Offshore System.

***585** As shown by the excerpted arguments above, the Debtors' arguments as to why they are not liable for International Penalties are the same arguments they made with respect to their liability for fraud penalties—*i.e.,* that they were given advice from many professionals that the IOM trusts were non-grantor trusts as to Sam and Charles, and that their reliance on that advice was reasonable despite the fact that it was wrong. Since the Debtors' arguments regarding their reasonable cause defense to the International Penalties are the same as their arguments with respect to their reasonable cause defense to fraud penalties, the Court's earlier analysis with respect to Sam is equally applicable here, as discussed below.

(1) As to Sam

[113] As to Sam, the IRS asserts International Penalties beginning in 1996.[1354] So, what advice did Sam get that is relevant here? For context, Sam argues that he was consistently advised that the Sam International Penalty Trusts were either non-grantor trusts as to him (Bulldog

IOM Trust, Lake Providence IOM Trust, and Delhi IOM Trust) or foreign grantor trusts as to King and Cairns (Bessie IOM Trust and La Fourche IOM Trust, respectively). However, the credible evidence at trial does not support Sam's argument, as explained below.

As previously found, Sam never received an opinion that the Bulldog IOM Trust was a non-grantor trust as to him.[1355] The legal opinions that Sam received in 1992 when the Bulldog IOM Trust was settled and the initial annuity transactions were undertaken from Pratter, Tedder & Graves addressed the tax consequences of the annuity transactions, *assumed* that the annuity transactions would be undertaken through entities wholly owned by a foreign non-grantor trust, but did not address the issue of the proper legal characterization of that trust —*i.e.,* the Bulldog IOM Trust—as a grantor or non-grantor trust.

Sam next argues that French told him that the Bulldog IOM Trust was a non-grantor trust. But, there are numerous problems with Sam relying on any tax advice French allegedly gave him, as discussed *supra* at pp. 501–13. First, French was not competent to give Sam advice regarding the proper legal characterization of the Bulldog IOM Trust as he was a securities lawyer, not a tax lawyer. That French was not competent to give such advice is demonstrated by the fact that the Wylys hired expert tax lawyers to advise them—*i.e.,* Lubar, Owens, Pulman, Chamberlain Hrdlicka, DeCastro West, and arguably Tedder and Chatzky. Further, that Larry Bean, a tax lawyer at French's law firm (Jackson Walker), reviewed the offshore system as proposed by Tedder early on and advised French that it "might work," after stating that their firm, Jackson Walker,[1356] would not issue any such legal opinion to the Wylys, is of little comfort to the reasonableness of Sam's reliance on the advice of counsel defense here. ***586** Finally, that French himself realized that he was not competent to advise the Wylys about the tax consequences of their offshore system is amply demonstrated by what French did—*i.e.,* after the Wylys received "advice" from Tedder, Chatzky, and Bean, French remained concerned about the legal characterization of the 1992 IOM trusts, so, in 1993, French sought out an extremely well credentialed international tax expert, Lubar, to get another opinion about the tax consequences flowing from the 1992 annuity transactions as discussed below. In short, Sam never received advice upon which he can reasonably rely regarding the proper characterization of the Bulldog IOM Trust as a non-grantor trust when that trust was first settled.

As previously found, on May 19, 1993, Sam did receive opinion letters from Tedder, Chatzky & Berends[1357] addressing the proper legal characterization of two other trusts Sam settled in December 1992—*i.e.,* the Lake Providence IOM Trust and the Delhi IOM Trust. The letters are identical and, based on the factual assumptions contained in the letters, the firm opined that "it is more likely than not that the trust will be construed to constitute a valid non-grantor trust for United States taxation purposes provided that the trust operates in accordance with the terms and provisions contained in the Trust Agreement." However, as previously held, Sam cannot rely upon these opinions for his reasonable cause defense because that advice was provided by the firm that promoted the offshore system to the Wylys.[1358]

As previously found, in 1993 Sam's trusted advisor and agent, French, sought and received an opinion regarding the proper legal characterization of the 1992 IOM trusts that Sam had settled—*i.e.,* Bulldog IOM Trust, Lake Providence IOM Trust, and Delhi IOM Trust. French was concerned about the conclusions reached by Tedder and Chatzky and so French went to an international tax specialist, Lubar, for advice on the Wylys' behalf.[1359] As previously found, Lubar advised French that there was a "significant risk" that the 1992 IOM trusts were properly characterized as grantor trusts to Sam, which would dramatically change the tax consequences of the 1992 annuity transactions and the reporting requirements imposed under U.S. tax laws.[1360] And, as previously found, French was authorized to seek such advice by the Wylys.[1361] As one of French's principals, Sam is charged with knowledge of the facts French learned from Lubar, including the fact that Lubar believed that the 1992 IOM trusts were properly characterized as grantor trusts as to Sam.[1362]

***587** That brings us to the settling of the IOM trusts in 1994 and 1995. As previously found, the settling of these trusts was highly irregular from the outset. Lubar advised French, as the Wylys' agent, on the settling of the 1994 and 1995 IOM trusts.[1363] But, Lubar's advice was predicated on three significant facts that French told Lubar to assume were true.[1364] Although Lubar did not know it, those facts were not true; they were lies.[1365] Because the factual predicate underlying Lubar's advice about the proper legal characterization of the Bessie IOM Trust and the La Fourche IOM Trust was incorrect, Lubar's advice cannot be relied upon here to support a reasonable cause defense by Sam.[1366]

As previously found, Sam turned to Owens for legal advice on tax issues beginning around 1998. However, as previously found, there is no credible evidence in the record that Owens' firm, Meadows Owens, independently analyzed the proper legal characterization of the Sam International Penalty Trusts until late October 2003.[1367] And, as previously found, the Meadows Owens analysis was precipitated by Lubar's more comprehensive review of the Wyly offshore system in mid–2003, which reconfirmed Lubar's original views that the 1992 IOM trusts were properly characterized as grantor trusts as to Sam.[1368] As previously found, Pulman of Meadows Owens concluded that Sam had a "reportable position" that the 1992 IOM trusts were foreign non-grantor trusts—a position inconsistent with Lubar's conclusions.[1369] So, in short and at best, by late 2003 Sam had received conflicting advice from experienced tax professionals regarding whether the 1992 IOM trusts were grantor or non-grantor trusts as to him—in essence, dueling opinions from respected tax lawyers that he hired to give him that advice. From the Court's perspective, Sam cannot now pick the advice he prefers—*i.e.,* Pulman's advice—and then claim to have reasonably relied upon it in connection with his reasonable cause defense to his liability for International Penalties.

As discussed above, Sam's liability for International Penalties flows from the characterization of the Sam International Penalty Trusts as grantor trusts to Sam. For the reasons just explained, Sam failed to prove that he received advice on which he can reasonably rely that characterizes the Sam International Penalty Trusts as non-grantor trusts as to him and his reasonable cause defense fails.

For the sake of completeness, one final argument will be addressed—*i.e.,* Sam's argument that his professionals never advised him to file Forms 3520–A and 5471 and that he relied upon this failure in concluding that he had filed all required forms. As the Debtors' note in their briefing, the failure of Sam's professionals to advise him to file Forms 3520–A and 5471 was "[b]ased on the conclusions reached by these advisors regarding the characterization ***588** of the trusts."[1370] The implicit advice not to file Forms 3520–A and 5471—if it had in fact been explicit—would have boiled down to this: you do not need to file Forms 3520–A and 5471 *because* you are not the grantor of the Sam International Penalty Trusts.[1371]

The Court takes no issue with the Debtors' contention that an advisor's failure to mention that a form must be filed can constitute advice that the form does not need to be filed.[1372] A tax advisor does not need to go through every possible IRS form and mention specifically that it does not have to be filed in order for a taxpayer to have received advice that he has met all of his filing requirements. A normal W–2 wage earner with no foreign dealings can rest easy despite the fact that his accountant does not discuss with him whether he needs to file a Form 3520–A or a Form 5471. The problem here, however, is that the implicit advice Sam received not to file these forms flows directly from the advice that the Court has concluded Sam could not reasonably rely on. If Sam cannot reasonably rely on the alleged explicit advice that the 1992 IOM trusts are non-grantor trusts as to him and the 1994 and 1995 IOM trusts are foreign grantor trusts as to King and Cairns, then it follows that Sam cannot rely on implicit advice that flowed from this alleged explicit advice.

What is more, Sam was aware that there were reporting requirements whose applicability depended upon the proper legal characterization of the Wyly offshore trusts as non-grantor trusts as to Sam or as foreign grantor trusts as to King and Cairns. As Sam's counsel noted, Sam filed Forms 3520–A for offshore trusts that he was advised were grantor trusts as to him—*i.e.,* certain of the offshore trusts involved in the 1996 private annuity transactions.[1373] Moreover, acting on Sam's behalf, Hennington and Boucher received a memo dated May 15, 2001 from Owens stating that "foreign grantor trusts [Bessie IOM Trust and La Fourche IOM Trust] are exempt from all U.S. taxation *as well as all U.S. reporting requirements* so long as such trusts are characterized as foreign grantor trusts [as to King and Cairns, non-resident aliens of the U.S.]," and Hennington's and Boucher's knowledge is imputed to Sam based on agency principles.[1374] In addition, the memorandum presented to Hennington by Pulman and Cousins of Meadows Owens in October 2003 regarding what actions Sam should take in light of Lubar's conclusions regarding the proper legal characterization of the 1992 IOM Trusts as grantor trusts to Sam noted that (i) there were penalties associated with not filing Forms 3520 and 5471, and (ii) "the biggest penalty risk is under § 6677, which provides for a penalty of 5% of the gross asset of the trust at the end of the ***589** year."[1375] Perhaps most telling of all, on June 12, 1991, Robertson sent Sam, Charles, Evan, and French notes that she took at one of Tedder's seminars.[1376] At the very top of this section, there is a note that says "[w]hen in doubt file a form even if you have to make up the form."[1377] From the very beginning, Sam was aware of these forms and their importance.

Thus, the evidence shows that Sam was aware—at least to some extent—of the reporting requirements that flowed from his status as a U.S. citizen grantor of foreign trusts. More importantly, Sam was aware that all of the advice he was given about tax consequences and reporting requirements regarding the Wyly offshore system depended on the fact that he was not the grantor of the Sam International Penalty Trusts. And, for the reasons discussed above and in the Court's analysis of Sam's reasonable cause defense to the imposition of fraud penalties, Sam had no advice on which he could reasonably rely that established this crucial fact. For all of these reasons, Sam has not established his reasonable cause defense under either § 6038(c)(4)(B) or § 6677(d).

Although Sam's lack of reasonable cause is enough to make him liable for International Penalties under both §§ 6038(c)(4)(B) and 6677(d), the Court also finds that Sam displayed willful neglect in failing to file Forms 3520–A and 5471 in relation to the Foreign Corporations. Sam's failure to file these forms was due to "a conscious, intentional failure or reckless indifference."[1378]

As with Sam's tax fraud, there is little direct evidence that Sam intentionally failed to file Forms 3520–A and 5471. This is unsurprising. It would be unrealistic to expect Sam —in a Perry Mason moment—to confess that he knew all along that he needed to file these forms but did not. The evidence does show, however, that Sam was aware that the decisions he was making regarding the offshore system were not based on a foundation of uniform, reliable tax advice. For the reasons explained below, this fact, among others, establishes that Sam's decisions to not file Forms 3520–A and 5471 regarding the Foreign Corporations for over two decades was a product of at least reckless indifference.

Sam was aware from the outset of his offshore system that the tax positions he was taking regarding the 1992 IOM trusts and the annuity transactions he undertook through them were aggressive.[1379] Sam was also aware that Tedder had advised early on to over report to the IRS about the offshore system.[1380] Moreover, Sam ***590** was aware as early as July 1993 that there was a significant risk that the 1992 IOM trusts he settled would be characterized as grantor trusts as to him when his agent, French, sought a second opinion on his behalf regarding the proper legal characterization of the 1992 IOM trusts and the tax consequences flowing from the annuity transactions undertaken through those trusts from an international tax expert, Lubar.[1381] In addition, Sam was aware that the factual foundation upon which Lubar based his advice that King and Cairns—rather than Sam—were the grantors of the Bessie IOM Trust and the La Fourche IOM Trust was false.[1382] Finally, Sam was aware from the inception of the offshore system that there were reporting requirements related to offshore trusts—particularly those trusts of which he was the grantor.

Sam testified at trial that he hired tax professionals because he realized that the United States tax laws were complicated, and that he needed experts to assist him in complying with those laws, going so far as to testify that he was not competent to even read his own tax returns due to their complexity.[1383] Of course, this testimony leads to Sam's argument—under *Boyle* —that he should not be subject to penalties because he received high quality tax advice that he was not competent to independently evaluate.

The Court agrees that Sam should not be charged with the responsibility to independently evaluate the correctness of the tax advice he received. Moreover, the Court does not expect Sam to be competent to determine which of his expert[1384] tax advisors was correct regarding the proper legal characterization of the 1992 IOM trusts and the tax consequences of the annuity transactions undertaken through them. But, as a well-educated, ***591** experienced, and sophisticated businessman, Sam was competent to understand that he had received conflicting advice from the tax professionals he had hired to give him that advice

—*i.e.,* Tedder and Chatzky on the one hand and Lubar on the other hand. Specifically, Tedder and Chatzky advised in May 1993 that it was more likely than not that the Lake Providence IOM Trust and the Delhi IOM Trust would be characterized as *nongrantor* trusts as to Sam, while Lubar advised in July 1993 that there was a significant risk that those two trusts, along with the earlier settled Bulldog IOM Trust, would be characterized as *grantor* trusts as to Sam. And, as previously found, the correct legal characterization of the 1992 IOM trusts —particularly the Bulldog IOM Trust through which the annuity transactions had been undertaken—drives both the tax consequences to Sam of the annuity transactions and his reporting obligations.

So, what did Sam do when he learned in 1993 that his expert advisers disagreed over the proper legal characterization of the 1992 IOM trusts and the tax consequences flowing from the annuity transactions undertaken through them? Similarly, what did Sam do knowing that the factual predicate underlying Lubar's advice regarding the characterization of the Bessie IOM Trust and the La Fourche IOM Trusts as grantor trusts as to King and Cairns, respectively, was wrong?

In short, Sam did nothing. He simply ignored their disagreement and the factual lies upon which the 1994 and 1995 IOM trusts were predicated and proceeded to undertake more annuity and other business transactions through the Sam International Penalty Trusts for the next decade until his hand was forced by a chance encounter that Boucher had with Lubar in the Cayman Islands in 2003. At that time Boucher learned of Lubar's 1993 advice to Sam's agent, French, [1385] and, as previously found, that led to a flurry of activity. [1386]

Specifically, Boucher and Hennington, also acting as Sam's agents, met with Lubar in London (just as French had done literally a decade earlier) and, after understanding Lubar's earlier concerns, Boucher and Hennington prepared a written memorandum addressed to their principal, Sam (among others), disclosing what they had learned. [1387] This led to Lubar being asked to reanalyze the Wyly offshore system, which he did and which reconfirmed his original conclusions about the proper legal characterization of the 1992 IOM trusts as foreign grantor trusts as to Sam and raised new concerns about the tax consequences of the annuity transactions undertaken through them.

And, as previously found, after a failed anonymous meeting with the IRS to try to resolve the Wyly's looming tax problems that Lubar undertook on Sam's and Charles' behalf in August 2003, Hennington ***592** approached Pulman at Meadows Owens for further advice in late September 2003 due to the looming due date of Sam's 2002 tax return (October 15, 2003). By late October, Hennington learned that Pulman believed that Sam had a "reportable position" that the 1992 IOM trusts were foreign non-grantor trusts. But, at best, that simply put Sam back where he was in 1993—*i.e.,* two tax experts hired to advise him about the offshore system disagreed as to whether the 1992 IOM trusts were grantor or non-grantor trusts as to Sam and the tax and reporting consequences flowing from those trusts. One difference here, however, from 1993 is that even Pulman warned Sam about the significant penalties attendant to his failing to report to the IRS. [1388] Another significant difference is that by late 2003, Sam knew several other things—he knew that (i) the IRS had expressed concerns in August 2003, at the anonymous meeting Lubar had with them on Sam's behalf, that there had been incomplete Form 3520 reporting, (ii) the legal advice on which the offshore system was based was in conflict with Lubar's advice and had been provided by promoters, and (iii) the entire offshore structure was fundamentally flawed. [1389] Notes from this meeting even indicate that Lubar agreed that the Wylys had neglected their obligation to file Forms 5471, and that one IRS representative commented that the Wylys would now be on notice that they had an obligation to file Forms 3520, 3520–A, and 5471. [1390]

So, once again, the question must be asked—what did Sam do to resolve the legal uncertainty and clarify his reporting obligations? The answer this time is slightly different but, as relevant here, the difference is not meaningful. While Sam did nothing to attempt to resolve the legal uncertainty, he did start filing Forms 8275 with the IRS disclosing the possibility that the IOM trusts were grantor trusts as to him, that there were possible funding issues with the 1994 and 1995 trusts, and that property had been exchanged with subsidiaries of these foreign trusts in exchange for private annuities. [1391] But, this was not meaningful disclosure compared to Sam's obligation to file Forms 3520–A and 5471 because the Forms 8275 did not provide the essential information required in order to satisfy Sam's obligations under 26 U.S.C. §§ 6038 and 6048.[1392] These sections of the Internal Revenue Code require a taxpayer to provide detailed information about foreign trusts and corporations so that the IRS is able to monitor taxpayer compliance. The Forms 8275 that Sam filed did not provide the names of the Sam International Penalty Trusts or the Foreign ***593** Corporations, information about trustees or beneficiaries of the Sam International Penalty Trusts, financial information about the Sam International Penalty Trusts or the Foreign Corporations, or detailed information about the transactions engaged in by any of these entities.[1393] All of this information is required in order to satisfy Sam's reporting obligations under §§ 6038 and 6048.[1394]

And, in early 2004, the IRS began its audit of Sam, the focal point of which was Sam's offshore system and the transactions undertaken offshore as Hennington testified.[1395] By then, Sam had to know that the secrecy surrounding his offshore system was about to be destroyed and the IRS was going to learn the extent of his offshore holdings. At this point there was no reason not to file all *possibly* required forms with the IRS; even if they were later determined not to have been required, filing them would insure that Sam would not be held liable for failing to file them when litigation with the IRS arose, as Sam had to know it would.[1396]

But, again, what did Sam actually do? Nothing of real consequence—he simply waited for the IRS to come after him, all the while continuing his offshore activities. Such a caviler attitude towards his reporting obligations for 20 plus years reflects, at a minimum, reckless indifference. For these reasons, the Court concludes that Sam acted with willful neglect when he failed to file Forms 3520–A and 5471.

(2) As to Dee

[114] Since the Court found that Dee is not liable for fraud penalties under § 6663, the Court has not previously examined Dee's reasonable cause defenses. Like Sam, Dee attempts to establish her reasonable cause and lack of willful neglect by her purported reliance on the advice of professionals. According to Dee, her reasonable cause defense boils down to this:

> Dee Wyly reasonably relied on her husband to handle the couple's financial, tax, and legal affairs. Dee Wyly never had any reason to suspect that Charles Wyly ever engaged in illegal or fraudulent activity, and there is no evidence that he ever did. Dee Wyly had no reason to suspect that the legal, financial, and tax professionals retained by her husband provided anything other than competent professional advice and counsel.[1397]

***594** In other words, when it came to tax matters Dee relied on her husband, Charles, who in turn relied on professionals, and Dee should be able to rely on the advice of professionals to the same extent Charles did. Through this reasoning, Dee attempts to use the same facts and circumstances as Sam did in order to establish reasonable cause and lack of willful neglect. Although the law on this issue pulls in somewhat conflicting directions, the Court ultimately concludes that Dee has established that she acted with reasonable cause and without willful neglect based on reliance on the advice of professionals, as explained below.

Under 26 C.F.R. § 1.6664–4 (which the Court acknowledges is not controlling here but is nevertheless helpful), advice "is any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly."[1398] Under this regulation there are thus grounds to define advice broadly, and it seems at least conceivable that Dee could rely on the advice of professionals through her husband as Debtors have argued.

However, if Dee is to rely on professionals through her reliance on Charles, then there is an argument that her reliance can only establish reasonable cause to the same extent as Charles' reliance could. This is important, because, like Sam, any reasonable cause defense asserted by Charles (or more accurately, by his probate estate) would fail here for the same reasons Sam's reasonable cause defenses failed. A brief reminder is appropriate. Although the names of Charles' offshore trusts and corporations were different than Sam's, and he established fewer offshore trusts and corporations than Sam, Charles' actions and the advice he received is identical, in all material respects, to that of Sam. In short, the two brothers implemented a substantively identical system of offshore trusts and corporations in the IOM through which they undertook substantively identical transactions from 1992 through 2011 when Charles died. Thus, for the reasons just explained as to Sam, Charles would not be able to prove that he received advice on which he can reasonably rely that characterizes the Charles and Dee International Penalty Trusts as non-grantor trusts as to him. And, for the same reasons that Sam's reasonable cause defenses to the imposition of International Penalties failed, any such defenses asserted by Charles (or his probate estate) would also fail.

Despite the problems Charles (or his probate estate) would have establishing a reasonable cause defense here, the case of *Reser v. C.I.R.* [1399] strongly suggests that Dee, as opposed to Charles, can establish reasonable cause through her indirect reliance on this advice. While the Court was somewhat surprised by this, it is prudent for it to follow the Fifth Circuit's decision and analysis in *Reser,* to which we now turn.

The taxpayers in *Reser* were a husband ("**Don**") and wife ("**Rebecca**"), both of whom were highly educated and had obtained their law degrees. [1400] Don and Rebecca's problems began when Don formed a subchapter S corporation ("**DRPC**") of which he was the sole shareholder, and ***595** then obtained a joint loan with this corporation from Frost Bank. [1401] Don had complete control over the use of the loan proceeds, and used them for both personal expenses and as operating capital for DRPC. [1402] Don and DRPC eventually defaulted on their loan with Frost Bank. [1403]

Tax issues arose when Don attempted to claim losses related to DRPC on his tax return. [1404] Don argued that he should be able to claim losses related to the Frost Bank loans, because in fact these loans had been made to Don who in turn lent the money to DRPC. [1405] The only evidence that Don presented in order to substantiate his claim that he had lent money to DRPC was a series of promissory notes. [1406] However, these promissory notes first appeared after the IRS made its final determination of tax liability. Don had not produced the notes in response to earlier IRS document requests, which caused the tax court to disregard them at trial. [1407] The tax court held that since there was no "actual, substantive debt" owed by DRPC to Don that losses related to these loans could not be deducted on Don's and Rebecca's joint tax return. [1408]

The IRS also sought to recover various penalties from Don and Rebecca related to the overstated losses stemming from the Frost Bank loans. [1409] Don and Rebecca argued that they should not be liable for these penalties because they relied on accountants to prepare their returns. [1410] The tax court rejected this argument, stating that: [1411]

> Stewart Goodson, the certified public accountant who prepared the returns here, testified that John Gwaltney, DRPC's accountant, told him to treat loans listed on the financial statements as coming from the bank as loans from [Don], and that such loans were in fact from [Don]. Mr. Goodson, an agent of DRPC, thus treated the loans as loans from [Don]. In light of our finding that there was no separate loan from [Don] to [DRPC], we find that [Don's] reliance on Mr. Goodson was not reasonable, as based on inaccurate information that Mr. Goodson made no effort to verify, and that appears to have been furnished to him on [Don's] instructions.

Apparently not eager to be held liable for tax penalties because of a dubious tax position taken by her husband, Rebecca also attempted to obtain penalty relief based on the innocent spouse defense. [1412] The tax court rejected her innocent spouse defense, stating that: [1413]

> Petitioner wife, an attorney, signed the 1987 tax return. She undoubtedly noticed that the losses attributable to her husband's corporation would act to shelter

> her income. Given the circumstances, we find that a reasonably prudent taxpayer should have known that the tax liability stated was erroneous, or that further investigation was warranted. ***596** We find that petitioner wife should have investigated whether the losses were properly deductible.
>
> Since we hold that petitioner wife should have known, or was on reasonable notice, that the loss was improper, we must conclude that she does not qualify for treatment as an innocent spouse under section 6013(e).

Thus, the tax court held that Rebecca was liable for both tax and penalties because her husband claimed erroneous deductions on their joint tax return. [1414]

Rebecca, but not Don, appealed the tax court's decision to the Fifth Circuit. [1415] The Fifth Circuit affirmed the tax court's decision that the losses related to the Frost Bank loans were not deductible, but reversed the tax court's decision to hold Rebecca liable for penalties. [1416] The Fifth Circuit held that the tax court's finding that Rebecca was not an innocent spouse was clearly erroneous. [1417] The Fifth Circuit based this conclusion, in part, on its determination that Rebecca did not actually know, did not have reason to know, and did not have a duty to inquire as to whether deducting the DRPC losses related to the Frost Bank loans was proper. [1418] The Fifth Circuit reached this conclusion for the following reasons: [1419]

> The relevant factors that we are to consider indicate that [Rebecca] did not know and did not have reason to know that the deductions in question would give rise to a substantial understatement on the 1987 joint return. First, [Rebecca's] education, albeit advanced, provided her with no special knowledge of complex tax issues such as basis computation. She had a background in history and practiced personal injury law. Second, [Rebecca] was not personally involved with DRPC's business and financial affairs to any significant degree; rather, she was engaged full-time in her law practice and was the family's sole source of financial support. In addition, she gave birth to their second child in 1987. Third, the record is devoid of evidence of lavish or unusual expenditures compared to the Resers' normal standard of living and spending patterns, which exhibits no notable changes during the years in question. To the contrary, they invested most of [Rebecca's] income into DRPC and consumed the rest on the family's living expenses. In addition, they incurred substantial debt when borrowing money to invest in DRPC. And ultimately, the Resers divorced, and Don filed for bankruptcy. Finally, [Rebecca] cannot be penalized for Don's discredited efforts to recast the Frost Bank loan in a tax-favorable light. Indeed, [Rebecca] was not even aware of the second set of "promissory notes" until 1991, several years after she had signed the 1987 joint return.

The Fifth Circuit also noted that the ultimate conclusion that these losses were not deductible by Don and Rebecca rested on the application of "an extremely difficult and technical process" that had been hotly contested and on which IRS agents had reached two different conclusions. [1420] Most importantly, the Fifth Circuit noted that Rebecca had been reasonable in relying on accountants to prepare her taxes, ***597** and had no duty to inquire as to the propriety of the deductions: [1421]

> Had [Rebecca] asked Don, [or the accountants] about the deductions, they would have told her what they believed-that DRPC's losses were properly deductible in full. Neither the court nor the law will penalize [Rebecca] for failing to perform the hollow act of asking questions, the answers to which would have provided no new or different information.

On this basis, the Fifth Circuit found that the tax court had been clearly erroneous in finding that Rebecca was not an innocent spouse.[1422]

However, there were certain penalties for which Rebecca did not qualify for innocent spouse relief based on a technicality, namely that the tax liability from which she sought relief was not a high enough amount.[1423] Thus, the Fifth Circuit explored whether she could be released from these liabilities for penalties based on other grounds —*i.e.,* absence of negligence and, as relevant to Dee, reasonable cause. The Court concluded first that Rebecca had not been negligent:[1424]

> The relevant inquiry for the imposition of a negligence penalty is whether the taxpayer acted reasonably in claiming the loss. The Tax Court found that [Rebecca's] reliance on Stewart Goodson, the CPA who prepared the 1988 joint return, was not reasonable, as based on inaccurate information, in light of its decision that there was no separate loan from Don to DRPC. We find clear error in this conclusion of the Tax Court. For the same reasons that we concluded that [Rebecca] did not have reason to know of the substantial understatement on the 1987 joint return, we conclude that she acted reasonably in relying on the professionals who prepared the 1988 joint return. In fact, but for her failure to meet a technical requirement, she would have been an innocent spouse for purposes of the 1988 joint return. Goodson and Bryan, two CPA's at a national accounting firm, both agreed that the Resers' basis in DRPC was sufficient to claim the losses as deductions. As we stated in *Chamberlain v. Commissioner,* "[t]o require the taxpayer to challenge the [expert], to seek a 'second opinion,' or try to monitor [the expert] on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place." Furthermore, [Rebecca] was wholly unaware of Don's belated attempt to recast the Frost Bank loan to his tax advantage.

The Fifth Circuit then considered whether, in addition to not being negligent, Rebecca had established that she had acted with reasonable cause and good faith.[1425] The Court concluded that Rebecca had established reasonable cause and good faith because:[1426]

> We have just concluded that [Rebecca] acted reasonably in relying on the professionals who prepared the 1988 joint return and would have been an innocent spouse for purposes of that return but for her failure to meet a technical requirement ... we exonerate her from liability for this penalty. Any other conclusion ***598** would be absurdly inconsistent with our earlier holdings.

In this way, Rebecca escaped all liability for taxes or penalties related to erroneous deductions taken by her husband on their joint return.[1427]

Thus, in *Reser,* the Fifth Circuit stated that it would be "absurdly inconsistent" to hold that an innocent spouse who had no actual knowledge or reason to know of a tax liability caused by her husband's actions did not also have reasonable cause in relation to penalties caused by those same actions. The Fifth Circuit reached this conclusion in part on the basis that a spouse who did not know that the professional advice she relied on was based on incorrect facts provided by her husband could still rely on that advice, especially when that advice was regarding complicated tax law. There was no indication in the Fifth Circuit's reasoning that it was important whether Rebecca relied on this advice on her own or "through her husband," and the court's admonition against punishing Rebecca based on the hollow act of asking Don or the accountants questions would be inconsistent with a need for direct reliance. If Rebecca had been relying on advice directly, she would not have needed to ask questions, because she would have known the advice's contents already.

Finally, the Fifth Circuit held that Rebecca had acted with reasonable cause despite the fact that she was a highly educated lawyer who was at least somewhat involved in her husband's financial affairs.

There are numerous similarities between Dee's situation here and Rebecca's situation in *Reser.* Like Rebecca, Dee has been found to be an innocent spouse with respect to their income tax underpayments because she did not know or have reason to know of the income coming in from the offshore system.[1428] This finding was based on Dee's credible testimony at trial that she relied entirely on Charles to handle all tax and business matters throughout their marriage.[1429] Dee has never prepared a tax return or discussed tax matters with her husband or any tax professional.[1430] In fact, Dee testified that it was her practice to sign whatever tax return Charles or someone from the Wyly family office gave her without reviewing it or asking questions about it throughout their fifty plus year marriage.[1431]

The evidence shows that even to this day Dee is completely unaware of the intricacies of the offshore system Charles established.[1432] At trial, Dee testified that ***599** she did not know what an annuity or a grantor or non-grantor trust was, and that she never discussed the offshore trusts or the other offshore corporations with her husband or with any other person.[1433] That Dee is largely unaware of even the basics of the offshore system is not incredible at all, as Dee testified that she "literally never" discussed business issues with Charles.[1434] Thus, Dee's lack of knowledge regarding the offshore system is presumably far greater than Rebecca's lack of knowledge regarding DRPC and its losses in *Reser*. Despite the fact that Rebecca was a highly educated lawyer who actually did have some involvement in her husband's business affairs, the Fifth Circuit found that Rebecca's education and experience and her level of involvement in her family's finances made it clear that she had no reason to know of the understatements caused by her husband.[1435] Dee's argument is much stronger than Rebecca's, as there is no evidence in the record that she has any business experience and she has credibly testified that she never even spoke about business matters with Charles.[1436]

Just as Rebecca in *Reser* was unaware that her husband had mischaracterized the nature of the DRPC loans to his professionals in seeking their advice, Dee was unaware (i) of the specifics of the advice that Charles had received, (ii) whether the advice actually addressed the relevant factual and legal issues that needed to be addressed, (iii) what factual assumptions served as the predicate for the advice, and (iv) whether there was anything wrong with the advice that was given to her husband by the many professionals that were consulted on his behalf regarding the offshore system. Although Charles is charged with knowledge of the contents of the advice that he received, albeit mostly indirectly through French, Robertson, Hennington and Boucher, and Charles is also charged with the knowledge that there were missing legal opinions, conflicting legal opinions, and legal opinions based on false factual assumptions that all impacted the tax status of the offshore system and his obligation to file reports about it with the IRS, Dee had no way of knowing any of that. In fact, had Dee sought out this information regarding the offshore system she—even more so than Rebecca in *Reser* —would in all likelihood have been told that nothing was amiss. Sam has consistently proclaimed his innocence of any wrongdoing here because, according to him, every professional he consulted told him all was fine with the offshore system. There is no reason to believe that Charles would have said anything different. And, while the Court has not found Sam's testimony credible given its review of the actual advice on which Sam purports to rely, Dee would have had no way of knowing that reassurances from Sam and Charles, if given, were untrue.

The Fifth Circuit refused to penalize Rebecca in *Reser* "for failing to perform the hollow act of asking questions, the answers to which would have provided no new or different information," especially when she had no knowledge that Don had falsely told their accountants that he had ***600** loaned money to DRPC.[1437] The rationale for refusing to penalize Dee is even stronger here, where Dee's asking questions would have been an even hollower act than Rebecca's. While the Court believes that Dee is an intelligent woman, the Court is satisfied that her absolute lack of business sophistication would have left her unable to ask the relevant questions of Charles. Dee has three years of college, no business or legal experience, and was faced with a set of transactions much more complicated than the ones at issue in *Reser* —transactions which the IRS' expert—a highly experienced forensic accountant —called "if not the most complicated, one of the most complicated cases" that he had ever investigated.[1438] It would have been all but impossible for Dee to "fact check" the advice Charles received regarding the offshore system.

Dee's case is also similar to Rebecca's in *Reser* in that Dee is not entitled to innocent spouse relief for International Penalties due to a technicality. The technicality in *Reser* was that, at that time, only tax liabilities greater than 25% of the adjusted gross income for the preadjustment year were eligible for innocent spouse relief.[1439] This restriction has since been repealed.[1440] For Dee, the technicality is that innocent spouse relief applies only to income tax liability, not liability for International Penalties.[1441] This is despite the fact that Dee is liable for International Penalties for essentially the same reason that she would have been liable for income tax underpayments but for her innocent spouse defense—*i.e.,* because the Charles and Dee International Penalty Trusts were grantor trusts as to Charles and her.

While the legal and factual issues are not identical, the similarity of Dee's situation to that of Rebecca in *Reser* strongly suggests that the Fifth Circuit would conclude that Dee acted with reasonable cause and not with willful neglect for the purposes of §§ 6038(c)(4)(B) and 6677(d). As the Fifth Circuit noted, it would be absurdly inconsistent to hold that Dee is an innocent spouse for the purposes of Charles' and her income tax underpayments but that she is not able to establish reasonable cause for the purposes of avoiding liability for the International Penalties, which flow from the same legal characterization of the Charles and Dee International Penalty Trusts as grantor trusts.

At trial, Dee credibly testified that, after Charles' death, she continued to rely on the Wyly family office to prepare her tax returns and to handle her finances, and that she has never had any reason to suspect that they were deficient in their duties.[1442] The fact that Charles died did not give Dee any new reason—or any new ability—to question whether she was filing all of the reports required by the IRS with respect to the offshore system.

In light of all of these facts and the legal principles articulated in *Reser,* the Court holds that Dee has established that she acted with reasonable cause and without willful neglect for all of the tax years at issue. Thus, Dee has established her reasonable cause defenses with respect to her liability for the International Penalties.

In coming to its conclusion as stated above, this Court has reviewed the cases ***601** that, on first reading, counsel for a different result. The tax court has stated that "the fact that a husband assumes the duty to file a tax return and fails to do so does not of itself provide the wife with reasonable cause for failure to file, at least where the wife has not taken steps to assure that her husband has performed this duty.[1443] The tax court's refusal to allow reliance on a husband, standing alone, to constitute reasonable cause extends to situations where one wonders what more a wife could be asked to do. For example, *Estate of Molever v. C.I.R.*[1444] involved the following facts:

> Mr. Molever always prepared joint Federal income tax returns for himself and [Mrs. Molever], and [Mrs. Molever] relied on him, as an accountant, to do it properly. If she questioned anything he did, he thundered at her and accused her of ignorance. He assured her that he was in frequent consultation with two certified public accountants in Phoenix. In fact, Mr. Molever was deducting the expenses of his litigation as business expenses, assuring petitioner that he had "loss carryforwards." Among these expenses he deducted 40 percent of the Molevers' living expenses (rent, electricity, water, and telephone). Mr. Molever insisted that petitioner file a Form W–4 for 1987 on which she claimed 10 dependency exemptions. For 1988, petitioner filed a Form W–4 claiming 2 exemptions. Mr. Molever became enraged when he learned of this, and insisted petitioner again claim 10 exemptions for 1989. When correspondence or calls from the IRS arrived, petitioner directed them to Mr. Molever and relied on him to handle all tax matters.
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> * * *
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> In early 1988, Mr. Molever was very ill with cancer and emphysema. After the episode in which he threatened petitioner with a gun, Mr. Molever's doctor advised petitioner that shortage of oxygen to his brain could explain his irrational episodes. Eventually, he required oxygen full-time. On April 10, 1991, Mr. Molever died.

Even in this situation, involving a wife faced with an irrational and violent husband who actively resisted her attempts to do what was right under the Internal Revenue Code, the tax court held that the taxpayer was negligent for not filing her tax return on time, and that reliance on her husband was insufficient to establish reasonable cause.[1445]

Dee's situation is distinguishable from the above cases in an important respect. ***602** Courts holding that reliance on a husband is insufficient to establish reasonable cause have so held in the context of wives who failed to file standard income tax returns, a document U.S. taxpayers generally know is required to be filed annually.[1446] In contrast, Dee's liability for International Penalties arises as a result of a failure to file information returns related to foreign corporations and foreign trusts, documents that most U.S. taxpayers would be unaware of. Dee relied on legal professionals—albeit through Charles—to tell her whether these information returns should be filed. The women in the above-cited cases were relying on their husbands to make sure that returns they knew or should have known were due were in fact filed. The Supreme Court in *U.S. v. Boyle* has made it clear that it is reasonable to rely on a professional's advice as to *whether* a certain return should be filed, but that it is an individual taxpayer's responsibility to ensure that returns which they know are due are filed and filed timely.[1447] The Court thus distinguishes these cases from Dee's case.

For all of these reasons, the Court concludes that Dee has established her reasonable cause defenses to her liability for the International Penalties under 26 U.S.C. §§ 6038(c)(4)(B) and 6677(d).

I. Does the Imposition of the International Penalties Violate the Eighth Amendment?

1. Applicable Supreme Court Precedent

The Debtors final argument to avoid liability for the International Penalties is that those penalties constitute excessive fines under the Eighth Amendment of the United States Constitution, which provides, as relevant here, that: "[e]xcessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted."[1448] The Debtors' argument concerns only the excessive fines clause of the Eighth Amendment (the "**Excessive Fines Clause**")—*i.e.,* that portion of the Eighth Amendment that provides that excessive fines shall not be imposed.[1449] Specifically, the Debtors argue that a quartet of relatively recent Supreme Court cases stand for the proposition that the International Penalties are unconstitutionally excessive fines as applied to them.[1450]

In contrast, while the IRS does not dispute the importance of these four Supreme Court decisions, it argues that under their holdings: (i) the International Penalties are not "fines" as that term is defined for purposes of the Excessive Fines Clause, and (ii) even if the International Penalties are "fines," they are not excessive. The ***603** IRS also correctly notes that almost all of the relatively few cases that have interpreted the Excessive Fines Clause "concern forfeitures related to crimes;" and thus, the IRS cautions this Court against expanding the Supreme Court's Excessive Fines Clause jurisprudence into the realm of civil tax penalties, where it has never before been successfully used to strike down a civil tax penalty as unconstitutional.[1451]

For the reasons explained below, the Court largely agrees with the IRS and concludes that the International Penalties are not fines. Alternatively, the Court concludes that if the International Penalties are properly construed as fines, they (i) are not excessive as applied to Sam, and (ii) are excessive as applied to Dee.

a) The Supreme Court Decisions

The Debtors rely upon *U.S. v. Halper,*[1452] which, although not explicitly stated in their briefing, is helpful to them because it defines the concept of "punishment" broadly and only sanctions that are "punishment" can be considered to be "fines" under the Excessive Fines Clause.[1453] Halper submitted 65 Medicare reimbursements that were overstated by $9 each, for a total of $5 85.[1454] For this overbilling, Halper was assessed a criminal fine of $5,000 and imprisoned for two years.[1455] A civil False Claims Act suit was subsequently brought against him.[1456] Since Halper had violated the relevant statute under the False Claims Act 65 separate times, and each violation of the statute called for a penalty of $2, 000, double damages, and costs; a total civil liability of $130,000 was assessed against him.[1457] Halper argued that this nominal civil penalty raised implications under the Double Jeopardy Clause, which states that "nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb...."[1458]

Thus, the *Halper* Court addressed the question of "whether a civil sanction, in application, may be so divorced from any remedial goal that it constitutes 'punishment' for the purposes of double jeopardy analysis."[1459] The *Halper* Court held that "under the Double Jeopardy Clause a defendant who already has been punished in a criminal prosecution may not be subjected to an additional civil sanction to the extent that the second sanction may not fairly be characterized as remedial, but only as a deterrent or retribution."[1460] In defining remedial versus deterrent or retributive sanctions, the *Halper* Court noted that "a civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also ***604** serving either retributive or deterrent purposes, is punishment."[1461] The Court also noted that both civil and criminal sanctions constitute punishment when "as applied in the individual case" they serve the goals of punishment.[1462]

It is important to stress that *Halper* is a double jeopardy case, and that a later Supreme Court case—*Hudson v. U.S.*—"in large part disavow[ed] the method of analysis used in *United States v. Halper* " in the double jeopardy context and called the *Halper* framework "ill considered" and "unworkable."[1463] Furthermore, the *Halper* Court itself noted that the rule it announced "is a rule for the rare case ... where a fixed-penalty provision subjects a prolific but small-gauge offender to a sanction overwhelmingly disproportionate to the damages he caused"[1464] and that "the only proscription established by our ruling is that the Government may not criminally prosecute a defendant, impose a criminal penalty upon him, and then bring a separate civil action based on the same conduct and receive a judgment not rationally related to the goal of making the Government whole."[1465] The *Halper* Court also noted that, despite its holding, "the Government is entitled to rough remedial justice ... according to somewhat imprecise formulas, such as reasonable liquidated damages or a fixed sum plus double damages ...,"[1466] and acknowledged that drawing the line between remedial and punitive sanctions is always an imprecise science and often an impossible one.[1467]

The second case relied upon by the Debtors here is *Browning–Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc.,*[1468] which held that "[w]hatever the outer confines of the [Excessive Fines Clause's] reach may be, we now decide only that it does not constrain an award of money damages in a civil suit when the government neither has prosecuted the action nor has any right to receive a share of the damages awarded." Thus, the Supreme Court did not apply the Excessive Fines Clause to a jury's award of punitive damages in a private, civil lawsuit.[1469] The relevance of this holding to the Motions ***605** and Claim Objections is not immediately apparent. However, the Debtors cite it for the proposition that the word "fine" in the context of the Excessive Fines Clause means "a payment to a sovereign as punishment for some offense."[1470]

The Debtors next rely upon *Austin v. U.S.,*[1471] which answered the question of "whether the Excessive Fines Clause of the Eighth Amendment applies to forfeitures of property under 21 U.S.C. §§ 881(a)(4) and (a)(7)." The *Austin* Court held that it did, because the forfeitures in question constituted "payment to a sovereign as punishment for some offense."[1472] The *Austin* Court reached this conclusion on the basis that, in certain cases, civil sanctions could be considered to be punishment under the Excessive Fines Clause:[1473]

> The Excessive Fines Clause limits the government's power to extract payments, whether in cash or in kind, "as *punishment* for some offense." [*Browning–Ferris,* 492 U.S. at 265, 109 S.Ct. 2909.] (emphasis added). "The notion of punishment, as we commonly understand it, cuts across the division between the civil and the criminal law." *United States v. Halper,* 490 U.S. 435, 447–448, 109 S.Ct. 1892, 1901, 104 L.Ed.2d 487 (1989). "It is commonly understood that civil proceedings may advance punitive as well as remedial goals, and, conversely, that both punitive and remedial goals may be served by criminal penalties." *Id.,* at 447, 109 S.Ct., at 1901. *See also United States ex rel. Marcus v. Hess,* 317 U.S. 537, 554, 63 S.Ct. 379, 389, 87 L.Ed. 443 (1943) (Frankfurter, J., concurring). Thus, the question is not, as the United States would have it, whether forfeiture under §§ 881(a)(4) and (a)(7) is civil or criminal, but rather whether it is punishment.
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> In considering this question, we are mindful of the fact that sanctions frequently serve more than one purpose. We need not exclude the possibility that a forfeiture serves remedial purposes to conclude that it is subject to the limitations of the Excessive Fines Clause. We, however, must determine that it can only be explained as serving in part to punish. We said in *Halper* that "a civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment, as we have come to understand the term." 490 U.S., at 448, 109 S.Ct., at 1902.

The *Austin* Court noted that the determination of whether a sanction was a punishment and therefore a fine under the Excessive Fines Clause was governed by *Halper* : "[u]nder [*Halper*], the question is whether forfeiture serves in part to punish, and one need not exclude the possibility that forfeiture serves other purposes to reach that conclusion."[1474] In rejecting the argument that the forfeitures in question were purely remedial, the Supreme Court noted "forfeiture of property is a penalty that has absolutely no correlation to any damages sustained by society or to the cost of enforcing the law."[1475]

***606** The *Austin* Court concluded that forfeitures under 21 U.S.C. §§ 881(a)(4) and (a)(7) did not serve a *solely* remedial purpose in light of (i) the historical understanding of forfeiture as punishment, (ii) the clear focus of the forfeiture statutes in question on the culpability of the owner, and (iii) evidence that Congress understood these provisions as serving to deter and punish.[1476] In a footnote, the *Austin* court drew a distinction between forfeitures and other types of monetary sanctions:[1477]

> In *Halper,* we focused on whether "the sanction as applied in the individual case serves the goals of punishment." 490 U.S., at 448, 109 S.Ct., at 1902. In this case, however, it makes sense to focus on §§ 881(a)(4) and (a)(7) as a whole. *Halper* involved a small, fixed-penalty provision, which "in the ordinary case ... can be said to do no more than make the Government whole." *Id.,* at 449, 109 S.Ct., at 1902. The value of the conveyances and real property forfeitable under §§ 881(a)(4) and (a)(7), on the other hand, can vary so dramatically that any relationship between the Government's actual costs and the amount of the sanction is merely coincidental. *See Ward,* 448 U.S., at 254, 100 S.Ct., at 2644. Furthermore, as we have seen, forfeiture statutes historically have been understood as serving not simply remedial goals but also those of punishment and deterrence. Finally, it appears to make little practical difference whether the Excessive Fines Clause applies to all forfeitures under §§ 881(a)(4) and (a)(7) or only to those that cannot be characterized as purely remedial. The Clause prohibits only the imposition of "excessive" fines, and a fine that serves purely remedial purposes cannot be considered "excessive" in any event.

The *Austin* Court did not articulate a test for determining whether a particular forfeiture or other type of punishment is excessive under the Excessive Fines Clause. Instead, it held only that payments to a sovereign that are made as punishment for some offense are subject to the limitations of the Excessive Fines Clause, and that a sanction is punishment under the Excessive Fines Clause if it serves a retributive or deterrent purpose.[1478]

Finally, the Debtors rely upon *U.S. v. Bajakajian.*[1479] *Bajakajian* was the first—and to date is the only—Supreme Court case that actually applies the Excessive Fines Clause.[1480] Bajakajian was convicted of willfully failing to report the fact that he was transporting more than $10,000 in currency out of the country.[1481] The penalty for this offense was the forfeiture of the entire amount that Bajakajian failed to report—$357,144.[1482] Bajakajian was transporting these funds to repay a lawful debt, and his failure to report the funds was not connected to any kind of unlawful activity, including tax evasion.[1483] The Supreme Court noted that the district court had found that Bajakajian "failed to report that he was taking the currency out of the United States because of fear stemming ***607** from cultural differences: Respondent, who had grown up as a member of the Armenian minority in Syria, had a distrust for the Government."[1484]

The *Bajakajian* Court adopted the *Austin* Court's analysis, and stated that "[f]orfeitures—payments in kind—are thus 'fines' if they constitute punishment for an offense."[1485] The *Bajakajian* Court also adopted the *Austin* Court's assertion that even if a forfeiture is only punitive in part that it is still within the purview of the Excessive Fines Clause.[1486] Having decided that the forfeiture in question was a fine within the meaning of the Excessive Fines Clause, the *Bajakajian* Court then turned to the question of whether that fine was excessive,[1487] holding that "a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of a defendant's offense."[1488] The Supreme Court reasoned that a forfeiture must be *grossly* disproportional to the gravity of a defendant's offense based on two observations: (i) "judgments about the appropriate punishment for an offense belong in the first instance to the legislature,"[1489] and (ii) "any judicial determination regarding the gravity of a particular criminal offense will be inherently imprecise." [1490] According to the Court, these two observations, taken together, "counsel against requiring strict proportionality between the amount of a punitive forfeiture and the gravity of a criminal offense;" [1491] "[i]f the amount of the forfeiture is grossly disproportional to the gravity of the defendant's offense, it is unconstitutional." [1492]

Applying this standard, the Supreme Court held that the forfeiture imposed on Bajakajian was grossly disproportional to the gravity of his offense, and thus violated the Excessive Fines Clause because [1493]

> Respondent's crime was solely a reporting offense. It was permissible to transport the currency out of the country so long as he reported it. Section 982(a)(1) orders currency to be forfeited for a "willful" violation of the reporting requirement. Thus, the essence of respondent's crime is a willful failure to report the removal of currency from the United States. Furthermore, as the District Court found, respondent's violation ***608** was unrelated to any other illegal activities. The money was the proceeds of legal activity and was to be used to repay a lawful debt. Whatever his other vices, respondent does not fit into the class of persons for whom the statute was principally designed: He is not a money launderer, a drug trafficker, or a tax evader ... And under the Sentencing Guidelines, the maximum sentence that could have been imposed on respondent was six months, while the maximum fine was $5,000.
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> * * *
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> The harm that respondent caused was also minimal. Failure to report his currency affected only one party, the Government, and in a relatively minor way. There was no fraud on the United States, and respondent caused no loss to the public fisc. Had his crime gone undetected, the Government would have been deprived only of the information that $357,144 had left the country.
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> * * *
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> Comparing the gravity of respondent's crime with the $357,144 forfeiture the Government seeks, we conclude that such a forfeiture would be grossly disproportional to the gravity of his offense. It is larger than the $5,000 fine imposed by the District Court by many orders of magnitude, and it bears no articulable correlation to any injury suffered by the Government.

[115] [116] [117] [118] [119] Thus, these cases—beginning with *Halper* and ending with *Bajakajian* —lay out a framework for how to apply the Excessive Fines Clause. In sum, to be constrained by the Excessive Fines Clause, a sanction must be (i) a fine, and (ii) excessive. [1494] A sanction is a "fine" if it is "payment to a sovereign as punishment for some offense." [1495] A payment is made "as punishment for some offense" when its purpose is —even in part—retribution or deterrence. [1496] A fine is excessive when it is "grossly disproportional to the gravity of the defendant's offense." [1497] In order to evaluate whether a fine is grossly disproportional to the gravity of a defendant's offense, courts should consider the *Bajakajian* factors, including: (i) the essence of the violator's wrongdoing and its relation to other illegal activity, (ii) whether the violator fits into the class of persons for whom the statute was principally designed, (iii) the nature of the harm caused by the violator's conduct, and (iv) the maximum non-forfeiture sentence and fine that could have been imposed. [1498]

b) Lower Courts' Interpretations of Supreme Court Precedent

The most recent of the Supreme Court cases just discussed, *Bajakajian,* was decided over fifteen years ago. Since *Bajakajian* was decided, lower courts have had ample opportunity to apply its holdings to monetary sanctions. Significantly, neither party has cited a case to the Court, nor has the Court been able to locate one through its own research, invalidating a non-forfeiture, legislative civil penalty under the Excessive Fines Clause. [1499] Indeed, ***609** the post-*Austin* and post-*Bajakajian* cases that the Court has reviewed largely counsel against a holding that the International Penalties are fines, [1500] or that they are excessive, as will be discussed below.

2. Are the International Penalties "Fines"?

[120] Various courts of appeals have categorically refused to extend *Austin* and *Bajakajian* into the realm of civil tax penalties. For example, in *McNichols v. C.I.R.*,[1501] McNichols forfeited all of the proceeds of his drug dealing to the United States.[1502] In addition, the IRS assessed fraud penalties against McNichols.[1503] The First Circuit held that the assessment of fraud penalties against McNichols on property that he had already forfeited to the government as a part of a criminal plea agreement was not a fine that could be limited by the Excessive Fines Clause, explaining that:[1504]

> Using *Austin* as a springboard, petitioner argues that the additions to the income tax were punitive, and that, by seizing his property and then subjecting that same property to an income tax along with penalties and interest, the IRS has violated the proportionality requirements of the Eighth Amendment. We decline to take the giant leap that petitioner urges for several reasons. First there is an insurmountable wall of tax cases, discussed *infra,* holding that the government has a right to do precisely what it has done here. Second, the instant case is a civil income tax not a forfeiture case as was *Austin.* And *Austin* does not directly or impliedly suggest that either its holding or statements to the effect that a forfeiture can be an excessive fine under the Eighth Amendment are or should be applicable to any actions other than forfeitures under 21 U.S.C. §§ 881(a)(4) and (a)(7). Nor, under the facts of this case, do we perceive any reason for applying the principles of *Austin* to petitioner. Petitioner agreed to the forfeiture. He stipulated to the tax court that he derived unreported taxable income in 1981 and 1982 from the sale of marijuana. The plea agreement warned petitioner that income tax might be due. Indeed, prior to signing the plea agreement, petitioner was sent a notice of deficiency assessing ***610** taxes and penalties for the years 1981 and 1982. The Supreme Court in *James v. United States,* 366 U.S. 213, 81 S.Ct. 1052, 6 L.Ed.2d 246 (1961) made an observation that applies to petitioner:
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> > We should not continue to confound confusion, particularly when the result would be to perpetuate the injustice of relieving embezzlers of the duty of paying income taxes on the money they enrich themselves with through theft while honest people pay their taxes on every conceivable type of income.
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> *Id.* at 221, 81 S.Ct. at 1056. We find no Eighth Amendment violations.

As is obvious from its decision, the First Circuit refused to read the *Austin* Court's definition of "fines" as encompassing civil tax penalties. The *McNichols* court also rejected an attempt to use *Halper* for the purpose of characterizing civil tax penalties as fines, stating that "[t]o use *Halper* as a base for vaulting into the tax arena would be to misapply the case and distort its holding."[1505] The *McNichols* court also noted—as does the IRS in its briefing here—that characterizing civil tax penalties as having the kind of punishment purpose that would make them fines under *Austin* runs counter to the Supreme Court decision in *Helvering v. Mitchell,*[1506] where the Court characterized additions to tax for fraud as remedial as opposed to punitive:[1507]

> The remedial character of sanctions imposing additions to a tax has been made clear by this Court ... They are provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud.

Holding that *Helvering v. Mitchell* was "the foundation stone" for "the wall of cases" that barred McNichols' Excessive Fines Clause defense, the First Circuit concluded that the *Helvering* Court's characterization of civil tax penalties as remedial meant that civil tax penalties are not fines, and that because they are not fines they are not subject to the Excessive Fines Clause's limitations.[1508]

While the Fifth Circuit has not spoken as directly as some of the other circuits on the issue of whether civil tax penalties can ever be "fines" under *Austin,* decisions of the Fifth Circuit that touch upon this issue also counsel against a holding that the International Penalties are fines. For example, in the context of a double jeopardy analysis, the Fifth Circuit noted that a civil penalty for failure to file an information return "is analogous to the fraud penalty at issue in *Helvering,*" and for that reason found the civil penalty for failure to file an information return to be remedial rather than punitive for double jeopardy purposes.[1509] The Fifth Circuit has also noted that *Austin* did not overrule an earlier Supreme Court decision—*Ingraham v. Wright* —where "the Court explicitly described the Eighth Amendment as being 'designed to protect those convicted of ***611** crimes.' "[1510] And, of course, both *Austin* and *Bajakajian* involved individuals who had been convicted of crimes, unlike the Debtors here.

As relevant here then, under *Austin,* a monetary sanction is a "fine" if it is "payment to a sovereign as punishment for some offense,"[1511] and a payment is made "as punishment for some offense" when its purpose is—even in part—retribution or deterrence.[1512] It is clear that the International Penalties have at least some deterrent purpose. The Joint Committee on Taxation explained in its report titled "General Explanation of Tax Legislation Enacted in the 104th Congress" that 26 U.S.C. §§ 6038, 6048, and 6677 were amended into their present forms because:

> The Congress was informed that certain U.S. settlors established foreign trusts, including grantor trusts, in tax haven jurisdictions. Income from such foreign grantor trusts was taxable on a current basis to the U.S. grantor, but the Congress understood that there was noncompliance in this regard. The Congress was concerned that the prior-law civil penalties for failure to comply with the reporting requirements applicable to foreign trusts established by U.S. persons had proven to be ineffective. *In order to deter noncompliance,* the Congress believed that it is appropriate to expand the reporting requirements relating to activities of foreign trusts with U.S. grantors or U.S. beneficiaries and to increase the civil penalties applicable to a failure to comply with such reporting requirements.[1513]

The "prior-law civil penalties" that the Joint Committee on Taxation described had been limited to a maximum of $1,000.[1514] Today, the penalty for each violation of § 6038 is $10,000.[1515] The penalty for violations of § 6048(b) is $10,000, or 5% of the gross value of the relevant ***612** trust's assets, whichever is greater.[1516]

The explanation of the Joint Committee on Taxation cited above indicates that the International Penalties are aimed at preventing—or deterring—the precise actions that the Wylys have engaged in here—*i.e.,* surreptitious transactions by U.S. taxpayers with foreign trusts on whose income tax should have been paid, and whose existence and taxability went undetected for many years, in part because reporting requirements were not followed. The International Penalties represent more than housekeeping requirements. As the IRS notes, the International Penalties "are connected to tax evasion."[1517] They operate to deter misconduct in an international sphere that, as the Joint Committee on Taxation pointed out, can be dominated by secrecy.[1518]

Under *Austin,* this deterrence factor weighs in favor of holding that the International Penalties have at least some punishment purpose, and are therefore fines that can be limited by the Excessive Fines Clause. However, there are also numerous factors that weigh against such a holding. Even the *Austin* Court noted—citing *Halper* —that in the ordinary case a small, fixed-penalty provision "can be said to do no more than make the government whole" and that such penalties are therefore remedial.[1519] Both *Austin* and *Bajakajian* were decided within the specific context of forfeitures that were imposed in connection with some crime.

The parties have not cited, nor has the Court located through its own research, a single case that holds that a tax penalty such as the International Penalties is a fine under the Excessive Fines Clause, let alone an excessive fine. As discussed above, most circuit courts that have considered the question of whether it is appropriate to treat tax penalties as fines under the Excessive Fines Clause have answered that question with a categorical "no," and the tax court has followed suit. The one circuit court that has left the door open to even the *possibility* of a tax penalty being treated as a fine under the Excessive Fines Clause has stated that such penalties could only be fines where "*no* remedial purpose" was served or where such penalties are "several times greater than necessary to achieve a remedial purpose."[1520] These courts rely on the Supreme Court's characterization of tax penalties as purely remedial in *Helvering v. Mitchell* as support for their analysis, an analysis that can be extended to the International Penalties.

Such a strong consensus among the circuit courts—as well as the tax court—that *Austin* and *Bajakajian* should not be extended into the tax realm counsels against ***613** treating the International Penalties as fines. Although the Fifth Circuit has not spoken as clearly on this issue as other courts, its precedent also counsels this result. The Fifth Circuit has specifically stated that a civil penalty for failure to file an information return "is analogous to the fraud penalty at issue in *Helvering"* and is thus purely remedial.[1521] The Fifth Circuit has also held that an administrative fine cannot be excessive as long as it "does not exceed the limits of the statute authorizing it."[1522] This statement leads to the inference that—under Fifth Circuit precedent—a non-forfeiture fine such as the International Penalties cannot violate the Eighth Amendment.

From this Court's perspective, a holding that the International Penalties are not fines is consistent with relevant Supreme Court precedent, including *Austin* and *Bajakajian.* First, both of those cases were decided within the narrow context of forfeitures related to crimes, and extending their holdings to the realm of civil tax penalties would be, as the First Circuit said, a "giant leap."[1523]

Second, when the Supreme Court disavowed the reasoning of *Halper* in *Hudson v. U.S.,* it observed that "all civil penalties have some deterrent effect."[1524] This observation makes sense. No one wants to pay a penalty, and thus the imposition of a penalty will always have at least *some* deterrent effect. But, this observation is in natural tension with *Austin's* statement that a "civil sanction that cannot fairly be said *solely* to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment, as we have come to understand the term."[1525] However, if *any* deterrent purpose is sufficient in order to declare a civil sanction to be punishment and therefore a fine, then all civil sanctions are necessarily punishment, and it therefore becomes unnecessary to evaluate whether a civil sanction is a "fine" under the Excessive Fines Clause. A court can simply proceed to analyze whether the civil sanction is excessive in every instance, because the answer to whether a particular civil sanction is a fine will always be "yes." This cannot be the proper result in light of the Supreme Court's decision in *Helvering v. Mitchell,* which declares civil tax penalties to be remedial. It also cannot be the proper result in light of the fact that *Austin* does not declare it unnecessary to analyze whether civil sanctions are fines, and the fact that *Bajakajian* declares that traditional, civil, *in rem* forfeitures as they were understood at the time the Eighth Amendment was enacted are not fines.[1526]

In sum, those courts that have been faced with the dilemma of how to apply an Excessive Fines Clause analysis to civil tax penalties have all arrived at largely the same answer—*i.e.,* civil tax penalties such as the International Penalties are not fines, and therefore the Excessive Fines Clause is not applicable to them. This Court likewise concludes that the International Penalties are not fines, adopting the reasoning of those courts.

*614 3. Alternatively, Are the International Penalties "Excessive?"

Alternatively, even if this Court concluded that the International Penalties are fines, lower court cases interpreting *Bajakajian* make strong arguments that fines such as the International Penalties under § 6677 can almost never be excessive. In *Bajakajian,* the Supreme Court held that in order to determine if a forfeiture is excessive, a court must: "compare the amount of the forfeiture to the gravity of the defendant's offense. If the amount of the forfeiture is grossly disproportional to the gravity of the defendant's offense, it is unconstitutional."[1527] Although decided prior to *Bajakajian,* the Fourth Circuit's observations in *Thomas*[1528] regarding percentage-based tax penalties are nevertheless still applicable here:

> Even assuming arguendo that the Excessive Fines Clause is implicated in this case, there is no basis for concluding that the $44,068 sanction is excessive. If the addition to tax is always calculated as fifty percent of the tax deficiency regardless of the means by which the income is accrued, the sanction could not be excessive as to one person, but not excessive as to another. All persons forced to pay additions to tax for

> civil fraud are treated in the same manner.

Moreover, the tax court agreed with the *Thomas* court's observation in a post-*Bajakajian* context in *Gorra v. C.I.R.*, [1529] noting that a civil tax penalty calculated as a percentage of an underpayment "could not be excessive to one person, but not excessive as to another" and that such a penalty by its nature "bears a relationship to the gravity of the offense that it is designed to remedy."

There is also a strong argument that a fixed-penalty provision such as the $10,000 fine assessed under § 6038 should rarely be considered excessive. The Supreme Court in *Halper* noted that "the Government is entitled to rough remedial justice, that is, it may demand compensation according to somewhat imprecise formulas, such as reasonable liquidated damages or a fixed sum plus double damages" without such a sanction being labeled as punishment. [1530] The *Halper* court also noted that its holding that a fixed-damages provision was punishment was a rule for the rare case. [1531] Indeed, it is telling that the Debtors have not cited to a case that declares a fixed, nonforfeiture, legislative fine such as the one imposed under § 6038 unconstitutional, nor has the Court been able to locate such a case through its own research.

Another factor counseling against declaring the International Penalties excessive here is that even in the realm of forfeitures—where offenders may be punished with a total surrender of property *on top of* the maximum statutory fine—courts have been reluctant to find that those forfeitures are "grossly disproportional." For example, in *U.S. v. Wallace,* [1532] the Fifth Circuit found that punishing a pilot for a simple failure to register his airplane by forcing him to forfeit that airplane was not a grossly disproportional fine. In arriving at this conclusion, the Fifth Circuit ***615** noted that the forfeiture was within the range of fines prescribed by Congress for the pilot's reporting violation, and that this created "a strong presumption ... that the forfeiture is constitutional." [1533]

The Eleventh Circuit explained the rationale for this conclusion in *U.S. v. 817 N.E. 29th Drive, Wilton Manors, Fla.*, [1534] where it noted that

> Translating the gravity of a crime into monetary terms—such that it can be proportioned to the value of forfeited property—is not a simple task. Fortunately for us, this task has already been performed by two very competent bodies. The first is Congress, which, in enacting criminal laws, has specified the maximum permissible fine for a given offense. Because Congress is a representative body, its pronouncements regarding the appropriate range of fines for a crime represent the collective opinion of the American people as to what is and is not excessive. Given that excessiveness is a highly subjective judgment, the courts should be hesitant to substitute their opinion for that of the people. Consequently, if the value of forfeited property is within the range of fines prescribed by Congress, a strong presumption arises that the forfeiture is constitutional.

The Eleventh Circuit also noted in *Wilton Manors* that "[i]t is important to remember that the Excessive Fines Clause was drafted in an era in which the amount of a fine was determined solely by the judiciary; the Clause was thus intended as a limitation on courts, not legislatures." [1535]

Here, the International Penalties represent the very maximum fine that the Fifth Circuit would use as a benchmark for assessing proportionality. Moreover, the Fifth Circuit in *Wallace* also noted that the pilot's violation was more serious than the one at issue in *Bajakajian,* as it was a continuing violation occurring over the course of seven years as opposed to a one-time violation. [1536] Finally, the *Wallace* court also considered the degree to which the pilot benefited from his violation. [1537]

Both *Wallace* and an additional Fifth Circuit case —*Newell Recycling Co., Inc. v. U.S. E.P.A.* [1538] —indicate that the Fifth Circuit would consider almost any fine that was within the statutory maximum to be non-excessive under the Excessive Fines Clause. In *Newell Recycling,* the Fifth Circuit held that "[n]o matter how excessive (in lay terms) an administrative fine may appear, if the fine does not exceed the limits prescribed by the statute authorizing it, the fine does not violate the Eighth Amendment."[1539] Although ***616** *Newell Recycling* was decided after both *Austin* and *Bajakajian,* it cites neither of these cases, which leads to an inference that the Fifth Circuit reads *Austin* and *Bajakajian* narrowly and to not apply outside of the context of forfeitures.[1540] If an administrative body's application of a maximum statutory fine is per se constitutional as the Fifth Circuit held in *Newell Recycling,* there is no reason to think that a court's application of a maximum statutory fine in a court proceeding would not also be per se constitutional.

a) As to Sam

[121] With these standards in mind, we turn to the International Penalties at issue here. According to the Computation Stipulations, Sam owes $427,614,822 in International Penalties related to failures to file Forms 3520–A and 5471.[1541] To reiterate, a fine is excessive when it is "grossly disproportional to the gravity of [Sam's] offense."[1542] And, in order to evaluate whether a fine is grossly disproportional to the gravity of Sam's offense, this Court is to consider the following factors: (i) the essence of Sam's wrongdoing and its relation to other illegal activity, (ii) whether Sam fits into the class of persons for whom the statute was principally designed, (iii) the nature of the harm caused by Sam's conduct, and (iv) the maximum non-forfeiture sentence and fine that could have been imposed.[1543] Sam has the burden of proof on the issue of excessiveness.[1544] For the reasons stated below and after analyzing the *Bajakajian* factors just identified, this Court finds that the International Penalties are not grossly disproportional to the gravity of Sam's offense, assuming that the International Penalties are fines.

First, it is important to note that the International Penalties are an inherently different type of penalty than the forfeitures at issue in *Austin* and *Bajakajian.* Unlike fixed penalty provisions such as the International Penalties, "forfeiture of property is a penalty that has absolutely no correlation to any damages sustained by society or to the cost of enforcing the law."[1545] Forfeitures thus have an inherent risk of disproportionality that is simply not present in the context of the International Penalties. Moreover, in *Bajakajian,* the Supreme Court pointed out that it was impossible to prove that the harm from Bajakajian's failure to report that he was taking $357,144 out of the country was "anywhere near 30 times greater than that caused by a hypothetical drug dealer who willfully fails to report taking $12,000 out of the country in order to purchase ***617** drugs."[1546] This conclusion was possible because the harm to the government—information loss—was not related to the amount of money at issue.

Here, that disconnect is lacking. Section 6677(b) penalizes United States persons who are treated as owners of foreign trusts under the Grantor Trust Rules.[1547] To the extent that a taxpayer is treated as an owner of a foreign trust, that trust's income is taxable to that United States person under 26 U.S.C. § 671. Thus, every dollar unreported by the United States taxpayer is also—in most instances, and especially in Sam's instance—a dollar untaxed, lending an inherent proportionality to penalties under § 6677(b).[1548] This analysis is in line with the Fourth Circuit's observation that penalties assessed on a percentage basis are inherently proportional.[1549] Indeed, the parties have not cited, nor has the Court located through its own research, a single case that has invalidated a percentage calculation penalty, such as the International Penalties assessed under § 6677, under the Excessive Fines Clause.

What is more, many courts—including the Fifth Circuit —have held that a forfeiture that involves property of a value that falls within the maximum statutory fine that could be imposed for the same offense is strongly presumed to be constitutional.[1550] These holdings lead to an inference that a fixed or percentage-based fine that falls within the statutory maximum is also strongly presumed to be constitutional.[1551] Here, there is no forfeiture involved, and the International Penalties themselves are the very maximum statutory fine that the Fifth Circuit and other courts would use as a benchmark to measure proportionality. Such an approach leaves this Court with little opportunity to declare that the International Penalties are grossly disproportional to the gravity of Sam's offense.

An assessment of the *Bajakajian* factors also leads the Court to the conclusion that the International

Penalties are not grossly disproportional as to Sam. The first *Bajakajian* factor—the essence of the violator's wrongdoing and its relation to other illegal activity [1552]—weighs against a finding that the International Penalties are grossly disproportional to the gravity of Sam's offense. Although Sam is liable for International Penalties as a result of "mere reporting offenses," the similarities to *Bajakajian* end there. Sam's reporting offense was very much related to other illegal activity—namely his decades long ***618** tax fraud and his violations of the securities laws. Indeed, as discussed above in the Court's reasonable cause and fraud analyses, Sam and his agents avoided reporting requirements such as those required by the International Penalties' provisions specifically in order to facilitate his tax fraud. [1553] Any need to file international reporting forms was of great concern to the Wyly family office, and Hennington in particular expressed a preference for transactions that did not come with reporting requirements [1554]—no doubt because of her principals' views.

Just as Sam avoided SEC reporting requirements by structuring the securities held in the offshore system so that no single entity held a reportable amount of stock in order to avoid an SEC position that was inconsistent with his tax position, Sam avoided filing Forms 3520–A and 5471 in order to conceal the extent of the Wyly offshore system and to avoid an IRS audit. [1555] Forms 3520–A and 5471 are information returns, and as the Joint Committee on Taxation noted in its report on §§ 6038, 6048, and 6677, they are necessary "because some of the jurisdictions in which U.S. settlors established foreign trusts have strict secrecy laws ... [that] may effectively preclude the Treasury Department from obtaining information necessary to determine the tax liabilities of the U.S. grantors or U.S. beneficiaries with respect to items related to such foreign trusts." [1556] Sam's lack of reporting was thus a key component of his tax fraud. All of these factors indicate that Sam's violation of a reporting requirement was thus, unlike the violation in *Bajakajian,* related to other illegal activity besides the reporting requirement itself.

The second *Bajakajian* factor—whether the violator fits into the class of persons for whom the statute was principally designed [1557]—also weighs against Sam. The International Penalties were designed in order to combat a very specific problem—*i.e.,* United States persons establishing foreign grantor trusts in tax haven jurisdictions and then failing to report the income from these trusts as taxable to them. [1558] Sam is a United States person who established multiple foreign trusts in a known ***619** tax haven. [1559] He then proceeded to not report the income from the grantor trusts as taxable income to him, which in turn led to an IRS audit, the filing of his Case here, and the filing of the Motion and Claim Objection in the Case. Sam falls squarely within the class of persons for whom the International Penalties statutes were designed. It is difficult to imagine an offender who "fits the mold" of the International Penalties better than Sam.

The third *Bajakajian* factor—the nature of the harm caused by the violator's conduct [1560]—also weighs against Sam. The *Bajakajian* Court noted that the reporting offense at issue there resulted in very little harm—the government was faced with a loss of information only, and there was no harm "to the public fisc." [1561] Here, the circumstances are starkly different. Sam's reporting failure allowed him to avoid paying hundreds of millions of dollars of tax liability, which in turn deprived the United States government of hundreds of millions of dollars of revenue, and which may now be more difficult for the government to collect given the passage of time and the dissipation of Sam's wealth. According to the Debtors' post-trial reply, Sam owes $121,193,181 in federal income tax liability for the years 1996 through 2013, the years at issue for which the IRS asserts International Penalties liability. [1562] This is a staggering amount of taxes to have failed to pay. As the Debtors point out, however, Sam's International Penalties liability for those same years is $427,614,822, which is more than three times his tax liability. [1563]

While interesting, Sam's argument lacks force. First, Sam has no one to blame but himself for the enormous amount of International Penalties he is liable for. As early as 1993, Sam's trusted agent, French, was made aware that there was a significant ***620** risk that the 1992 IOM trusts were grantor trusts as to Sam. This characterization of the trusts as grantor trusts, if correct, would change both the tax consequences of the trusts to Sam and Sam's reporting obligations. This knowledge is imputed to Sam under agency principles. [1564] Moreover, the factual predicates for the 1994 and 1995 IOM trusts being foreign grantor trusts as to King and Cairns were not satisfied, as Sam either knew or should have known. [1565] However, Sam chose to (i) ignore these problems, and (ii) fail to report his ownership interest in these offshore trusts on Form 3520–A or his ownership interest in the Foreign Corporations on Form 5471. As the years wore on and the International Penalties grew, so too did the magnitude of Sam's tax fraud, and therefore the magnitude of the harm caused by Sam's reporting violations.

Second, the harm caused by Sam's reporting violations should not be measured merely against the amount of Sam's tax liability. Sam should have paid the taxes he owes without the need for a lengthy audit and a multi-year federal court proceeding. Moreover, Sam had the use of the $121 million of income taxes he owed for the period that he failed to pay his tax obligation. Obviously, the ongoing harm of Sam's reporting violations—in addition to the base amount of taxes owed—is compounded by: (i) the time value of money lost by the government, (ii) the significant costs incurred by the government in pursuing Sam, (iii) the general blow to the integrity of the tax system caused by Sam's conduct, and (iv) the risk of collection the government now faces given the passage of time and the dissipation of Sam's assets. While the penalties assessed against Sam are vast, so too is the harm that he caused. Thus, the third *Bajakajian* factor weighs against a finding that the International Penalties are grossly disproportional to the gravity of Sam's offense.

The final *Bajakajian* factor—the maximum non-forfeiture sentence and fine that could have been imposed [1566]—also weighs against a holding that the International Penalties are grossly disproportional to the gravity of Sam's offense. This is because the International Penalties *are* one of the relevant, non-forfeiture fines that can be imposed against Sam. It is also noteworthy that the International Penalties under § 6677 have their own built-in maximum: [1567]

> At such time as the gross reportable amount with respect to any failure can be determined by the Secretary, any subsequent penalty imposed under this subsection with respect to such failure shall be reduced as necessary to assure that the aggregate amount of such penalties do not exceed the gross reportable amount (and to the extent that such aggregate amount already exceeds the gross reportable amount the Secretary shall refund such excess to the taxpayer).

For the purposes of Sam's violations of § 6048(b), "gross reportable amount" is defined as "the gross value of the portion of the trust's assets at the close of the year treated as owned by the United States person." [1568] Thus, a percentage-based penalty under § 6677 can never result in a ***621** penalty more severe than total forfeiture of all assets in the trust. [1569] This cap, which places an upper limit on the percentage-based penalty under § 6677, lends even more weight to the idea that a penalty under § 6677 is strongly presumed to be constitutional and that the International Penalties here are not grossly disproportional as to Sam.

For all of these reasons, even if the International Penalties are fines, they are not excessive fines as applied to Sam.

b) As to Dee

[122] According to the Computation Stipulations, Dee owes $277,312,325 in International Penalties related to failures to file Forms 3520–A and 5471. [1570] Dee's Eighth Amendment argument is more compelling than Sam's if the International Penalties are properly construed as fines. The analysis the Court is about to undertake is once again done in the alternative to its previous holding that the International Penalties are not fines to which the Eighth Amendment applies.

In assessing whether the International Penalties are grossly disproportional to the gravity of Dee's violation, the Court is guided by the Second Circuit's decision in *von Hofe v. U.S.* [1571] *von Hofe* is a forfeiture case, and it is one of the very few forfeiture cases that the Court found declaring the forfeiture of an individual's interest in a home to be an excessive fine under the Excessive Fines Clause. [1572] *von Hofe* involved a husband ("**Harold**") and a wife ("**Kathleen**") who each faced forfeiture of their one half interest in their marital home. [1573] Harold and Kathleen had both been convicted of drug offenses under Connecticut law as a part of a plea agreement. [1574] Harold was convicted of manufacturing and/or distributing a controlled substance and Kathleen was convicted of possession of a controlled substance.[1575] The government subsequently brought a civil *in rem* forfeiture action against the von Hofes, seeking forfeiture of their home.[1576]

This series of events came about because Harold had engaged in a relatively small-time marijuana cultivation operation in the couple's basement.[1577] Although a jury found that Kathleen was not an innocent owner who "did not know of the conduct giving rise to the forfeiture,"[1578] the district court found in a subsequent evidentiary hearing that she was not aware that anyone was selling marijuana in her home.[1579] The Second Circuit applied the *Bajakajian* factors, and held that "[b]ecause the extent of the forfeiture bears no correlation either with Mrs. von Hofe's minimal culpability or any harm she purportedly caused, the Excessive Fines Clause precludes forfeiture of her entire one-half interest in 32 Medley Lane."[1580] The Second Circuit noted that Kathleen's culpability was "best described as turning ***622** a blind eye to her husband's marijuana cultivation in their basement."[1581] In describing Kathleen's situation, the Second Circuit was candid:[1582]

> Mrs. von Hofe's offensive conduct boils down to her joint ownership of 32 Medley Lane and silence in the face of her husband's decision to grow marijuana in their basement almost thirty years into their marriage. And yet she is being punished as if she were distributing drugs, when the district court concluded as a matter of fact that she had no knowledge of any distribution or remuneration. The government cannot justify forfeiture of Mrs. von Hofe's interest in 32 Medley Lane, for the punishment bears no reasonable correlation either to her minimal culpability or any harm she caused.

The Second Circuit reached the opposite conclusion regarding Harold, holding that "Mr. von Hofe's lengthy and extensive involvement in the manufacture and distribution of marijuana from his basement, the seriousness of his offenses and their relationship to his other criminal activity, allow us to easily conclude that forfeiture of his one-half interest in 32 Medley Lane is not an excessive fine."[1583]

The key takeaway that this Court draws from *von Hofe* is the need to apply the *Bajakajian* factors in view of each offender's particular involvement in the relevant offense. For example, in assessing the harm factor against Dee, it is the harm caused *by Dee,* not the harm caused by the reporting failure in the abstract that is relevant. With this in mind, the Court applies the *Bajakajian* factors to Dee.

The first *Bajakajian* factor—the essence of the violator's wrongdoing and its relation to other illegal activity[1584]—weighs in favor of a holding that the International Penalties are grossly disproportional to the gravity of Dee's offense. Dee's violation of §§ 6038 and 6048 are simple reporting violations, which were not made to conceal other illegal activity on her part. As found previously, Dee lacked anything but the most basic knowledge regarding the offshore system throughout the period for which the IRS seeks to recover International Penalties.[1585] Dee did not commit tax fraud, she was not willfully blind, and she is entitled to the innocent spouse defense regarding her income tax underpayments. Dee's level of culpability is low; her biggest "offense" was trusting her husband of fifty plus years, which "offense," if it is one, is minor.

The second *Bajakajian* factor—whether the violator fits into the class of persons for whom the statute was principally designed[1586]—also weighs in favor of a holding that the International Penalties are grossly disproportional to the gravity of Dee's offense. The International Penalties were designed in order to combat the problem of United States persons establishing foreign grantor trusts in tax haven jurisdictions and failing to report the income from these trusts as taxable to them.[1587] Although Dee and Charles ***623** should have paid taxes and reported on the Charles and Dee International Penalty Trusts, Dee did not (i) cause those trusts to be established in tax haven jurisdictions, and (ii) make the decision to not (a) pay taxes on the trust income, or (b) file the required reporting forms. Dee relied entirely on Charles to handle all tax and business matters throughout their marriage.[1588] Dee has never prepared a tax return and never discussed tax matters with Charles.[1589] Dee testified that it was her practice to sign whatever tax return Charles gave her without reviewing it and without asking questions about it throughout their fifty plus year marriage.[1590] Unlike Kathleen in *von Hofe,* Dee did not "turn a blind eye" to Charles' and Sam's fraudulent activities.[1591] The record shows that Dee had no knowledge of, and was not engaged in, their fraudulent activities. For these reasons, Dee does not fit into the class of persons for whom the International Penalties were principally designed.

The third *Bajakajian* factor—the nature of the harm caused by the violator's conduct[1592]—also weighs in favor of a holding that the International Penalties are grossly disproportional to the gravity of Dee's offense. Dee's reporting violations did cause harm. It facilitated Charles' tax fraud. However, as did the Second Circuit in *von Hofe,* the Court here finds it significant that Dee was in no sense the engine that drove these reporting failures. As the Court discussed in its assessment of the first two *Bajakajian* factors, Dee had no knowledge of, and did not participate in, Charles' tax fraud. The harm that Dee herself caused was minimal.

The final *Bajakajian* factor—the maximum non-forfeiture sentence and fine that could have been imposed against Dee, does weigh against a holding that the International Penalties are grossly disproportional to the gravity of Dee's offense. As with Sam, the International Penalties are the relevant, non-forfeiture fines that can be imposed against Dee.

After assessing the *Bajakajian* factors as they apply to Dee, this Court concludes that the International Penalties —both under §§ 6038 and 6677—are excessive fines as to Dee. In spite of its general concerns about finding a percentage-based or flat fine (such as the International Penalties) excessive, the Court cannot ignore the extent to which the *Bajakajian* factors favor Dee. Of course, one last reminder, this conclusion that the International Penalties as applied to Dee are excessive fines under the Eighth Amendment is an alternative conclusion to an alternative conclusion. The Court's primary conclusions are that: (i) Dee is not liable for International Penalties because she established her reasonable cause defenses, and (ii) the International Penalties are not "fines" under the Excessive Fines Clause. The Court's conclusion that the International Penalties are excessive as to Dee is only reached if one or both of its other conclusions are held to be in error.

***624** J. Do the Equitable Doctrines of Laches or Estoppel Apply Here, or Does the Court have Discretion Regarding the Assessment of Taxes or Penalties Against the Debtors?

1. Does Laches Apply Here?

[123] **[124]** The Debtors argue that those IRS claims that are not barred by a statute of limitations should be barred by laches. Laches is an equitable defense,[1593] and thus the Debtors have the burden of proving that it applies. The Court rejects the Debtors' argument that laches should bar the IRS' claims for three reasons: (i) many of the IRS' claims are subject to express statutes of limitation that then preclude the application of laches, (ii) there is strong precedent indicating that the doctrine of laches may not be asserted against the United States in order to prevent the collection of taxes and tax penalties, and (iii) even if the doctrine of laches is applicable here, the Debtors' failed in their proof to establish its required elements. Each reason is explained below.

While the Debtors state that the Fifth Circuit's decision in *Sage v. U.S.*[1594] supports their position that the doctrine of laches applies here, their reliance on this case is misplaced. *Sage's* holding was that the bringing of an action by the IRS to collect penalties under 26 U.S.C. § 6700 is not subject to any statute of limitations.[1595] In reaching this conclusion, the *Sage* court noted that the doctrine of laches could still, potentially, curb the IRS' penalty assessment power under § 6700.[1596] The idea that laches could apply to an IRS claim not subject to any express statute of limitations is of no moment here. That is because the IRS' claims for taxes here are subject to a specific statute of limitations—*i.e.,* 26 U.S.C. § 6501.[1597] As relevant ***625** here, this explicit statute of limitations is kept open by §§ 6501(c)(1) and/or (c)(8).[1598] As the Supreme Court noted in *Petrella v. Metro–Goldwyn–Mayer, Inc.,*[1599] there is no case where the Supreme Court "has approved the application of laches to bar a claim for damages brought within the time allowed by a federal statute of limitations." Thus, to the extent that a statute of limitation exists for the IRS' claims here, and the claims are brought within that limitations period, the application of the equitable doctrine of laches is not appropriate.

Even if all of the IRS' claims here were not subject to an express statute of limitation, Fifth Circuit precedent has also clearly established that the doctrine of laches may not be invoked by taxpayers in order to prevent the IRS from collecting taxes or penalties. In discussing whether a debtor in bankruptcy could invoke the doctrine of laches in order to prevent the IRS from collecting taxes and penalties, the Fifth Circuit stated in *In re Fein* :[1600]

> We need not reach the substantive issue of whether the circumstances of this case are appropriate for the invocation of laches, as laches "may not be asserted against the United States when it is acting in its sovereign capacity to enforce a public right or protect the public interest." *See United States v. Popovich,* 820 F.2d 134, 136 (5th Cir.), *cert. denied,* 484 U.S. 976, 108 S.Ct. 487, 98 L.Ed.2d 485 (1987). The timeliness of government claims is governed by the statute of limitations enacted by Congress. *See United States v. Summerlin,* 310 U.S. 414, 416, 60 S.Ct. 1019, 1020, 84 L.Ed. 1283 (1940); *Chevron, U.S.A., Inc. v. United States,* 705 F.2d 1487, 1491 (9th Cir.1983). Fein admits that the government timely asserted the federal tax liabilities.

The Fifth Circuit has relied upon this well-known rule in multiple situations where the United States sought to collect outstanding tax deficiencies.[1601] The Fifth Circuit's conclusions in those cases are based on the Supreme Court's observations ***626** in *U.S. v. Summerlin*[1602] that "[i]t is well settled that the United States is not bound by state statutes of limitation or subject to the defense of laches in enforcing its rights."

It is beyond dispute that the United States is enforcing its own rights when it seeks to collect taxes and penalties, as it is doing here. As the Seventh Circuit noted in *U.S. v. Administrative Enterprises, Inc.,*[1603] "[t]here is no better illustration of the enforcement of a sovereign right than the use of compulsory process to determine liability for unpaid taxes." In addition, the Fifth Circuit affirmed, albeit in an unpublished opinion, a tax court decision that held that the doctrine of laches did not prevent the IRS from assessing taxes or penalties where "section 6501(c)(1), which we have determined to be applicable, expressly authorizes respondent to assess deficiencies against petitioner 'at any time.' "[1604]

Since the doctrine of laches may not be used in order to bar the United States from collecting taxes, the Debtors' defense of laches cannot succeed.

Alternatively, even if the doctrine of laches was applicable here, the Debtors have failed in their proof. Under Fifth Circuit precedent, "[t]o establish that a cause of action is barred by laches, the defendant must show (1) a delay in asserting the right or claim; (2) that the delay was not excusable; and (3) that there was undue prejudice to the defendant."[1605] The Debtors state the allegations that underlay their laches defense in their pre-trial briefing:

> The [IRS] claims are extremely late; they were filed a dozen years after attorney Charles Lubar met on behalf of the Wylys with senior IRS officials in Washington in August 2003, in which meeting the IRS advised that it was going to appoint a "champion" to address and resolve all offshore-related issues not only with the IOM trusts related to the Wylys but also any other similarly situated taxpayers' trusts, and after the Wylys had first included Form 8275 in their annual tax returns. The claims come eleven years after the IRS commenced audits of Charles and Sam's 2000 returns in early 2004, and nine years after a Senate investigation made public the same facts on which the IRS relies; and four years after a key witness, Charles Wyly, died. The delay is not excusable and it has prejudiced the Debtors, subjecting the IRS Proofs of Claim, not to limitations, but to the defense of equitable laches; and the Debtors so assert.[1606]

Putting aside for the moment the fact that the Debtors lump together all of the tax years for which the IRS has filed a Proof of Claim as if the delay alleged was equal for all of the years at issue (which it is not), the Debtors have presented no evidence that an eleven-year period between the commencement of an audit and the filing of a proof of claim constitutes an ***627** inexcusable "delay" under the unique facts of these Cases. As the Court has noted many times, these are fraud cases of incredible complexity. A cursory examination of civil tax fraud cases show that multi-year delays between the commencement of an IRS investigation and a tax court decision are not uncommon, even in run-of-the-mill cases.[1607] That these Cases—which all parties acknowledge are unusually complex—should take longer than "normal" to proceed from audit to decision is not remarkable.

This same complexity makes the IRS' delay—if in fact it has delayed—excusable. The Cases involve dozens of offshore entities that engaged in a myriad of complicated financial transactions that were designed—by the Wylys and their sophisticated advisors—to be difficult to unravel.[1608] That the IRS took time to investigate the Wylys' offshore system and the transactions undertaken offshore was—far from being an inexcusable mistake—probably the most prudent course. Moreover, that the IRS would await the outcome of the SEC Action in the SDNY Court is also not terribly surprising, as the same offshore trusts and corporations were at issue there too, at least in large part.

Finally, the Debtors have failed to show that the IRS' supposedly inexcusable delay has unduly prejudiced them. Although the Debtors allege that Charles was a key witness, they fail to point to any additional facts or insights that Charles would have provided here that Sam or Evan was not capable of providing. The evidence presented at trial shows that Sam and Charles largely moved in lockstep with respect to their respective offshore systems and the transactions undertaken through them. In fact, from the mountain of evidence presented at trial, it appears to this Court that Sam was the instigator of moving Wyly wealth offshore and that Charles simply followed in his brother's footsteps. In short, the Debtors' failed to offer any evidence to support their argument that Charles' passing has unduly prejudiced them. If anything, Charles' passing may have strengthened Dee's other defenses, as there is no witness available to question her testimony about what Charles and she discussed throughout their marriage.

For all of these reasons, the Debtors' defense of laches fails.

2. Does Estoppel Apply Here?

[125] [126] [127] The Debtors also assert that estoppel should bar the IRS' claim(s) again them. Estoppel is an equitable doctrine, and it may be invoked in order to avoid injustice in a particular case.[1609] According to the Fifth Circuit, a party seeking to establish estoppel against the United States must prove five things:

> (1) affirmative misconduct by the government, (2) that the government was aware of the relevant facts and (3) intended its act or omission to be acted upon, (4) that the party seeking estoppel had no knowledge of the relevant facts and (5) reasonably relied on the government's conduct and as a result of his reliance, suffered substantial injury.[1610]

***628** The first element, affirmative misconduct, is unique to instances where the party against whom estoppel is sought is the government. The Fifth Circuit has noted that "[c]ourts have been exceedingly reluctant to grant equitable estoppel against the government."[1611] In fact, it appears to be an open question in the Fifth Circuit whether equitable estoppel may *ever* be applied against the government.[1612] What is known is that "the rarity of this remedy means that the burden that a petitioner must meet is very high."[1613]

There are strong policy reasons underlying courts' reluctance to apply equitable estoppel against the government. As the Supreme Court has pointed out:

> When the Government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined. It is for this reason that it is well settled that the Government may not be estopped on the same terms as any other litigant.[1614]

In terms of when it might be appropriate to apply equitable estoppel against the government, the Fifth Circuit and the Supreme Court agree that "estoppel might be appropriate when the public interest in ensuring that the Government can enforce the law free from estoppel is outweighed by the countervailing interest of citizens in some minimum standard of decency, honor, and reliability in their dealings with their Government."[1615] And, although certain ***629** courts have applied estoppel in order to restrain the IRS from collecting tax penalties, the Debtors' situations do not present the sort of extreme case where the application of estoppel against the government is appropriate.

[128] Here, the Debtors have failed in their proof. Specifically, the Debtors have not proven the first element of their estoppel defense against the government—*i.e.,* that the IRS engaged in any affirmative misconduct. The Debtors allege that estoppel should apply here for largely the same reasons that they believe that laches should apply—because of "the IRS's failure to act during its interminable auditing process."[1616] However, the Fifth Circuit has held that "affirmative misconduct is something more than merely negligent conduct."[1617] Indeed, the Fifth Circuit has clearly stated that "to state a cause of action for estoppel against the government, a private party must allege more than mere negligence, delay, inaction, or failure to follow an internal agency guideline"[1618] and that "[a]ffirmative misconduct requires an affirmative misrepresentation or affirmative concealment of a material fact by the government."[1619] Since the IRS' alleged failure to act here is simply its delay in acting and not an affirmative misrepresentation or affirmative concealment, it cannot qualify as affirmative misconduct.

The only conduct that the Debtors' arguably point to that could potentially qualify as an affirmative misrepresentation or affirmative concealment by the IRS is that allegedly "the IRS advised that it was going to appoint a 'champion' to address and resolve all offshore-related issues not only with the IOM trusts related to the Wylys but also any other similarly situated taxpayers' trusts."[1620] However, the evidence does not establish that the IRS ever definitively advised the Wylys that it was going to appoint such a champion. Notes taken by a Wyly lawyer during the anonymous meeting where the IRS supposedly ***630** made the representation that it would appoint an issue champion also indicate that the IRS' lawyers who were present at the meeting made it clear that they had no authority to settle the taxpayers' claims, especially on an anonymous basis, and that they would have to defer to their client—the IRS.[1621] Even taking a single line of these notes out of the context of multiple other portions of the notes where the IRS' lawyers indicated their lack of authority to settle, this alleged statement hardly amounts to an affirmative misrepresentation or affirmative concealment.[1622] The Debtors have not offered any evidence that IRS personnel or lawyers were lying or concealing facts when they allegedly stated that they were going to appoint an issue champion. It is just as plausible—if not more plausible—to infer that the idea of appointing an issue champion to resolve the offshore tax issues of the Wylys and other similarly situated taxpayers simply never panned out, as it is to infer that the IRS was making an affirmative misrepresentation or affirmatively concealing facts when its lawyer allegedly stated that an issue champion would be appointed.

Furthermore, a rebuttal witness called by the IRS who attended the anonymous meeting in August 2003, Danielle Grimm ("**Grimm**"), specifically denied that it was ever represented at that meeting that an issue champion would be appointed.[1623] Given that the Wyly lawyer who took the notes did not testify at trial and that Grimm did, the Court doubts that there was ever anything approaching an explicit promise to appoint an issue champion made by anyone who attended the meeting on behalf of the IRS. Even if there was, neither such an explicit promise nor the mere fact of the IRS' delay amount to the kind of affirmative misconduct necessary to satisfy the first element necessary to estop the government.

Moreover, it is also important to remember that cases on equitable estoppel against the government generally state that the government can only be bound by the acts or statements of its agents that are within the scope of those agents' authority.[1624] In other words—as the Fifth ***631** Circuit has explained—"courts have insisted that any estoppel against the government result from a representation of an official acting within the scope of her official authority, thus implying that the concept of apparent authority does not apply in the case of a government estoppel."[1625] Indeed, the Fifth Circuit has specifically noted that "the government cannot be bound by unauthorized or incorrect statements of its agents."[1626] Thus, even if the IRS lawyers who attended the August 2003 meeting did in fact unequivocally state that an issue champion would be appointed to resolve the Wylys' tax issues, the IRS could not be estopped by such a statement if that promise was not within the scope of those IRS lawyers' authority. As Grimm testified, and as the notes from the meeting indicate, no one present at the meeting had the authority to appoint an issue champion.[1627] Thus, even if someone at the meeting had explicitly asserted that the IRS was going to appoint an issue champion, the lack of authority of anyone at the meeting to take that step would prevent the application of estoppel against the IRS here.[1628]

***632** While it is clear that the Debtors have failed to prove that the IRS engaged in the kind of affirmative misconduct that is necessary to estop it here, Debtors have also failed to prove other of the more traditional elements of estoppel. For example, the Debtors have not proven the third element of estoppel—*i.e.,* that the government intended its act or omission to be acted upon—or the fifth element of estoppel—*i.e.,* that the Debtors reasonably relied on the government's conduct and, as a result of their reliance, suffered substantial injury. The Debtors' attempt to compare the IRS' silence after the August 2003 meeting and the commencement of the audit of Sam's and Charles' 2000 tax returns in February 2004 to the facts of *Fredericks v. C.I.R.*[1629] is unavailing, as explained below.

In *Fredericks,* the taxpayer ("**Fredericks**") filed a form consenting to an unlimited extension of the statute of limitations for the assessment of taxes.[1630] Fredericks was then told by the IRS that this unlimited extension form was never received, and subsequently submitted (at the IRS' request) numerous forms consenting to a series of 1–year extensions of the statute of limitations.[1631] Sometime before the Fredericks' final 1–year extension expired, the IRS discovered that it actually did have the unlimited extension form, but did not inform Fredericks of this fact.[1632] The IRS allowed the final 1–year form to expire, and then proceeded to rely on the unlimited extension form (which as far as the Fredericks knew the IRS had never received) to investigate Fredericks for another 8 years and eventually assess tax deficiencies, interest, and penalties.[1633] It is important to note that the unlimited extension form could have been revoked by Fredericks, had Fredericks in fact known that the IRS had received an unlimited extension form from him.[1634]

Moreover, in *Fredericks,* the IRS used silence for the specific purpose of creating a misapprehension of the facts in the mind of the taxpayer.[1635] As just noted, had Fredricks known that the IRS had received the unlimited extension form, he could have revoked that form at any time and prevented the IRS from continuing its investigation.[1636] In order to prevent this ***633** from happening, the IRS lied by omission to Fredericks so that it could continue its investigation.

Here, however, there is simply no evidence that the IRS intended to cause the Wylys to take any action one way or the other as a result of its lawyers' alleged representations at the August 2003 meeting or due to the time it took to conduct its audit of Sam's and Charles' tax returns. In the first place, there is no evidence that the IRS knew at the time of the August 2003 meeting with Lubar that it was speaking with a Wyly representative.[1637] It is difficult to imagine how the IRS could attempt to induce the Wylys to refrain from taking action without knowing that the Wylys were even involved. Furthermore, Grimm testified that no one at the IRS has ever told a taxpayer's representative to continue on as they were until an issue champion was appointed.[1638] It is equally implausible to infer that the IRS intended—through auditing the Wylys for an extended period—to induce the Wylys to continue in their use of the offshore system and thereby cause interest and penalty amounts to increase due to the passage of time. Had the Wylys chosen to unwind the offshore system in the face of an IRS audit and repatriate the offshore assets, as French did even without an IRS audit, the IRS—far from being disappointed that its supposed scheme to inflate interest and penalty amounts had been thwarted—doubtless would have been thrilled that the offshore assets were now in the United States and subject to its claims. Thus, there is no credible evidence that the third element of estoppel—that the government intended its act or omission to be acted upon—is satisfied here.

Similarly, there is no evidence that the fifth element of estoppel—that the Debtors reasonably relied on the government's conduct and as a result of their reliance, suffered substantial injury—is satisfied here. This is because there is no evidence that the Wylys' actions were influenced in any way by the IRS' conduct at the August 2003 meeting or over the course of the audit. The basic structure of the offshore system has not changed since its inception. The idea that Sam and Charles—who are/were incredibly sophisticated businessmen and who have/had the advantage of incredibly sophisticated counsel—could reasonably rely on the fact that the IRS indicated it might appoint an issue champion and that the IRS had begun auditing the offshore system to continue on their present course without change defies common sense. If anything, these facts—which so clearly indicated that the IRS thought there was something amiss with the offshore system—should have caused Sam and Charles to consider unravelling the offshore system or at least start reporting based upon the potential that the reporting was required. Had Sam and Charles taken this step, much of the sting of the IRS' so-called delay would be removed, as almost ten years' worth of taxes, fraud penalties, and International Penalties would not be in dispute today. As the Supreme Court has pointed out: "the party claiming the estoppel must have relied on its adversary's conduct in such a manner as to change his position for the worse [,] and ***634** that reliance must have been reasonable in that the party claiming the estoppel did not know nor should it have known that its adversary's conduct was misleading."[1639] The Debtors have not changed their position in any way in reliance on the IRS, and the blame for any increase in interest and penalty amounts due to the passage of time is most properly placed on Sam and Charles, rather than the IRS.[1640]

The Debtors have also not proven the second and fourth elements of estoppel. The second element of estoppel is that the government was aware of the relevant facts and the fourth element of estoppel is that that the party seeking estoppel had no knowledge of the relevant facts.[1641] When the *Fredericks* court found that equitable estoppel could be applied against the IRS, it noted that "[t]he IRS was the only party with knowledge of all the facts in this case."[1642] Here, the situation is almost entirely reversed. At the August 2003 meeting, the Wylys did not even reveal their identities, let alone all of the relevant facts surrounding their offshore system.[1643] The details surrounding the offshore system were only revealed to the IRS over the course of the audit process and litigation in this Court, and were at all times known to the Wylys. The information imbalance present in these Cases—far from presenting a case for estoppel—explains why the IRS' audit process took so long, as there were many facts about the offshore system that were known to the Wylys but unknown to the IRS, and it took a long time for all of these facts to come to light. Thus, the second and fourth elements of estoppel against the government are not satisfied.

Because the Debtors have not satisfied any of the elements necessary for the Court to invoke the rare remedy of estopping the government, the Court rejects the Debtors' estoppel defense.

3. Does the Court have Discretion to Alter the Penalty Amounts?

[129] Although the Joint Pre–Trial Order filed by the parties indicates that one of the issues to be resolved is "[w]hether the Bankruptcy Court has discretion regarding the assessment or amounts of any penalty sought by the IRS," this issue does not appear to be discussed in any of the Debtors' briefing or in their proposed findings of fact and conclusions of law.[1644] Happily, this issue is easily resolved; finally, an easy one. The Fifth Circuit has specifically held in a tax context that "equity will not bar the imposition of a statutory penalty"[1645] and more generally that "there is no inherent power for the judiciary to mitigate congressionally-mandated penalties."[1646] As the Supreme Court observed long ago, to hold otherwise would be to violate one of the most basic elements of the principle of Separation of Powers—*i.e.,* that the judiciary must interpret ***635** the laws as Congress has written them.[1647]

For these reasons, the Court has no discretion to modify the penalties Congress imposed by statute on the Wylys in these Cases.

K. Suspension of Interest Under 26 U.S.C. § 6404(g)

The Debtors also argue that they are entitled to mandatory interest suspension for tax years 1998 through 2010[1648] in accordance with 26 U.S.C. § 6404(g), which provides as follows:

> (g) Suspension of interest and certain penalties where Secretary fails to contact taxpayer.—

(1) Suspension.—

> (A) In general.—In the case of an individual who files a return of tax imposed by subtitle A for a taxable year on or before the due date for the return (including extensions), if the Secretary does not provide a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability before the close of the 36–month period [1649] beginning on the later of—
>
> > (i) the date on which the return is filed; or
> >
> > (ii) the due date of the return without regard to extensions,
> >
> > the Secretary shall suspend the imposition of any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return which is computed by reference to the period of time the failure continues to exist and which is properly allocable to the suspension period.
>
> (B) Separate application.—This paragraph shall be applied separately with respect to each item or adjustment.
>
> If, after the return for a taxable year is filed, the taxpayer provides to the Secretary 1 or more signed written documents showing that the taxpayer owes an additional amount of tax for the taxable year, clause (i) shall be applied by substituting the date the last of the documents was provided for the date on which the return is filed.

According to the Debtors: (i) both Sam and Dee timely filed their 1998 through 2010 tax returns, as stipulated by the parties, [1650] and (ii) prior to the IRS filing its Proofs of Claim, the Debtors were never provided with the notice referenced in § 6404(g)(1)(A); thus, they are entitled to **mandatory** suspension of interest for the relevant years.

***636** The IRS disagrees, arguing that mandatory interest suspension under § 6404(g) does not apply (i) because the "return of tax" referenced in § 6404(g)(1)(A) is a Form 5471 [1651] that was never filed (so that interest suspension was never triggered), (ii) to any gross misstatement of income, [1652] and/or (iii) to cases involving fraud. [1653] The IRS further argues that, in any event, this Court lacks jurisdiction to consider interest suspension under § 6404(g) based upon the mandates of 26 U.S.C. § 6404(h), as interpreted by the Supreme Court in *Hinck v. U.S.* [1654] and the tax court in *Corbalis v. C.I.R.* [1655] Because the latter two arguments are dispositive of this issue, the Court will address the IRS' arguments in reverse order.

1. This Court has Jurisdiction to Determine the Amount of Interest Payable by the Debtors, Including Whether the Debtors Are Entitled to Mandatory Interest Suspension under 26 U.S.C. § 6404(g)

[130] Before turning to the IRS' argument that this Court lacks jurisdiction, it is helpful to understand the process involved when a taxpayer believes he is entitled to interest suspension under 26 U.S.C. § 6404(g). As explained in Revenue Procedure 2005–38: [1656]

> taxpayers may notify the Service that interest was assessed in violation of section 6404(g) by submitting Form 843, "Claim for Refund and Request for Abatement." Taxpayers should write "Section 6404(g) Notification" at the top of the Form 843. The Service will review the Form 843 notification, decide whether to abate interest under section 6404(a), and notify the taxpayer of its decision. Because section 6404(g) is an interest suspension provision, rather than an interest abatement provision, and because section 6404(b) generally bars claims for abatement with respect to income tax, the notification to the taxpayer of the Service's abatement determination does not constitute a final determination letter from which the taxpayer can petition the Tax Court under section 6404(h). [1657]
>
> If the Service does not exercise its authority under section 6404(a) to abate interest alleged to have been assessed in violation of section 6404(g), the taxpayer may pay the disputed interest assessment, file an administrative claim for refund and, if that claim is denied or not acted upon within six months from the date of filing, bring suit for refund under section 7422 and 28 U.S.C. § 1346(a)(1).

Returning to the statute, 26 U.S.C. § 6404(h) provides that:

> [t]he Tax Court shall have jurisdiction over any action brought

> by a taxpayer who meets the requirements referred to ***637** in section 7430(c)(4)(A)(ii) [providing net worth limitations] to determine whether the Secretary's failure to abate interest under this section was an abuse of discretion, and may order an abatement, if such action is brought within 180 days after the date of the mailing of the Secretary's final determination not to abate such interest.

The Supreme Court interpreted 26 U.S.C. § 6404(h) in the case of *Hinck v. U.S.*,[1658] where it held that the tax court has exclusive jurisdiction to review the IRS' refusal to abate interest under 26 U.S.C. § 6404(e)(1):

> [Section 6404(h)] is a precisely drawn, detailed statute that, in a single sentence, provides a forum for adjudication, a limited class of potential plaintiffs, a statute of limitations, a standard of review, and authorization for judicial relief. And Congress enacted this provision against a backdrop of decisions uniformly rejecting the possibility of any review for taxpayers wishing to challenge the Secretary's § 6404(e)(1)[1659] determination. Therefore, despite Congress's failure explicitly to define the Tax Court's jurisdiction as exclusive, we think it quite plain that the terms of § 6404(h)—a precisely drawn, detailed statute filling a perceived hole in the law—control all requests for review of § 6404(e)(1) determinations. Those terms include the forum for adjudication.

In *Corbalis v. C.I.R.*,[1660] the tax court was faced with the issue of whether § 6404(h) applied equally to § 6404(e), as addressed in *Hinck,* and § 6404(g). The tax court held that § 6404(h) applies equally to both subsections, finding that: (i) because § 6404 is titled "Abatements," a claim for suspension of interest under § 6404(g) was the logical equivalent of a claim for abatement under § 6404(e), and (ii) there was no reason for nondiscretionary acts under § 6404(g) ("the Secretary shall suspend") to be less susceptible to judicial review than discretionary acts under § 6404(e)(1) ("the Secretary may abate").

According to the IRS, the reasoning in *Hinck* and *Corbalis* applies equally here, leaving the tax court with exclusive jurisdiction to consider the Debtors' claims for interest abatement under § 6404(g). As explained below, this Court disagrees.

Notably, both *Hinck* and *Corbalis* are procedurally distinct from the Cases. There, the taxpayers requested abatement or suspension, and the IRS issued a final ***638** determination as required by the statute. It was the request/refusal process that implicated § 6404(h) and judicial review by the tax court to determine whether the IRS abused its discretion. Here, there is nothing in the record showing that (i) the Debtors filed a Form 843, or (ii) that the IRS mailed a "final determination" refusing to suspend interest. Thus, this Court has not been placed into a position where it must review the IRS' decision for an abuse of discretion. Simply put, the statutory prerequisites to § 6404(h) have not been met, and the statute does not apply to the facts of the Cases.[1661]

Instead, from this Court's perspective, the relevant statute is 11 U.S.C. § 505(a), which states in relevant part:

> (a)(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.
>
> (2) The court may not so determine—
>
>> (A) the amount or legality of a tax, fine, penalty, or addition to tax if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title[.]

As explained by the Fifth Circuit in *In re Luongo,*[1662] § 505(a) is a "broad grant of jurisdiction" and "absent the express statutory limitations in § 505(a)(2)(A) and

(B), bankruptcy courts have universally recognized their jurisdiction to consider tax issues brought by the debtor, limited only by their discretion to abstain." Thus, based upon the facts of the Cases and the jurisdiction conferred under 11 U.S.C. § 505(a), this Court concludes that it has jurisdiction to determine the proper amount of interest payable by the Debtors, including whether the Debtors are entitled to mandatory interest suspension under 26 U.S.C. § 6404(g).

2. Mandatory Suspension of Interest Does Not Apply in Any Case Involving Fraud, Precluding Suspension for Sam in the Relevant Years

[131] As set forth in 26 U.S.C. § 6404(g)(2)(B), interest suspension shall not apply to "any interest, penalty, addition to tax, or additional amount in a case involving fraud." As explained by the Code of Federal Regulations,[1663] suspension:

> does not apply to any interest, penalty, addition to tax, or additional amount for a year involving a false or fraudulent return. If a taxpayer files a fraudulent return for a particular year, paragraph (a) [suspension] of this section may apply to any other tax year of the taxpayer that does not involve fraud. Fraud affecting a particular item on a return precludes paragraph (a) of this section ***639** from applying to any other items on that return.

Although few courts have addressed the meaning of "fraud" in relation to § 6404(g), those addressing it have interpreted the term consistent with its use in other portions of the statute:[1664]

> The dispute underlying this motion is whether Sala's return is a "case involving fraud" under § 6404(g). While no court has addressed fraud under this statute, it is well established that the Government must prove fraud in other parts of the tax code by clear and convincing evidence. *Upshaw's Estate v. C.I.R.,* 416 F.2d 737, 741 (7th Cir.1969); *Hebrank v. C.I.R.,* 81 T.C. 640, 642, 1983 WL 14880 (1983); *Petzoldt v. C.I.R.,* 92 T.C. 661, 699, 1989 WL 27845 (1989). I conclude that the Government's burden of proof under 6404(g) is also clear and convincing evidence.

Thus, to the extent that this Court has found fraud in existence for any given tax year, interest suspension under § 6404(g) is not available for any item on the return.

With respect to Sam, the Court has found fraud in each of tax years 1998 through 2010, the years for which Sam claims to be entitled to interest suspension under § 6404(g).[1665] Thus, the Court concludes that Sam is not entitled to the suspension of interest under 26 U.S.C. § 6404(g) for any of these tax years.

3. Interest Suspension is Moot as to Dee Because She Did Not Commit Tax Fraud and She is Entitled to Innocent Spouse Relief from the Income Tax Underpayments to Which § 6404(g) Interest Suspension Would Apply

[132] Section 6404(g) states that "[i]n the case of an individual who files a return of tax imposed by subtitle A [titled "Income Tax"] ... the Secretary shall suspend the imposition of any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return which is computed by reference to the [relevant time period]." On its face, § 6404(g) applies only to income tax-related interest, penalties, additions to tax, or additional amounts. And, as previously found, Dee did not commit fraud[1666] and, because of the success of her innocent spouse defense, Dee is not liable for subtitle A income tax underpayments alleged by the IRS in its Proof of Claim in any year when interest suspension would apply. Thus, interest suspension is moot as to her.

V. CONCLUSION

Although there were numerous other issues to be addressed (as is obvious from our over 400–page opinion), the heart of the Motions largely boiled down to the Court answering two questions. First, did Sam and Charles commit tax fraud?[1667] ***640** Second, if they did, what role, if any, did Dee have in that fraud?

And, as noted at the outset of this opinion, the parties' respective views on how these questions should be answered varied widely. The Court acknowledged at the outset of this opinion that its responsibility was to thoughtfully evaluate the evidence and the parties' legal arguments in order to come to its own determination of what happened.

After (i) three weeks of trial, (ii) days spent reading designated portions of deposition testimony or trial testimony from the SEC Action of eleven (11) witnesses who did not offer live testimony here,[1668] (iii) two days of closing arguments, (iv) careful analysis of the parties' pre and post-trial briefs, along with its own legal research, and (v) literally countless hours spent pouring over those one hundred (100) formal written legal opinions, legal memoranda, trust agreements and related formation documents (along with amendments to those documents), annuity agreements and amendments to annuity agreements, internal communications, letters of wishes, communications from trust protectors to trustees, SEC filings, tax returns, formation documents of offshore and domestic entities, real estate documents, and hundreds of other exhibits admitted into evidence at trial, the Court is convinced—by clear and convincing evidence —that Sam and Charles committed tax fraud. That the tax scheme implemented here was "papered" in such a way as to attempt to shield the Wylys from this outcome is equally clear. But the substance of those documents, if carefully examined, reveals the truth.

The Wylys' version of the truth is simply too glib. We received all this tax advice from a myriad of capable professionals, so we cannot have committed tax fraud. Now, we didn't read any of the advice ourselves, or hear most of the advice directly, but what we were told about the advice by French, Robertson, Boucher, and Hennington was enough to make our hearts pure.

But, to accept the Wylys' explanation requires the Court to be satisfied that it is appropriate for extraordinarily wealthy individuals to hire middlemen to do their bidding in order to insulate themselves from wrong-doing so that, when the fraud is ultimately exposed, they have plausible deniability. To put a finer point on it—here is the Court's version of what happened, which it has come to after much thought and analysis.

Sam likes what Tedder has to sell in 1991—a scheme to put hundreds of millions of dollars of wealth offshore in exchange for unsecured private annuities that will only be taxed—at ordinary income rates—when Sam actually receives annuity payments years in the future. So Sam tells his chief outside lawyer, French, who is not a tax lawyer (French is a securities lawyer), to make it happen from a legal perspective, while telling the chief financial officer of the Wyly family office, Robertson, to make it happen from an administrative perspective.

So, it happens—Sam settles the Bulldog IOM Trust with $100 in early 1992 and then enters into six extremely complicated private annuity transactions in February 1992 involving six newly created domestic corporations and six newly created IOM corporations, all of which are owned, directly or indirectly, by Bulldog IOM Trust. Why so many entities to do the private annuity transactions in 1992? Simple—the options Sam assigned to the Nevada corporations ***641** are for the stock of public companies on whose boards Sam sat. Sam wanted to keep each corporation under the SEC reporting threshold so that the extent of his offshore system did not become public for fear of jeopardizing the anticipated tax benefits from the offshore system.

No tax is paid when these annuity transactions are undertaken. Why? Because Sam received—although he never read—written legal opinions from the lawyer who promoted the scheme to him that there would be no tax consequences to him at the time of implementation. However, a key predicate for that legal advice was that the Bulldog IOM Trust had to be a valid foreign non-grantor trust. And, while that's certainly what the trust formation documents say, surprisingly, in the one hundred formal written legal opinions Sam received over the years concerning the offshore system (including for the 1992 annuity transactions), he never received a written legal opinion stating that the Bulldog IOM Trust was a valid foreign non-grantor trust—from the promoter or anyone else—until 2003, when he got conflicting advice from two different tax professionals Hennington hired on his behalf—Lubar (in mid–2003) and Pulman (in late October 2003), both pieces of advice relayed to him by Hennington, about the characterization of the Bulldog IOM Trust as a grantor or non-grantor trust—Lubar opining that it was a foreign grantor trust as to Sam and Pulman opining that Sam had a "reportable position" that it was not. Of course, simple math tells us that this advice was received over twenty-one years after the Bulldog IOM Trust was established and began conducting business offshore tax-free. But we get ahead of ourselves in the Court's version of what happened here.

Returning to the 1990s, Sam's trusted securities lawyer, French, has lingering concerns about the tax consequences flowing from the 1992 annuity transactions, so French goes to London in 1993 to meet with an extremely well-credentialed international tax lawyer, Lubar, to get a second opinion concerning the status of the Bulldog IOM Trust as a foreign non-grantor trust and the tax consequences flowing from Sam's 1992 private annuity transactions. French learns that Lubar has concluded that there is a "significant risk" that the Bulldog IOM Trust (and two other similar trusts established in late 1992) will be characterized as foreign *grantor* trusts to Sam, which dramatically changes the tax consequences flowing from Sam's 1992 private annuity transactions and any other business transaction undertaken through the Bulldog IOM Trust along with Sam's reporting obligations.

Although Sam never directly testified he did not know about the fact that French got this advice from Lubar in 1993, we are asked to conclude that Sam did not know about this advice because the IRS failed to prove that Sam knew about it. In fact, Sam wants us to believe that he did not even know that French went to see Lubar to get a second opinion (again because the IRS failed to prove that he did), although the Court reasonably infers from the trial record that Lubar did not work for free, but instead billed the Wylys for his advice and that the Wyly family office paid those bills.

Given Lubar's conclusions about the offshore structure used in 1992, French asks Lubar about an alternate structure that might work better and Lubar advises that a foreign grantor trust settled by an individual who is a nonresident alien of the United States could be a better device through which to accomplish the Wylys' goals. In February 1994, Lubar issues a ***642** memorandum to French that states his specific advice about such a foreign grantor trust.[1669] However, of critical importance to Lubar's advice were three facts he was told to assume were true by French: (i) the grantor of the trust has known the Wylys "for a considerable period of time," (ii) the trust is being established as "an entirely gratuitous act," and (iii) the grantor has not received and will not receive any "consideration, reimbursement or other benefit" for settling the trust, "directly or indirectly."[1670] Those three factual assumptions are expressly and unequivocally stated in the written memorandum containing Lubar's advice to French, who was acting as the Wylys' agent.

French apparently told Sam about at least part of this advice from Lubar, because an individual residing in the IOM who Sam barely knew, King, settled a trust in February 1994 naming Sam and his family members as beneficiaries.[1671] That trust was the Bessie IOM Trust. Of course, Sam wants to rely on Lubar's advice (as contained in his February 1994 memorandum to French) for the tax consequences flowing from transactions undertaken by Sam through the Bessie IOM Trust—*i.e.,* no tax (or other reporting) is due because King is not subject to tax or reporting in the United States, but Sam denies knowing the predicate facts upon which that favorable advice depended—*i.e.,* that King had known Sam for a considerable period of time, that King established the Bessie IOM Trust as an entirely gratuitous act, and that King would not receive any benefit for settling the trust, which were untrue. And, although the Deed of Settlement for the Bessie IOM Trust states that King settled the trust with $25,000, that too was a lie, which Sam again denies knowing. Once the Bessie IOM Trust was settled, however, Sam starts transacting business through it offshore by undertaking two more complicated private annuity transactions in 1996[1672] and a myriad of extremely complicated real estate transactions involving, among other things, homes, an art gallery, and an office for himself and other family members in Texas and Colorado in the late 1990s and early 2000s[1673]—all tax and reporting free.

Then, in 1995, another purported foreign grantor trust—La Fourche IOM Trust—is settled,[1674] again naming Sam and his family as beneficiaries—this time by Cairns, an IOM resident who did not know Sam *at all*[1675] and who signed a letter prepared by French[1676] that falsely states:[1677]

> I wanted to take this opportunity to let you know what a pleasure it has been knowing you over the past years and ***643** dealing with you on

> both business and social matters. I appreciate your many courtesies. As you know, I have established a trust with Wychwood Trust Limited, called The La Fourche Trust, for the benefit of you and your family, and have provided this trust with the sum of $25,000.00. This is to show my gratitude for your loyalty to our mutual ventures and your personal support and friendship. I hope that, wisely managed, this trust fund can grow for many years and inure to the benefit of many generations of your family.

All of this is a lie, except that the La Fourche IOM Trust was established with Wychwood Trust Limited. [1678] When asked why he would sign a letter full of lies, he glibly responded that he was a friend of Ronnie Buchanan. [1679] So, who was Ronnie Buchanan and why would he ask Cairns to sign a false letter? Buchanan was the primary Wyly contact at Lome House Trust, who served as trustee for Bessie IOM Trust as well as other Wyly IOM trusts. [1680]

The Court has no idea why Buchanan would ask a friend of his to lie for the Wylys, wealthy Americans Cairns had never laid eyes on, although it is likely explained by the fact that Buchanan continued to serve as a trustee of the Bessie IOM Trust through 1998, [1681] earning fees for those trust management services. Similarly, the Court has no idea why Cairns would sign a letter full of lies addressed to someone he didn't even know—Sam—although it is likely explained by the fact that shortly after signing it, Cairns' trust management company was hired to serve as trustee for some of the Wylys' IOM trusts, including La Fourche IOM Trust. [1682]

Although the Deed of Settlement for the La Fourche IOM Trust states that Cairns settled the trust with $25,000, that too was a lie. And, once the La Fourche IOM Trust was purportedly "settled," Sam starts transacting business through it offshore including undertaking another complicated private annuity transaction in 1996.

Once again, Sam wants to rely on Lubar's advice as contained in the February 15, 1994 memorandum addressed to French for the tax consequences flowing from transactions undertaken by him through the La Fourche IOM Trust—*i.e.,* no tax (or other reporting) is due because Cairns is not subject to tax or reporting in the United States, but Sam denies knowing the predicate factual assumptions upon which that favorable advice depended—*i.e.,* that Cairns had known Sam for a considerable period of time, that Cairns established the La Fourche IOM Trust as an entirely gratuitous act, and that Cairns would not benefit from his settling of the trust, all of which were untrue.

***644** Although fourteen more offshore entities wholly owned by Bessie IOM Trust were established at Sam's direction in the IOM or the Cayman Islands in the late 1990s and early 2000s, by 1996 the heart of the Wyly offshore system had been established through deceptive and fraudulent actions. While Sam wants us to believe that he had no idea of these fraudulent and deceptive acts, his silence is deafening, as he never denied knowledge of the "bad acts." Moreover, even assuming Sam did not know about all of the "bad acts" undertaken to benefit him because he hired others to "make it happen," the fact that Sam had the financial wherewithal to attempt to insulate himself from the "bad acts" that occurred here cannot change the proper outcome or, if it does, an appellate court will have to so rule.

From this Court's perspective, Sam cannot have the good without taking the bad. Sam never actually read any of the legal opinions or memoranda he received in connection with the offshore system and that he claims his reliance upon defeats his fraudulent intent or proves his reasonable cause and good faith defense; nor was he required to do so, as he can receive advice indirectly under the tax regulation at issue. Moreover, Sam rarely dealt directly with a lawyer, choosing again to deal with them through middlemen —*i.e.,* French, Robertson, Hennington, and Boucher, which the tax regulation also permits. But it is hard to believe that those middlemen chose to only tell Sam about the favorable aspects of the advice they were given on his behalf by the tax professionals they hired on his behalf. We certainly know Hennington and Boucher didn't, as reflected by what happened in 2003 when Boucher had a chance meeting with Lubar in the Cayman Islands, which led to Hennington's and Boucher's discovery of many disconcerting facts about the Wyly offshore system and the tax consequences of the transactions undertaken through the offshore system, all of which were reported to Sam, among others, in writing, in detail, immediately.

That Sam may have only heard what he wanted to hear from some of those middlemen—*i.e.,* the favorable aspects of the advice upon which he purports to rely here—is certainly possible, but the Court rejects the argument that he never knew or understood the assumptions upon which that favorable advice depended. In short, Sam cannot rely on the favorable portions of the professional's advice he sought, while feigning ignorance of the factual predicates upon which that advice relied for its accuracy. For example, did Sam not wonder why King and Cairns, one individual he barely knew and the other who he did not know at all, each settled a trust with $25,000 in the IOM and named him and his wife and children as beneficiaries? Perhaps that happens all the time in Sam's life, but if it happened in mine, I would be asking questions —lots of them.

Sam is a sophisticated and well-educated businessman that accumulated great wealth through his business acumen and hard work. And, while he may be an “idea guy” that leaves the day-to-day business details to professional managers and advisors he hires, it is clear that he expects results and is knowledgeable about the results they obtain on his behalf. He does not simply turn his wealth over to others and wish them luck. As relevant here, the Court is convinced Sam knew what was happening in connection with the offshore system and that no money or assets moved within that system without Sam's knowledge and express direction. Let me be clear, that Sam's directions to the offshore trustees was usually done through the formality of Sam making his “wishes” known to them—directly or through the trust protectors he appointed—is of little consequence. ***645** The IOM trustees *never* refused to follow Sam's “wishes”—even when that made little sense—as they understood that their jobs depended upon it. If a Sam “wish” was not granted, they would be removed—plain and simple.

The Court does not believe that the law permits Sam to hide behind others and claim not to have known what was going on around him. This Court has taken its responsibility to sift through the mountains of evidence presented here seriously; it had the benefit of seeing the witnesses and evaluating their credibility and it spent countless hours reviewing the documents introduced into evidence, including those that were created to attempt to shield Sam from the fraud that the Court is convinced—by clear and convincing evidence—occurred here.

At the same time, the Court is equally convinced that Dee is innocent of any wrongdoing. That she did not know the details of what Sam and Charles had done offshore is clear. And, there was nothing that should have “tipped her off” that something was amiss. She did not commit fraud, she did not participate in any fraud, she was not willfully blind, and she is entitled to the benefit of the innocent spouse defense.

Orders reflecting these rulings shall be entered separately in each of the Cases. The Court hereby directs the parties' counsel to confer with each other and attempt to submit agreed forms of orders to the Court consistent with this Memorandum Opinion and allowing the IRS' claims in agreed amounts within thirty days of the entry of this Memorandum Opinion on the Court's docket. If no agreement can be reached, each party shall submit its own proposed form of order on or before the forty-fifth day after entry of this Memorandum Opinion on the Court's docket, along with an explanation of why the other side's proposed order is improper.

Attachment

Collateral Estoppel Findings

1. Between 1992 and 1996, Sam and Charles Wyly created a number of IOM trusts, each of which owned several subsidiary companies. Michael French, the Wylys' family attorney, Sharyl Robertson, the Chief Financial Officer (“CFO”) of the Wyly family office, and Michelle Boucher, the CFO of the Irish Trust Company, a Wyly-related entity in the Cayman Islands, served as protectors of the IOM trusts. French, Robertson, and Boucher conveyed the Wylys' investment recommendations to the trust management companies administering the Wylys' IOM trusts (the “IOM trustees”). All of the IOM trustees' securities transactions were based on the Wylys' recommendations and the IOM trustees never declined to follow a Wyly recommendation.

2. The Wylys served as directors of Michaels Stores, Sterling Software, Sterling Commerce, and Scottish Annuity and Life Holdings, Ltd. (“Scottish Re”). As part of their compensation,

the Wylys received stock options and warrants. “Between 1992 and 1999, Sam and Charles Wyly sold or transferred to the [IOM] trusts and companies stock options in Michaels Stores, Sterling Software and Sterling Commerce” in exchange for private annuities while simultaneously disclaiming beneficial ownership over the securities in public filings with the SEC. Between 1995 and 2005, the IOM trusts and companies exercised these options and warrants, ***646** separately acquired options and stock in all four companies, and sold the shares, without filing disclosures.

3. The jury found that the Wylys were beneficial owners of the Issuer securities transferred to, held, and sold by the IOM trusts because the Wylys, directly or indirectly, had or shared voting and/or investment power over these securities. Thus, the jury concluded that the Wylys failed to accurately disclose the extent of their beneficial ownership in the Issuer securities under sections 13(d) and 16(a) of the Securities Exchange Act (the “Exchange Act”). The jury also found that the Wylys caused the Issuers to violate section 14(a) of the Exchange Act, because the Wylys misrepresented the extent of their beneficial ownership to the Issuers in their Director and Officer (“D & O”) questionnaires, which were incorporated by the Issuers in proxy statements.

4. In addition to these disclosure violations, the Wylys were found liable for securities fraud in violation of section 10(b) of the Exchange Act and section 17(a) of the Securities Act of 1933 (the “Securities Act”), and for aiding and abetting the Issuers' and the IOM trusts' securities law violations.

5. In early to mid–1991, Sam Wyly asked Robertson to attend a seminar held by lawyer and trust promoter David Tedder on the use of foreign trusts as a method of asset protection and tax deferral. Shortly thereafter, the Wylys, Robertson, and French attended another Tedder seminar in New Orleans. Tedder, French, and the Wylys then had a private meeting at Sam Wyly's house in Malibu, California. At that meeting, Tedder “talked about establishing trusts that would provide tax deferral, and how the Wylys could transfer assets to those trusts and get tax deferral on the growth of those assets.”

6. Specifically, Tedder recommended transferring the Wylys' stock options in Sterling Software and Michaels Stores to a foreign trust in exchange for a private annuity “in a tax-free kind of transaction.” Under Tedder's plan, it was “expressly intended that [the Wylys] ... irrevocably surrender the enjoyment, control, ownership, and all economic benefits attributable to the ownership of the [options] which are sold in exchange for the private annuity.”

7. The Wylys pursued the offshore program primarily for its tax advantages.

8. However, because Tedder suggested transferring stock options in publicly traded companies—Sterling Software and Michaels Stores—any such transaction would implicate the securities laws. French testified that he raised concerns about whether the Wylys would continue to have filing obligations as directors of Sterling Software and Michaels Stores, even after the transfers. Tedder responded that making SEC filings could threaten the Wylys' tax benefits, because “disclosure of the offshore trusts in SEC filings may lead the IRS to discover and investigate the tax issue, and ... the IRS might use the Wylys' SEC filings against them if the tax issue was ever litigated.”

9. But Sam Wyly corroborated French's account by testifying that ***647** Tedder told him that SEC filings “could trigger tax problems if you had these things on file and [were] reporting the trust shares on [Schedule] 13Ds.” Further, it would be logical to draw an inference that the Wylys would have been concerned about taking inconsistent positions in their SEC and IRS filings when millions of dollars of tax savings were at stake.

10. The jury found that the Wylys *always* had beneficial ownership over the options, warrants, and securities held by the IOM trusts.

11. Thus, the Wylys were obligated to disclose, on the filings required by sections 13 and 16, any time they *or* the trusts transacted in those securities. Because beneficial ownership under the securities laws turns on having voting and/or investment power, truthful SEC filings would have forced the Wylys to admit having some element of control over the securities held by the trusts. To the Wylys, this would mean conceding some element of control over the trustees. But the Wylys believed—rightly or wrongly—that it was critical to conceal their control of the trustees in order to maintain the tax-free status of the trusts, including income from transactions in the Issuer securities.

12. Footnote 91. (Sam Wyly) ("We took steps to avoid control, and those are steps to create the appearance of avoiding control. It's reality and it's appearance. You want the appearance to match the reality.") *Accord* PX 890 (11/3/00 email from Robertson to Evan Wyly) ("Remember that it is critical from a U.S. tax standpoint that there is no appearance that the Wyly's [sic] are in control of the trusts or the protectors.").

13. Because the Wylys made public filings showing the transfer of options to foreign trusts, and at other times publicized their relationship to the foreign trusts, the Wylys also took affirmative steps to minimize the trusts' SEC filings to conceal the ultimate exercise and sale of those options. For example, the Wyly family office tracked the percentage of ownership each trust management company had in a particular Issuer to avoid triggering mandatory SEC reporting. Thus, as Sam Wyly testified, not making SEC filings was logically "something that consistently went on" throughout the duration of the offshore system.

14. Even when it would have been otherwise helpful to assert beneficial ownership over the stock held by the foreign trusts, such as during Sam Wyly's proxy battle for control of Computer Associates (the acquirer of Sterling Software) in February 2002, the Wylys chose not to do it in fear of inconsistent tax positions. From these facts, it is logical to draw the inference that making misleading statements in SEC filings, or not making SEC filings at all, was part of the Wylys' plan to maintain the appearance of separation and independence from the foreign trusts.

15. Footnote 95. *See* PX 1101 (2/26/02 email from Keeley Hennington, tax director and, starting in 2000, CFO of the Wyly family office, to Boucher, attaching Hennington's note to Sam Wyly) ("The trusts are record ***648** owners of the shares on C[omputer] A[ssociates]' books. If it is represented [that] there are $2.9 shares [sic], I think it is likely CA may say we show the Wyly's [sic] only own 1.5M options and again the difference would need to be explained ... Our friendly IRS agent is still looming around and although he has verbally agreed not to look further at any foreign entities or trusts, I would not want to give him any fresh ammunition.").

16. The Wylys ultimately hired Tedder to help establish the first group of offshore trusts and subsidiary companies in 1992 (together with the Plaquemines Trust, the "Bulldog Trusts"). These trusts were settled by Sam or Charles Wyly and had beneficiaries including the Wylys' wives and children and several charitable organizations. The trust deeds permitted the protectors to "add [ ] or substitut[e]" a charitable organization "by notice in writing to the trustees." These trusts were explicitly set up as "non-grantor trust[s] rather than [ ] grantor trust[s] under Section 671–678 of the Code." Under the terms of the trusts, no United States beneficiary could receive a distribution from the trust until two years after the settlor's death.

17. Footnote 97. (Robertson). The 1992 Trusts relevant to the remedies phase are: 1) the Bulldog Non–Grantor Trust; 2) Lake Providence International Trust; 3) the Delhi International Trust; 4) the Pitkin Non–Grantor Trust; and 5) the Castle Creek International Trust. In 1995, the Bulldog Trust settled the Plaquemines Trust, which had a class of beneficiaries including Sam Wyly's children. These trusts are referred to as the "Bulldog Trusts" for purposes of this Opinion and Order. The terminology was

coined by defendants' expert, Professor Robert Danforth, and has been adopted by the parties in their briefing and argument.

18. In 1993, French approached the law firm of Morgan, Lewis & Brockius (“Morgan Lewis”) to discuss whether the Bulldog Trust was a “grantor or non-grantor trust.” Morgan Lewis prepared a memorandum concluding 1) that there was a “significant risk that the [Bulldog] Trust will be characterized as a grantor trust under § 679 [because] income is being currently accumulated for the benefit of U.S. beneficiaries,” and 2) that “[i]t is also likely that the Trustee's power to add or substitute other foreign charities (within the class [of beneficiaries]) causes the Trust to be characterized as a grantor trust under § 674. Charles Lubar, the partner at Morgan Lewis retained to work on this matter, gave the memorandum to French and spoke with him about its conclusions.

19. The following year, French asked Lubar to advise the Wylys about whether a trust settled by “a foreign person who had done business with Sam Wyly” would be treated as a grantor trust. Lubar advised that “as long as there wasn't an indirect transfer of assets by the U.S. person and the foreign person put the money up, and there were certain powers in the trust, then it would be a foreign grantor trust, ***649** and the distributions then would not be taxable.” For the purposes of rendering his opinion, Lubar assumed that the foreign grantor would be the “sole transferor of property to the trust [ ],” unless the taxpayers transferred funds “on an ‘arm's length’ basis.”

20. In 1994 and 1995, two foreign citizens established several trusts for the benefit of the Wylys and their families (collectively, the “Bessie Trusts”). The Bessie Trust and the Tyler Trust were purportedly settled by Keith King, an individual associated with Ronald Buchanan, an IOM trustee selected by the Wylys, with initial contributions of $25,000 each. However, no such contribution was ever made. The trusts “were settled with a factual dollar bill ... plus an indebtedness of $24,999 each on the part of Keith King as settlor.” That indebtedness was immediately forgiven.

21. Footnote 107. The 1994/1995 trusts relevant to this Opinion and Order are: 1) the Bessie Trust; 2) the La Fourche Trust; 3) the Red Mountain Trust; and 4) the Tyler Trust. These trusts will be referred to as the “Bessie Trusts,” as per Professor Danforth's grouping.

22. The La Fourche Trust and the Red Mountain Trusts were purportedly settled by Shaun Cairns, another individual associated with Buchanan, also with initial contributions of $25,000 each. Cairns testified that French prepared letters stating that Cairns was establishing the trusts “to show [his] gratitude for [the Wylys'] loyalty to our mutual ventures and [their] personal support and friendship,” and asked Cairns to sign them. In truth, Cairns had never met nor dealt with the Wylys before establishing the trusts, and had provided only $100 towards the trusts. Shortly after these trusts were settled, Cairns's trust management company was hired to serve as trustee for some of the Wylys' IOM trusts.

23. These transactions were shams intended to circumvent the grantor trust rules. French and Buchanan, acting as the Wylys' agents, recruited King and Cairns to create a falsified record of a gratuitous foreign grantor trust. The trust documents are admittedly false—King and Cairns never contributed $25,000 towards the initial settlement.

24. There were no gratuitous transfers here. *First,* I am doubtful that King provided even the factual $1 towards the trusts. In a November 26, 1995 fax to French, Buchanan writes that “Keith never produced the money.” Buchanan explains that the King-related trusts “were settled with a factual dollar bill” only so that “there [was] no question of the[ ] [trusts] being voidable by reason of the absence of assets” pending the Wylys' transfer of options. Even if King had contributed the $1, the premise that an unreimbursed dollar bill is sufficient to establish a tax-free foreign grantor trust cannot be taken seriously. *Second,* Cairns's transfer of $100

cannot be considered gratuitous because shortly after settling these trusts, he received lucrative work from the Wylys as trustee. Finally, in light of the falsified trust deeds and supporting documentation surrounding ***650** these trusts, it would be unjust to consider anyone but the Wylys to be the true grantors of these trusts.

25. The trusts were administered by professional asset management companies located on the Isle of Man. The trustees were selected by the Wylys or the protectors. The protectors, all of whom were Wyly agents, had the authority to remove and replace trustees. As mentioned earlier, the protectors also transmitted the Wylys' investment recommendations to the trustees. Defendants have presented no evidence of an investment made by the IOM trusts that did not originate with the Wylys' recommendations. Nor have defendants presented evidence of an IOM trustee rejecting a Wyly recommendation.

26. The SEC, on the other hand, has identified several transactions where the Wylys bypassed the trustees altogether. In October 2001, Keeley Hennington, who replaced Robertson as the head of the Wyly family office in June 2000, called Lehman Brothers and directed it to sell 100,000 shares of Michaels Stores held by Quayle Limited, an IOM company, at Charles Wyly's request. Neither Wyly nor Hennington contacted the trustees before placing the sell order. On another occasion in June 2002, Sam Wyly contacted a broker directly and instructed him to "hold on" to 100,000 shares of TYCO stock, overriding a previous order from the IOM trustee, based on an earlier Wyly recommendation, to sell all TYCO shares.

27. The SEC also presented evidence of transactions that no independent trustee would reasonably initiate.

28. For example, on September 26, 1998, Boucher contacted an IOM trust to recommend a ten million dollar investment in the Edinburgh Fund. On September 28, Boucher told the trustee for the first time that the Edinburgh Fund was a fund run by Sam Wyly's son-in-law and that it did not have a prospectus or subscription documents. Despite knowing nothing about the investment beyond its connection to the Wyly family, the trustee agreed to "forward the necessary instructions to Lehman Brothers." One day later, Boucher followed up with the trustee "to ask for an update on progress with regard to making funds available for the proposed investment in the Edinburgh Fund.... [Boucher] mentioned that the Fund had already commenced trading and that the funds would therefore be required urgently."

29. Some of the Wylys' recommendations had nothing to do with securities at all. Among the many personal purchases, loans, and investments the Wylys directed the IOM trustees to make, were businesses for Wyly children and family members, real estate, artwork, jewelry, collectibles, and furniture.

30. "In April 1992, Sam and Charles Wyly transferred 960,000 Michaels Stores options and 1,983,588 Sterling Software options to ten Nevada companies indirectly owned by two Isle of Man trusts in exchange for deferred private annuity agreements." In 1995 and 1996, the Wylys transferred 1,350,000 Michaels ***651** Stores options, 2,650,000 Sterling Software options, and 4,600,000 Sterling Commerce options to the IOM trusts, also in exchange for annuities.

31. In June 1997, French approached Morgan Lewis to discuss the tax consequences of the private annuity transaction. Lubar remembers that he was "really concerned about the transaction" and "worried that the transfer of the options to a company that didn't have any other assets in exchange for a private annuity raised a question about whether that was an arms-length transfer." However, Lubar acknowledged that "other tax lawyers would look at a transfer of a private annuity in different ways."

32. After studying the issue, Lubar advised French that the transfers created potential problems under sections 674 and 679, amongst other provisions.

33. Ordinarily, a company granting stock options as compensation issues a Form 1099 or W2 reporting income to the director or officer and takes a corresponding deduction for the compensation expense when the option is exercised. When the Wylys transferred their stock options to the IOM trusts in exchange for private annuities, the Issuers of the options—that is, Sterling Software and Michaels Stores—had to decide whether that transfer was a taxable event that required issuing a Form 1099 or W2 to report income to the Wylys. To address these concerns, Tedder sent an opinion letter to both companies explaining that the Wylys should not have to recognize income because the annuity did not require payment until a date certain in the future.

34. Jeannette Meier, general counsel of Sterling Software, asked French's law firm, Jackson Walker, to give a "back up" tax opinion to support Tedder's letter. French provided a draft opinion, but never finalized the letter. Nevertheless, based on French and Tedder's representations, Sterling Software decided not to issue a Form 1099 to the Wylys and declined to take a corresponding deduction for compensation expense. But Meier testified that the company was "concerned about ... whether, not having gotten a backup opinion from Jackson Walker, [it] was on good ground not to have to put [the compensation expense] in the [Section] 10–Q [financial statements.]" The value of the options was "a big number" and "would have affected the accuracy of the public filings" if Sterling Software had decided to report it as compensation.

35. Michaels Stores treated the transfer of options identically. In addition, French instructed Mark Beasley, general counsel for Michaels Stores, not to issue Form 1099s for any of the foreign trust entities upon those companies' exercise of stock options.

36. In March 2000, SBC Communications Inc. ("SBC") acquired Sterling Commerce, which had been spun off from Sterling Software in 1995. "As part of [the] acquisition ... all outstanding options to purchase shares of Sterling [Commerce] were canceled. All option holders received cash ... based on the excess of the stock purchase ***652** price over the option price." On January 11, 2001, SBC notified the Wylys that it was planning "to issue a Form 1099 to [the respective Wylys]/[their] trusts showing taxable income" in the total amount of $73,912,500. The Wylys, through Boucher and Robertson, reached out to Rodney Owens, a partner at the Meadows Owens law firm in Dallas, to write a memo to SBC explaining why a 1099 should not be issued. On January 26, 2001, Owens wrote in a letter to SBC that "it is not appropriate for SBC to file a 1099 or any other reporting papers regarding this transaction because [the IOM entity] is a foreign corporation, and the income from the purchase of the stock is not subject to U.S. taxation." After receiving the letter, SBC sought additional information about the private annuity transaction, including whether the transfer of options had been recognized as a taxable event at the time of the original transaction, and if not, what the schedule of annuity payments was. Although French's relationship with the Wylys had broken down by this point, he agreed to write a memorandum supporting the tax treatment of the annuities.

37. All in all, between 1992 and 2004, the Issuers never reported income related to the exercise of options or warrants transferred to the foreign trusts. Their decision not to report was a result of the Wylys' deceptive behavior and affirmative misrepresentations. Because the Wylys disclaimed beneficial ownership of the options upon transfer, convinced the Issuers that the private annuity transactions were not taxable events, and did not disclose their beneficial ownership of the securities held by the IOM trusts in their Director and Officer questionnaires, the Issuers did not attribute taxable income to the Wylys.

38. The annuity payments for the original option transfers had been due to commence in the late 1990s, but that period was extended to 2004. In early 2003, Boucher and Hennington approached Lubar to discuss potential issues

arising from the upcoming annuity payments. Lubar told Hennington and Boucher that, as he explained to French years before, he believed the trusts were grantor trusts under either sections 674 or 679 and should have been taxable to the Wylys all along. Further, Lubar believed the IRS would challenge the private annuity transactions. Lubar and other Morgan Lewis attorneys suggested approaching the IRS "on a no-name basis" to see "where the negotiations with the IRS might lead" in the event the Wylys wanted to pursue a voluntary disclosure.

39. Boucher and Hennington summarized Lubar's advice in a July 2, 2003 memorandum to Sam Wyly, Charles Wyly, Evan Wyly, and Donald Miller. The memorandum addressed several concerns about the "logistical problems of paying the annuities." Hennington and Boucher were concerned that "[i]t is almost certain given the large amount of these payments that the reporting will result in an IRS audit. [Further], [t]here is also a high likelihood that as a result of this audit the entire structure of ***653** the foreign system will be audited by the IRS."

40. Additionally, Hennington and Boucher reported that [t]he annuity payments will bankrupt several of the IOM companies, which could bring the validity of the annuity transaction into question. [And] [a]fter a few years of payments, [other] companies will be left with non-liquid assets, which will result in payments being made in kind ... [which] may also call into question the validity of the transaction and the 'arms length' nature of the transaction.

41. On August 13, 2003, several attorneys representing the Wyly family met with Internal Revenue Service ("IRS") officials. Lubar gave the IRS some details about the trusts, and admitted that there was a "serious risk [that] they were grantor trusts from the beginning." Lubar also explained the private annuity transactions, and told the IRS, after questioning, that the options were for stock in publicly traded corporations, that no income was reported upon exercise, and that the corporations claimed no deductions.

42. According to attorney notes memorializing the meeting, an IRS officer asked if the taxpayers were "significant enough shareholders that their holdings would be listed on SEC filings" and asked if the "SEC filings show[ed] beneficial interest in shares." Lubar said that he believed they were significant enough shareholders for "at least [the] first two [companies]" but did not know if the filings showed beneficial ownership. Hennington and Boucher reported to the Wylys that the IRS was primarily interested in the structure of the annuity, but added that one of the IRS representatives "seemed very interested in any SEC reporting of the initial transactions [even though] [t]his seems out of their area of expertise or control."

43. The Wylys did not proceed with Morgan Lewis on a voluntary disclosure path. But by February 2, 2004, Charles Wyly received a notice of audit. Shortly thereafter, Sam Wyly asked Hennington, Boucher, and Charles Pulman, another attorney at Meadows Owens, "to explore what happens [for purposes of taxation] if he is not a U.S. citizen." The firm concluded that an expatriate U.S. citizen who has a net worth of more than $622,000 "will be treated as having a principal purpose of tax avoidance" and will continue to be taxed pursuant to several special provisions.

44. From May to August 2004, the IRS sent a number of information document requests ("IDRs") to both Sam and Charles Wyly. In at least one of the IDRs, the IRS requested additional information about a transfer of Michaels Stores options to an independent trust, such as "the identity of all original and current beneficiaries, including their nationality, place of residence, and current mailing address" as well as the identity of "the grantor(s) of the trust(s)." At an October 21, 2004 meeting between attorneys representing the Wyly family and the IRS, an IRS agent said that the IDRs regarding the options transfers were based on information "pulled from SEC filings." At that ***654** meeting, the IRS agents also asked questions about the trusts, including about why Keith King set up the Tyler Trust.

45. The SEC has not shown that the Wylys' or Issuers' SEC filings *launched* the IRS audit of the Wylys and the offshore system, or even that accurate filings would have been likely to trigger an earlier examination. However, it is evident from the IDRs and from the October 2004 meeting, that once the IRS investigation was under way, agents and investigators were consulting SEC filings as part of their fact finding process and identified numerous issues and misstatements.

46. The IOM trusts sold 1.8 million shares of unregistered stock between June and December 1997, at prices ranging from approximately $21 per share in the summer to approximately $35 per share in the fall. The trusts sold 200,000 of these shares less than one year after the December 1996 private placement, in violation of the terms of the purchase agreement. In 1998, the IOM trusts sold a small number of shares at approximately $32 per share. In 2000 and 2001, the IOM trusts sold approximately 1.2 million shares at prices ranging from approximately $40 per share in September 2000 to approximately $55 per share in November 2001.

47. Defendants must concede that if I conclude that the Wylys were the real grantors of the Bessie Trusts, then the profits earned on the sale of Issuer securities by those trusts are taxable to the Wylys, not the purported foreign grantors. Because I conclude that the purported foreign grantors made no gratuitous contributions, "the trusts at issue [are] clearly grantor trusts taxable to the domestic grantors."

48. Section 674(a) provides that: "[t]he grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom *is subject to a power of disposition,* exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party." Quoting a prominent tax treatise, defendants concede that the "power of disposition" includes "powers to 'effect such major changes in the enjoyment of a trust's income and corpus as the addition and elimination of beneficiaries' as well as 'minor and customary power[s]' over income and corpus distribution." Because a non-beneficiary trustee is considered a non-adverse party under the statute, "[s]ection 674(a) captures virtually every trust, including the [IOM] trusts." Thus, defendants concede that "[u]ltimate liability under [s]ection 674[ ] ... turns on whether any of the statutory exceptions apply."

49. According to defendants, the Bulldog Trusts are not grantor trusts because they fall under the section 674(c) exemption. Under that exemption, section 674(a) does not apply to "certain powers that are exercisable by independent trustees." According to the corresponding IRS regulation, which summarizes the statute, [t]he powers to which section 674(c) apply are powers (a) to distribute, apportion, or accumulate income to or for a beneficiary ***655** or beneficiaries, or to, for, or within a class of beneficiaries, or (b) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries). In order for such a power to fall within the exception of section 674(c) it must be exercisable solely (without the approval or consent of any other person) by a trustee or trustees none of whom is the grantor and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor.

50. To determine whether the Bulldog Trusts are covered by this exception, it is necessary to answer three questions: 1) Did the IOM trustees have the power to "distribute, apportion, or accumulate income" or "pay out corpus" to or for a beneficiary or beneficiaries?; 2) Were the IOM trustees a) the grantor, or b) a "related or subordinate" party as defined by the statute?; and 3) Were the trustees able to "exercis[e] [those powers] solely (without the approval or consent of any other person)"?

51. The first two questions are straightforward. *First,* the IOM trustees certainly had the power, as set out in the trust deeds, to "distribute, apportion, or accumulate income" or "pay out corpus" to or for a beneficiary. *Second,* the IOM

trustees were neither the grantor, nor one of the individuals on the exclusive list of "related or subordinate" parties defined by the statute. The only remaining question is whether the IOM trustees were able to exercise those powers "solely" or "without the approval or consent of any other person."

52. The Wylys, through the trust protectors who were all loyal Wyly agents, retained the ability to terminate and replace trustees. The Wylys expected that the trustees would execute their every order, and that is exactly what the trustees did.

53. The evidence amply shows that the IOM trustees followed every Wyly recommendation, whether it pertained to transactions in the Issuer securities, making unsecured loans to Wyly enterprises, or purchases of real estate, artwork, collectibles, and other personal items for the Wylys and their children. The trustees made no meaningful decisions about the trust income or corpus other than at the behest of the Wylys. On certain occasions, such as the establishment of the Bessie Trusts, the IOM trustees actively participated in fraudulent activity along with the Wylys. The Wylys freely directed the distribution of trust assets for personal purchases and personal use. Because the Wylys and their family members were beneficiaries, the IOM trustees were thus "distributing" income *for* a beneficiary at the direction of the grantors—the Wylys.

54. Footnote 218. Because I conclude that both the Bulldog and Bessie Trusts were grantor trusts under Section 674, I need not reach the issue of whether they were also grantor trusts under Section 679.

55. The Wylys engaged in a thirteen year fraud, creating seventeen trusts and forty subsidiary companies, employing numerous IOM trustees, a veritable "army of lawyers," ***656** hiring an offshore accountant to hold records outside the United States, and delegating several domestic employees to handle the administration of the trusts.

56. Reasonable and savvy businessmen do not engage in such activity unless it is profitable. Of course it was profitable—by transferring property, including valuable options and warrants, to the trusts, exercising the options and trading in secret, and using the proceed to reinvest in other ventures, the Wylys were able to accumulate tremendous tax-free wealth.

57. The jury found that the Wylys were beneficial owners of all of the Issuer securities—from the time the options were transferred to the trusts to the time the trusts exercised the options or otherwise acquired stock to the time they were sold. The jury also found that the Wylys' pervasive failure to disclose beneficial ownership constituted securities fraud. There is no evidence in the record that the purpose of this fraud was to manipulate or distort the market.

58. There *is* ample evidence, however, that the driving purpose of the securities fraud was to conceal the Wylys' relationship to the IOM trusts and preserve the preferential tax treatment on secret offshore profits for as long as possible.

59. *First,* defendants' motivation to preserve tax benefits was important to their decision to misrepresent their beneficial ownership. Admitting beneficial ownership would have forced defendants to take conflicting positions with two separate government agencies. Even if admission of "beneficial ownership" on a schedule 13D would not immediately reveal a fact that would establish control of an offshore trust, it would at least be facially inconsistent with a tax reporting position that did not include the profits from trades made by that offshore trust. It would have been reasonable, and in fact, prudent, for the Wylys to be concerned about taking conflicting positions in public SEC filings and on their tax returns because that SEC filing could constitute an admission for purposes of future tax litigation.

60. Given the Wylys' high profile background, tremendous wealth, and history of litigation with the IRS, the possibility of an IRS audit was not remote. In fact, it was highly likely. Thus, even if the Wylys had no reason to believe that SEC

filings could *trigger* an audit, they certainly had reason to believe and fear that the IRS would consult all public filings in the event of an audit.

61. *Second,* the securities fraud was intimately connected to protecting the tax benefits in other ways. The Wylys took numerous steps to prevent the Issuers from issuing Forms 1099 to report income to either the Wylys in an individual capacity or to the offshore entities. The Issuers did not report income to the Wylys after the 1992 private annuity transaction because of the Wylys' misrepresentations about disclaiming beneficial ownership over the options, and French and Tedders' misrepresentations about the economic substance of that transaction. In 2001, nearly ten years later, the Wylys continued ***657** the fraud by convincing SBC not to issue 1099s based on the same misrepresentations. None of the four Issuers reported income to the Wylys in connection with the options granted as compensation and transferred to the trusts, even though the Wylys certainly enjoyed the benefit of those options once they were exercised and the stock was sold.

62. The Wylys engaged in securities fraud to conceal their relationship to and control of the IOM trusts in order to maintain the secrecy of the offshore system and preserve their tax benefits. The unlawful gains causally related to the securities violations found by the jury, is an amount equivalent to the taxes avoided on the profits the Wylys realized on the sale of Issuer securities.

63. The Wylys' securities violations helped them establish the offshore system, conceal their trading profits, and use those trading profits to invest in other ventures and amass tremendous untaxed wealth.

64. Sam Wyly engaged in a large securities fraud spanning thirteen years, involving multiple trusts and entities and hundreds, if not thousands, of misstatements, all while being subject to a previous injunction entered in 1979.

***658**

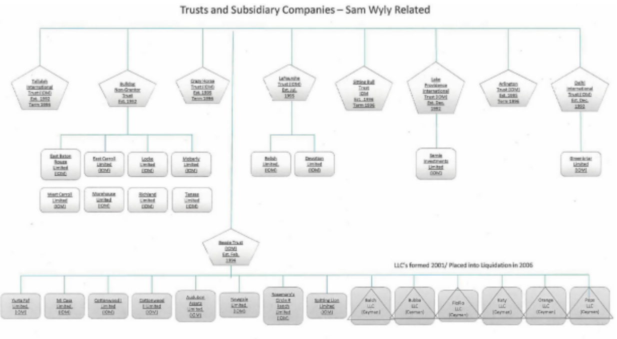
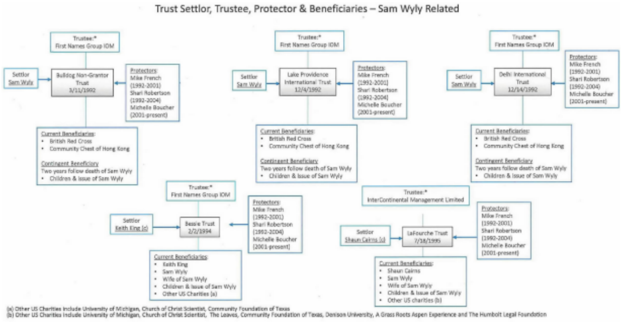

Trusts and Subsidiary Companies – Sam Wyly Related
Tallulah International Trust (IOM) Est. 1992 Term 1996
Bulldog Non-Grantor Trust Est. 1992
Crazy Horse Trust (IOM) Est. 1995 Term 1996
LaFourche Trust (IOM) Est. Jul. 1995
Sitting Bull Trust IOM Est. 1996 Term 1996
Lake Providence International Trust (IOM) Est. Dec. 1992
Arlington Trust (IOM) Est. 1995 Term 1996
Delhi International Trust (IOM) Est. Dec. 1992
East Baton Rouge Limited (IOM)
East Carroll Limited (IOM)
Locke Limited (IOM)
Moberly Limited (IOM)
West Carroll Limited (IOM)
Morehouse Limited (IOM)
Richland Limited (IOM)
Tensas Limited (IOM)
Balch Limited (IOM)
Devotion Limited (IOM)
Sarnia Investments Limited (IOM)
Greenbriar Limited (IOM)
Bessie Trust (IOM) Est. Feb. 1994
LLC's formed 2001/ Placed into Liquidation in 2006
Yurta Faf Limited (IOM)
Mi Casa Limited (IOM)
Cottonwood I Limited (IOM)
Cottonwood II Limited (IOM)
Audubon Assets Limited (IOM)
Rosemary's Circle R Ranch Limited (IOM)
Spitting Lion Limited (IOM)
Balch LLC (Cayman)
Bubba LLC (Cayman)
FloFlo LLC (Cayman)
Katy LLC (Cayman)
Orange LLC (Cayman)
Pops LLC (Cayman)

Exhibit B

***659**


Trust Settlor, Trustee, Protector & Beneficiaries – Sam Wyly Related
Trustee:* First Names Group IOM
Settlor Sam Wyly
Bulldog Non-Grantor Trust 3/11/1992
Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)
Current Beneficiaries: • British Red Cross • Community Chest of Hong Kong
Contingent Beneficiary Two years follow death of Sam Wyly • Children & Issue of Sam Wyly
Trustee:* First Names Group IOM
Settlor Sam Wyly
Lake Providence International Trust 12/4/1992
Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)
Current Beneficiaries: • British Red Cross • Community Chest of Hong Kong
Contingent Beneficiary Two years follow death of Sam Wyly • Children & Issue of Sam Wyly
Trustee:* First Names Group IOM
Settlor Sam Wyly
Delhi International Trust 12/14/1992
Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)
Current Beneficiaries: • British Red Cross • Community Chest of Hong Kong
Contingent Beneficiary Two years follow death of Sam Wyly • Children & Issue of Sam Wyly
Trustee:* First Names Group IOM
Settlor Keith King (c)
Bessie Trust 2/2/1994
Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)
Current Beneficiaries: • Keith King • Sam Wyly • Wife of Sam Wyly • Children & Issue of Sam Wyly • Other US Charities (a)
Trustee:* InterContinental Management Limited
Settlor Shaun Cairns (c)
LaFourche Trust 7/18/1995
Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)
Current Beneficiaries: • Shaun Cairns • Sam Wyly • Wife of Sam Wyly • Children & Issue of Sam Wyly • Other US charities (b)

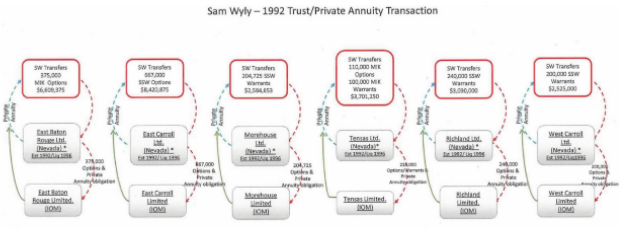
(a) Other US Charities include University of Michigan, Church of Christ Scientist, Community Foundation of Texas
(b) Other US Charities include University of Michigan, Church of Christ Scientist, The Leaves, Community Foundation of Texas, Denison University, A Grass Roots Aspen Experience and The Humbolt Legal Foundation

(c (Debtors understood this Court to be requesting charts based on what the documents in evidence provide. Pursuant to the Trust Deeds, King and Cairns were the grantors of the 94/95 trusts. However, the IRS points out that Judge Scheindlin found that "the trusts at issue [are] clearly grantor trusts to the domestic grantors." Disgorgement Opinion, at 62-63.

*See Joint Stipulation #66 for predecessor trustees

Exhibit B

***660**

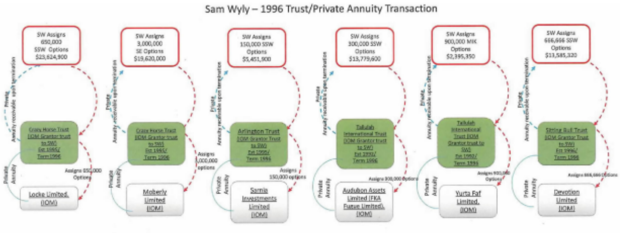

Sam Wyly – 1992 Trust/Private Annuity Transaction
SW Transfers 375,000 MIK Options $6,609,375
SW Transfers 667,000 SSW Options $8,420,875
SW Transfers 204,725 SSW Warrants $2,584,653
SW Transfers 110,000 MIK Options 100,000 MIK Warrants $3,701,250
SW Transfers 240,000 SSW Warrants $3,090,000
SW Transfers 200,000 SSW Warrants $2,525,000
Private Annuity
East Baton Rouge Ltd. (Nevada) * Est 1992/Liq 1996
East Carroll Ltd. (Nevada) * Est 1992/ Liq 1996
Morehouse Ltd. (Nevada) * Est 1992/Liq 1996
Tensas Ltd. (Nevada)* Est 1992/Liq 1996
Richland Ltd. (Nevada) * Est 1992/ Liq 1996
West Carroll Ltd. (Nevada) * Est 1992/Liq1996
375,000 Options & Private Annuity obligation
667,000 Options & Private Annuity obligation
204,725 Options & Private Annuity obligation
210,000 Options/Warrants & Private Annuity obligation
240,000 Options & Private Annuity obligation
200,000 Options & Private Annuity obligation
East Baton Rouge Limited. (IOM)
East Carroll Limited (IOM)
Morehouse Limited (IOM)
Tensas Limited. (IOM)
Richland Limited. (IOM)
West Carroll Limited (IOM)

Dollar value reflects the value assigned under the annuity contracts

* Dubinsky testified that his research showed that Ms. Robertson was the initial Director, President, Vice President , Secretary and Treasurer. Tr. 3266

Exhibit B

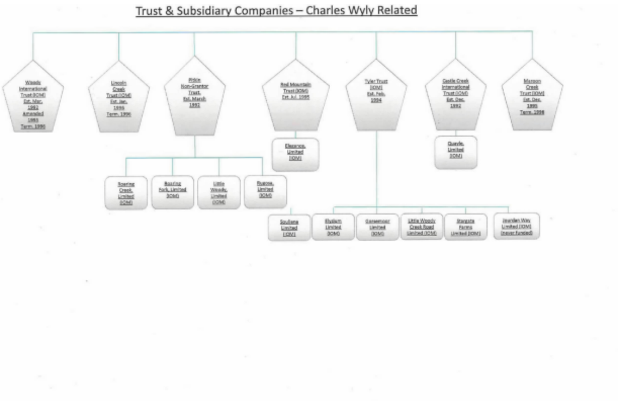
***661**


Sam Wyly – 1996 Trust/Private Annuity Transaction
SW Assigns 650,000 SSW Options $23,624,900
SW Assigns 3,000,000 SE Options $19,620,000
SW Assigns 150,000 SSW Options $5,451,900
SW Assigns 300,000 SSW Options $13,779,600
SW Assigns 900,000 MIK Options $2,395,350
SW Assigns 666,666 SSW Options $13,585,320
Private Annuity receivable upon termination
Crazy Horse Trust (IOM Grantor trust to SW) Est 1995/ Term1996
Crazy Horse Trust (IOM Grantor trust to SW) Est 1995/ Term 1996
Arlington Trust (IOM Grantor Trust to SW) Est 1995/ Term 1996
Tallulah International Trust (IOM Grantor trust to SW) Est 1992/ Term 1996
Tallulah International Trust (IOM Grantor trust to SW) Est 1992/ Term 1996
Sitting Bull Trust (IOM Grantor Trust to SW) Est 1996/ Term 1996
Private Annuity
Assigns 650,000 Options
Assigns 3,000,000 options
Assigns 150,000 options
Assigns 300,000 Options
Assigns 900,000 Options
Assigns 666,666 Options
Locke Limited. (IOM)
Moberly Limited (IOM)
Sarnia Investments Limited (IOM)
Audubon Assets Limited (FKA Fugue Limited). (IOM)
Yurta Faf Limited. (IOM)
Devotion Limited (IOM)

Dollar value reflects the value assigned under the annuity contracts

Exhibit B

*662



Trust & Subsidiary Companies – Charles Wyly Related

Woody International Trust (IOM) Est. Mar. 1992 Amended 1993 Term. 1996

Lincoln Creek Trust (IOM) Est. Jan. 1996 Term. 1996

Pitkin Non-Grantor Trust, Est. March 1992

Red Mountain Trust (IOM) Est. Jul. 1995

Tyler Trust (IOM) Est. Feb. 1994

Castle Creek International Trust (IOM) Est. Dec. 1992

Maroon Creek Trust (IOM) Est. Dec. 1995 Term. 1996

Elegance, Limited (IOM)

Quayle, Limited (IOM)

Roaring Creek, Limited (IOM)

Roaring Fork, Limited (IOM)

Little Woody, Limited (IOM)

Rugosa, Limited (IOM)

Soulieana Limited (IOM)

Elysium Limited (IOM)

Gorsemoor Limited (IOM)

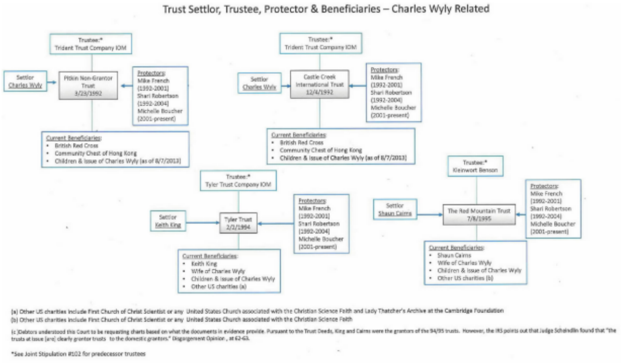
Little Woody Creek Road Limited (IOM)

Stargate Farms Limited (IOM)

Jeandon Way Limited (IOM) (never funded)

Exhibit C

*663



Trust Settlor, Trustee, Protector & Beneficiaries – Charles Wyly Related

Trustee:* Trident Trust Company IOM

Settlor Charles Wyly

Pitkin Non-Grantor Trust 3/23/1992

Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)

Current Beneficiaries:
- British Red Cross
- Community Chest of Hong Kong
- Children & Issue of Charles Wyly (as of 8/7/2013)

Trustee:* Trident Trust Company IOM

Settlor Charles Wyly

Castle Creek International Trust 12/4/1992

Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)

Current Beneficiaries:
- British Red Cross
- Community Chest of Hong Kong
- Children & Issue of Charles Wyly (as of 8/7/2013)

Trustee:* Tyler Trust Company IOM

Settlor Keith King

Tyler Trust 2/2/1994

Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)

Current Beneficiaries:
- Keith King
- Wife of Charles Wyly
- Children & Issue of Charles Wyly
- Other US charities (a)

Trustee:* Kleinwort Benson

Settlor Shaun Cairns

The Red Mountain Trust 7/6/1995

Protectors: Mike French (1992-2001) Shari Robertson (1992-2004) Michelle Boucher (2001-present)

Current Beneficiaries:
- Shaun Cairns
- Wife of Charles Wyly
- Children & Issue of Charles Wyly
- Other US charities (b)

(a) Other US charities include First Church of Christ Scientist or any United States Church associated with the Christian Science Faith and Lady Thatcher's Archive at the Cambridge Foundation

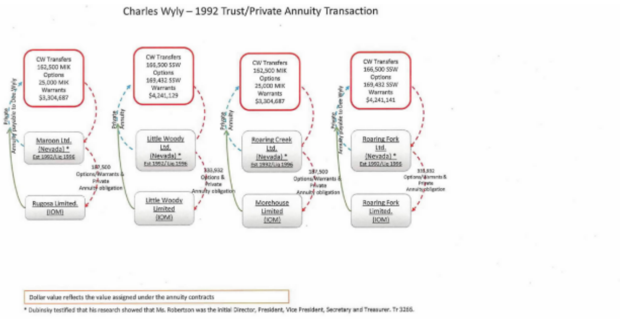
(b) Other US charities include First Church of Christ Scientist or any United States Church associated with the Christian Science Faith

(c)Debtors understood this Court to be requesting charts based on what the documents in evidence provide. Pursuant to the Trust Deeds, King and Cairns were the grantors of the 94/95 trusts. However, the IRS points out that Judge Scheindlin found that "the trusts at issue [are] clearly grantor trusts to the domestic grantors." Disgorgement Opinion , at 62-63.

*See Joint Stipulation #102 for predecessor trustees

Exhibit C

*664



Charles Wyly – 1992 Trust/Private Annuity Transaction

CW Transfers 162,500 MIK Options 25,000 MIK Warrants $3,304,687

Maroon Ltd. (Nevada) * Est 1992/Liq 1996

187,500 Options/Warrants & Private Annuity obligation

Rugosa Limited. (IOM)

Private Annuity payable to Dee Wyly

CW Transfers 166,500 SSW Options 169,432 SSW Warrants $4,241,129

Little Woody Ltd. (Nevada) * Est 1992/Liq 1996

335,932 Options & Private Annuity obligation

Little Woody Limited (IOM)

Private Annuity

CW Transfers 162,500 MIK Options 25,000 MIK Warrants $3,304,687

Roaring Creek Ltd. (Nevada) * Est 1992/Liq 1996

187,500 Options/Warrants & Private Annuity obligation

Morehouse Limited (IOM)

Private Annuity

CW Transfers 166,500 SSW Options 169,432 SSW Warrants $4,241,141

Roaring Fork Ltd. (Nevada) * Est 1992/Liq 1996

335,932 Options/Warrants & Private Annuity obligation

Roaring Fork Limited. (IOM)

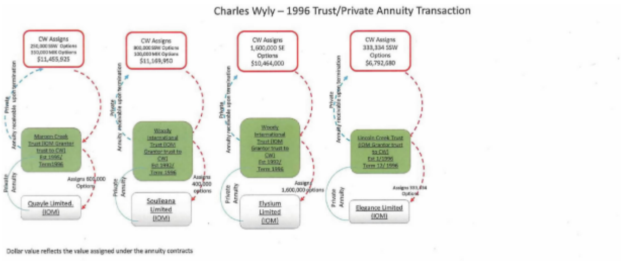
Private Annuity payable to Dee Wyly

Dollar value reflects the value assigned under the annuity contracts

* Dubinsky testified that his research showed that Ms. Robertson was the initial Director, President, Vice President, Secretary and Treasurer. Tr 3266.

Exhibit C

*665



Charles Wyly – 1996 Trust/Private Annuity Transaction

CW Assigns 250,000 SSW Options 350,000 MIK Options $11,455,925

Maroon Creek Trust (IOM Grantor trust to CW) Est 1995/ Term1996

Private Annuity receivable upon termination

Assigns 600,000 Options

Private Annuity

Quayle Limited. (IOM)

CW Assigns 300,000 SSW Options 100,000 MIK Options $11,169,950

Woody International Trust (IOM Grantor trust to CW) Est 1992/ Term 1996

Private Annuity receivable upon termination

Assigns 400,000 options

Private Annuity

Soulieana Limited (IOM)

CW Assigns 1,600,000 SE Options $10,464,000

Woody International Trust (IOM Grantor trust to CW) Est 1992/ Term 1996

Private Annuity receivable upon termination

Assigns 1,600,000 options

Private Annuity

Elysium Limited (IOM)

CW Assigns 333,334 SSW Options $6,792,680

Lincoln Creek Trust (IOM Grantor trust to CW) Est 1/1996 Term 12/ 1996

Private Annuity receivable upon termination

Assigns 333,334 Options

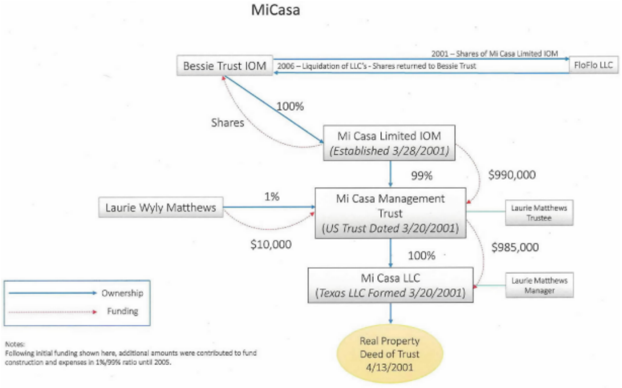
Private Annuity

Elegance Limited (IOM)

Dollar value reflects the value assigned under the annuity contracts

Exhibit C

*666



MiCasa

Bessie Trust IOM

2001 – Shares of Mi Casa Limited IOM

2006 – Liquidation of LLC's - Shares returned to Bessie Trust

FloFlo LLC

100%

Shares

Mi Casa Limited IOM (Established 3/28/2001)

99%

$990,000

Laurie Wyly Matthews

1%

$10,000

Mi Casa Management Trust (US Trust Dated 3/20/2001)

Laurie Matthews Trustee

100%

$985,000

Mi Casa LLC (Texas LLC Formed 3/20/2001)

Laurie Matthews Manager

Ownership

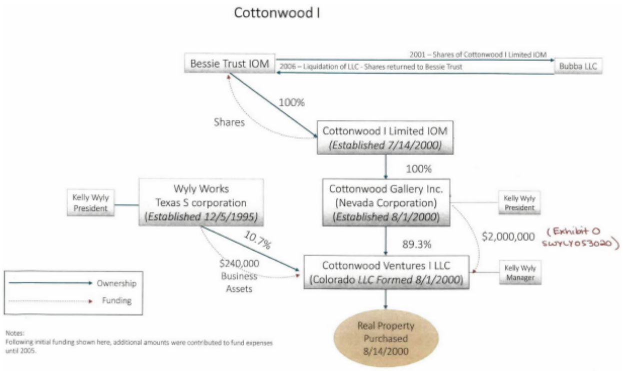
Funding

Notes:
Following initial funding shown here, additional amounts were contributed to fund construction and expenses in 1%/99% ratio until 2005.

Real Property Deed of Trust 4/13/2001

Exhibit D

*667



Cottonwood I

Bessie Trust IOM

2001 – Shares of Cottonwood I Limited IOM

2006 – Liquidation of LLC - Shares returned to Bessie Trust

Bubba LLC

100%

Shares

Cottonwood I Limited IOM (Established 7/14/2000)

100%

Kelly Wyly President

Wyly Works Texas S corporation (Established 12/5/1995)

Cottonwood Gallery Inc. (Nevada Corporation) (Established 8/1/2000)

Kelly Wyly President

10.7%

89.3%

$2,000,000 (Exhibit O SWYLY053020)

$240,000 Business Assets

Cottonwood Ventures I LLC (Colorado LLC Formed 8/1/2000)

Kelly Wyly Manager

Ownership

Funding

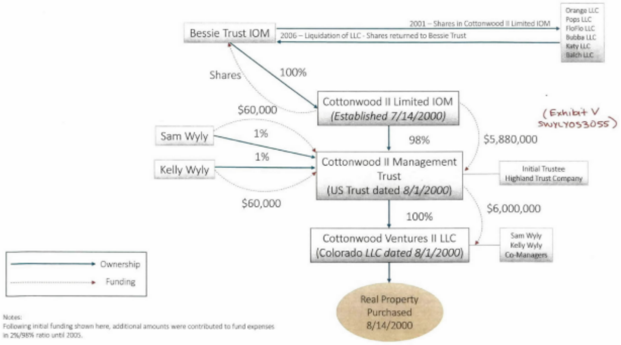
Notes:
Following initial funding shown here, additional amounts were contributed to fund expenses until 2005.

Real Property Purchased 8/14/2000

Exhibit E

*668

Cottonwood II

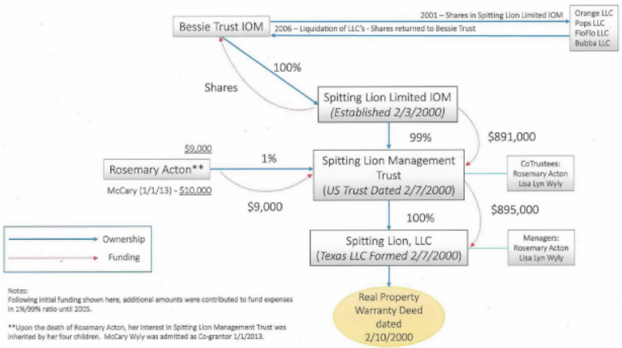

Bessie Trust IOM
2001 – Shares in Cottonwood II Limited IOM
2006 – Liquidation of LLC - Shares returned to Bessie Trust
Orange LLC
Pops LLC
FloFlo LLC
Bubba LLC
Katy LLC
Balch LLC
Shares
100%
Cottonwood II Limited IOM
(Established 7/14/2000)
(Exhibit V
SWYLY053055)
$60,000
Sam Wyly
1%
1%
Kelly Wyly
98%
$5,880,000
Cottonwood II Management
Trust
(US Trust dated 8/1/2000)
Initial Trustee
Highland Trust Company
$60,000
$6,000,000
100%
Cottonwood Ventures II LLC
(Colorado LLC dated 8/1/2000)
Sam Wyly
Kelly Wyly
Co-Managers
Ownership
Funding
Real Property
Purchased
8/14/2000

Notes:
Following initial funding shown here, additional amounts were contributed to fund expenses in 2%/98% ratio until 2005.

Exhibit F

*669

Spitting Lion


Bessie Trust IOM
2001 – Shares in Spitting Lion Limited IOM
2006 – Liquidation of LLC's - Shares returned to Bessie Trust
Orange LLC
Pops LLC
FloFlo LLC
Bubba LLC
100%
Shares
Spitting Lion Limited IOM
(Established 2/3/2000)
99%
$891,000
$9,000
1%
Rosemary Acton**
McCary (1/1/13) - $10,000
Spitting Lion Management
Trust
(US Trust Dated 2/7/2000)
CoTrustees:
Rosemary Acton
Lisa Lyn Wyly
$9,000
100%
$895,000
Spitting Lion, LLC
(Texas LLC Formed 2/7/2000)
Managers:
Rosemary Acton
Lisa Lyn Wyly
Ownership
Funding
Real Property
Warranty Deed
dated
2/10/2000

Notes:
Following initial funding shown here, additional amounts were contributed to fund expenses in 1%/99% ratio until 2005.

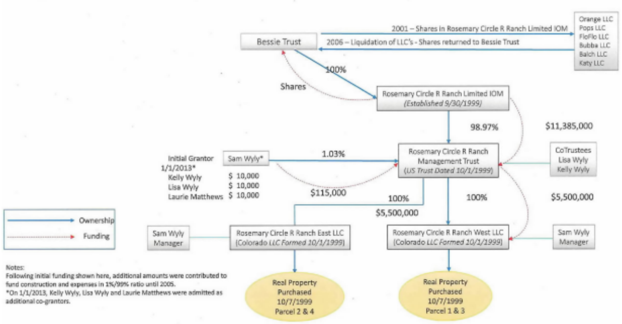
**Upon the death of Rosemary Acton, her interest in Spitting Lion Management Trust was inherited by her four children. McCary Wyly was admitted as Co-grantor 1/1/2013.

Exhibit G

*670

Rosemary Circle R Ranch

(formerly Two Mile Ranch, Woody Creek Ranch and Rocky Mountain Serenity Ranch)

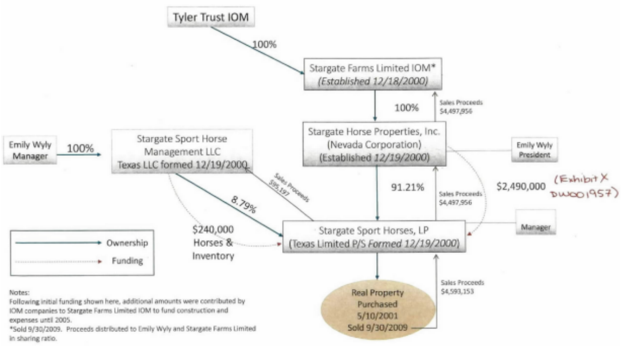

Bessie Trust
2001 – Shares in Rosemary Circle R Ranch Limited IOM
2006 – Liquidation of LLC's - Shares returned to Bessie Trust
Orange LLC
Pops LLC
FloFlo LLC
Bubba LLC
Balch LLC
Katy LLC
100%
Shares
Rosemary Circle R Ranch Limited IOM
(Established 9/30/1999)
98.97%
$11,385,000
Initial Grantor
1/1/2013*
Kelly Wyly $ 10,000
Lisa Wyly $ 10,000
Laurie Matthews $ 10,000
Sam Wyly*
1.03%
Rosemary Circle R Ranch
Management Trust
(US Trust Dated 10/1/1999)
CoTrustees
Lisa Wyly
Kelly Wyly
$115,000
100%
$5,500,000
100%
$5,500,000
Ownership
Funding
Sam Wyly
Manager
Rosemary Circle R Ranch East LLC
(Colorado LLC Formed 10/1/1999)
Rosemary Circle R Ranch West LLC
(Colorado LLC Formed 10/1/1999)
Sam Wyly
Manager
Real Property
Purchased
10/7/1999
Parcel 2 & 4
Real Property
Purchased
10/7/1999
Parcel 1 & 3

Notes:
Following initial funding shown here, additional amounts were contributed to fund construction and expenses in 1%/99% ratio until 2005.
*On 1/1/2013, Kelly Wyly, Lisa Wyly and Laurie Matthews were admitted as additional co-grantors.

Exhibit H

*671

Stargate Horse Farm

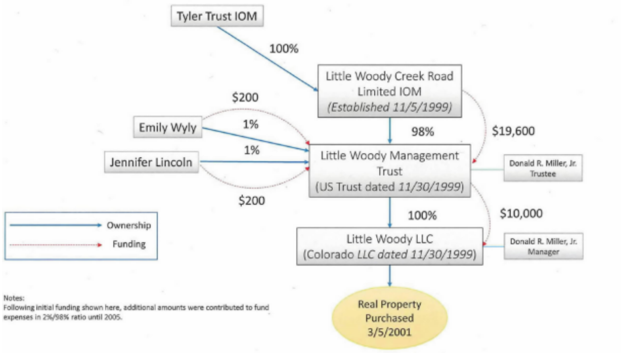

Tyler Trust IOM
100%
Stargate Farms Limited IOM*
(Established 12/18/2000)
100%
Sales Proceeds
$4,497,956
Emily Wyly
Manager
100%
Stargate Sport Horse
Management LLC
Texas LLC formed 12/19/2000
Stargate Horse Properties, Inc.
(Nevada Corporation)
(Established 12/19/2000)
Emily Wyly
President
Sales Proceeds
$95,197
8.79%
91.21%
Sales Proceeds
$4,497,956
$2,490,000
(Exhibit X
DW001957)
Manager
$240,000
Horses &
Inventory
Stargate Sport Horses, LP
(Texas Limited P/S Formed 12/19/2000)
Ownership
Funding
Sales Proceeds
$4,593,153
Real Property
Purchased
5/10/2001
Sold 9/30/2009

Notes:
Following initial funding shown here, additional amounts were contributed by IOM companies to Stargate Farms Limited IOM to fund construction and expenses until 2005.
*Sold 9/30/2009. Proceeds distributed to Emily Wyly and Stargate Farms Limited in sharing ratio.

Exhibit I

*672

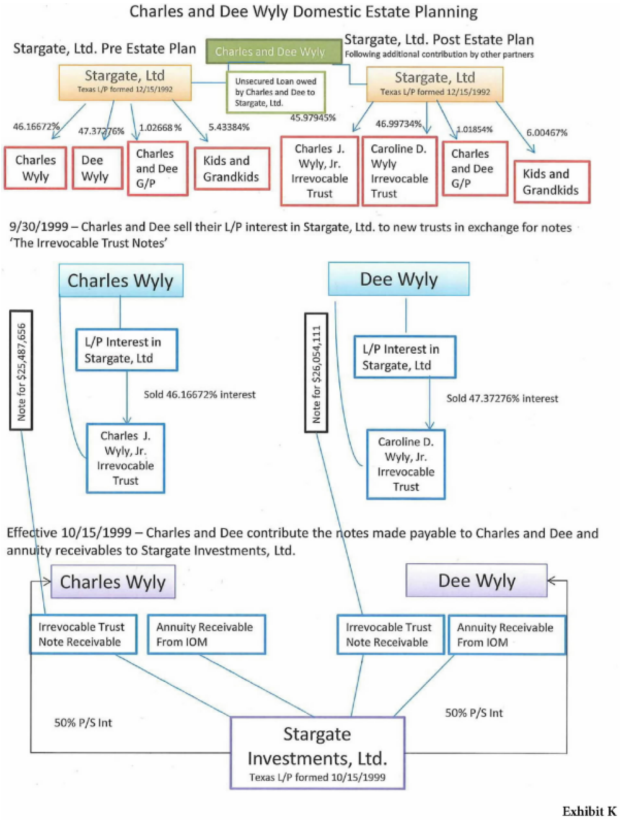
Little Woody


Tyler Trust IOM
100%
Little Woody Creek Road
Limited IOM
(Established 11/5/1999)
$200
Emily Wyly
1%
1%
Jennifer Lincoln
98%
$19,600
Little Woody Management
Trust
(US Trust dated 11/30/1999)
Donald R. Miller, Jr.
Trustee
$200
100%
$10,000
Ownership
Funding
Little Woody LLC
(Colorado LLC dated 11/30/1999)
Donald R. Miller, Jr.
Manager
Real Property
Purchased
3/5/2001

Notes:
Following initial funding shown here, additional amounts were contributed to fund expenses in 2%/98% ratio until 2005.

Exhibit J

*673


Charles and Dee Wyly Domestic Estate Planning

Stargate, Ltd. Pre Estate Plan
Charles and Dee Wyly
Stargate, Ltd. Post Estate Plan
Following additional contribution by other partners
Stargate, Ltd
Texas L/P formed 12/15/1992
Unsecured Loan owed by Charles and Dee to Stargate, Ltd.
Stargate, Ltd
Texas L/P formed 12/15/1992
46.16672%
47.37276%
1.02668 %
5.43384%
45.97945%
46.99734%
1.01854%
6.00467%
Charles Wyly
Dee Wyly
Charles and Dee G/P
Kids and Grandkids
Charles J. Wyly, Jr. Irrevocable Trust
Caroline D. Wyly Irrevocable Trust
Charles and Dee G/P
Kids and Grandkids

9/30/1999 – Charles and Dee sell their L/P interest in Stargate, Ltd. to new trusts in exchange for notes 'The Irrevocable Trust Notes'

Charles Wyly
Note for $25,487,656
L/P Interest in Stargate, Ltd
Sold 46.16672% interest
Charles J. Wyly, Jr. Irrevocable Trust
Dee Wyly
Note for $26,054,111
L/P Interest in Stargate, Ltd
Sold 47.37276% interest
Caroline D. Wyly, Jr. Irrevocable Trust

Effective 10/15/1999 – Charles and Dee contribute the notes made payable to Charles and Dee and annuity receivables to Stargate Investments, Ltd.

Charles Wyly
Dee Wyly
Irrevocable Trust Note Receivable
Annuity Receivable From IOM
Irrevocable Trust Note Receivable
Annuity Receivable From IOM
50% P/S Int
50% P/S Int
Stargate Investments, Ltd.
Texas L/P formed 10/15/1999

Exhibit K

All Citations

552 B.R. 338, 117 A.F.T.R.2d 2016-1508, 2016-1 USTC P 50,282

Footnotes

[1] On April 15, 2015, the IRS filed Claim No. 18 against Sam's bankruptcy estate in Case No. 14–35043–BJH–11 and Claim No. 11 against Dee's bankruptcy estate in Case No. 14–35074–BJH–11 (together, the "**Proofs of Claim** "). As indicated above, the Debtors' bankruptcy cases are being jointly administered under Case No. 14–35073–BJH–11.

[2] *See* Debtor Sam Wyly's Objection to Proof of Claim No. 18 Filed by the IRS [ECF No. 938] and Debtor Caroline D. Wyly's Amended Objection to Claim Number 11 of the Department of Treasury—Internal Revenue Service [Case No. 14–35074, ECF No. 75].

[3] To the extent that a finding of fact is more properly construed as a conclusion of law, or vice versa, it should be so construed.

[4] 11 U.S.C. § 505 expressly provides that a bankruptcy court may determine a debtor's tax liability:

> (a)(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.
>
> (2) The court may not so determine—
>
> (A) the amount or legality of a tax, fine, penalty, or addition to tax if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title[.]

[5] *See I.R.S. v. Luongo (In re Luongo),* 259 F.3d 323, 328–30 (5th Cir.2001) (citing legislative history referencing the jurisdictional nature of § 505).

[6] The Court wishes to express its appreciation to the parties for the enormous efforts that went into simplifying this trial whenever possible. The Joint Stipulations and the Computation Stipulations saved weeks of trial testimony.

[7] Dee is Charles' widow. Dee and Charles were married for 56 years and they filed joint tax returns throughout their marriage.

[8] *SEC v. Wyly,* 56 F.Supp.3d 394, 434 (S.D.N.Y.2014) ("For the foregoing reasons, Sam Wyly must disgorge $123,836,958.76 and Charles Wyly must disgorge $63,881,743.97. The Wylys shall also pay prejudgment interest for the entire period of the fraud through December 1, 2014, calculated in accordance with this Opinion and Order."). Sam's

bankruptcy schedules list the judgment, including prejudgment interest, at $198,118,825.16. *See* Amended Schedule F, Case No. 14–35043, ECF No. 472 at p. 88 of 94.

[9] *See* Memorandum Opinion Exhibit A. The Court will cite to these findings by the number assigned to each on Exhibit A (*e.g.,* Collateral Estoppel No. 1).

[10] This Court heard substantial evidence that overlaps with that the jury and the SDNY Court heard in the SEC Action. While various witnesses who testified there were not called here, the parties agreed to rely on their testimony in the SEC Action here. While this Court did not retry the legal determination of whether the Bulldog Trusts and the Bessie Trusts (as defined by the SDNY Court) were grantor trusts to Sam and Charles, having decided to apply collateral estoppel to that determination of the SDNY Court at the IRS' request, many of the factual findings made there (and to which this Court has applied collateral estoppel) were proven here also. Where the Court quotes from findings of fact made in the SEC Action in this Memorandum Opinion to which it has applied collateral estoppel, the Court will also note if that finding was independently proven here too. Unless the Court specifically notes otherwise, the finding here was proven by clear and convincing evidence.

[11] At certain points in this Memorandum Opinion, the Court refers to understatements of income instead of underpayments of income taxes. The parties agree that it is the Debtors' respective understatements of income that resulted in their respective underpayments of income taxes here.

[12] This agreement is contingent upon (i) the SDNY Court's determination of foreign grantor trust status being affirmed on appeal, which appeal is currently pending before the Second Circuit Court of Appeals, and/or (ii) this Court's collateral estoppel decision being affirmed on appeal, assuming such an appeal is taken.

[13] 26 U.S.C. § 7701(a)(31). Prior to August 20, 1996, a "foreign" trust was defined as a trust "the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A." 26 U.S.C. § 7701(a)(31) (1996).

[14] 26 U.S.C. § 7701(a)(30)(E).

[15] ROBERT T. DANFORTH, ET AL. TAX TREATMENT OF GRANTOR TRUSTS ¶ 7.01, 1999 WL 1017325 (2016).

[16] 26 U.S.C. § 671–79.

[17] Tr. Trans. 331:18–24 (Cole).

[18] Appendix to Rubenstein Motion [ECF No. 926] at App. 0004.

[19] *Id.*

[20] *Askanase v. Fatjo,* 130 F.3d 657, 672–73 (5th Cir.1997) (quoting *Specht v. Jensen,* 853 F.2d 805, 807 (10th Cir.1988)); *see* Rubenstein Motion at 2–17.

[21] *See* FED. R. EVID. 702; *Daubert v. Merrell Dow Pharm., Inc.,* 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993); Rubenstein Motion at 17–22.

[22] *See* Rubenstein Motion at 20–22.

[23] *See Askanase,* 130 F.3d at 672–73; *Burkhart v. Washington Metr. Area Transit Auth.,* 112 F.3d 1207, 1212–13 (D.C.Cir.1997).

[24] *See Askanase,* 130 F.3d at 672–73; *Snap–Drape, Inc. v. C.I.R.,* 98 F.3d 194, 198 (5th Cir.1996).

[25] Tr. Trans. 450:20–452:4 (Rubenstein). Citations in this Memorandum Opinion to "Tr. Trans." refer to the transcript of the January 2016 trial on the Motions and Claim Objections, while citations to "SEC Tr. Trans." refer to the trial transcript in the SEC Action. The pin cites are page:line—page:line.

[26] *See, e.g., id.* at 468:22–469:13 (Rubenstein) (discussing uncertainty among practitioners during the relevant time period as to how to treat a trust with only contingent United States beneficiaries under 26 U.S.C. § 679).

[27] Appendix to Rubenstein Motion [ECF No. 926] at App. 0004.

[28] *Owen v. Kerr–McGee Corp.,* 698 F.2d 236, 240 (5th Cir.1983).

[29] *U.S. v. West,* 22 F.3d 586, 599 (5th Cir.1994).

[30] 737 F.2d 439, 444 (5th Cir.1984) (emphasis added).

[31] 607 F.2d 92 (5th Cir.1979).

[32] *Burton,* 737 F.2d at 444.

[33] As explained *infra* at pp. 371–74, 413–16, French (who served as the Wylys primary counsel and trusted agent for about twenty years, IRS Ex. 1199 ¶ 4 (p. 6)) learned in 1993 that an experienced international tax lawyer, Charles Lubar, who French hired on the Wylys' behalf, believed that the 1992 IOM trusts were properly characterized as foreign grantor trusts as to Sam and Charles. The Court imputes this knowledge to Sam and Charles under agency principles.

[34] *See* pp. 371–74, *infra.*

35 *See* Tr. Trans. 513:23–514:22 (Rubenstein).

36 There is no evidence suggesting that Dee was involved in any decisions regarding the structure of the offshore system at issue here. Nor is there any evidence suggesting that Dee knew of any uncertainty in the law during the relevant time period. Thus, Rubenstein's testimony has virtually no relevance as to Dee.

37 *Askanase,* 130 F.3d at 672 (citation omitted); *see Waco Intern., Inc. v. KHK Scaffolding Houston, Inc.,* 278 F.3d 523, 533 (5th Cir.2002) (lawyer could testify as to "issues an attorney typically investigates in determining whether to pursue an *ex parte* seizure order").

38 As explained by Rubenstein, a trust protector is an intermediary between the settlor of a trust and its beneficiaries, on the one hand, and the trustee, on the other hand. Trust protectors are usually individuals. Tr. Trans. 355:9–16 (Rubenstein).

39 As explained by Rubenstein, an accommodation grantor describes a situation where a third party creates and forms a trust as an accommodation to the person who is going to grow the wealth in that trust. *Id.* at 479:2–8 (Rubenstein).

40 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993).

41 526 U.S. 137, 119 S.Ct. 1167, 143 L.Ed.2d 238 (1999).

42 *Gibbs v. Gibbs*, 210 F.3d 491, 500 (5th Cir.2000); *see Wells Fargo Bank N.A. v. Texas Grand Prairie Hotel Realty, L.L.C. (In re Texas Grand Prairie Hotel Realty, L.L.C.),* 710 F.3d 324, 329 (5th Cir.2013) (quoting *Gibbs* for this proposition).

43 *See Seatrax, Inc. v. Sonbeck Intern., Inc.,* 200 F.3d 358, 371 (5th Cir.2000).

44 *See U.S. v. Tucker,* 345 F.3d 320, 327 (5th Cir.2003) (quoting *Daubert,* 509 U.S. at 589, 113 S.Ct. 2786); *see also Pipitone v. Biomatrix, Inc.,* 288 F.3d 239, 244 (5th Cir.2002)).

45 *Daubert,* 509 U.S. at 589, 113 S.Ct. 2786.

46 526 U.S. at 141–42, 119 S.Ct. 1167.

47 526 U.S. 137, 119 S.Ct. 1167 (1999).

48 *See Skidmore v. Precision Printing and Pkg., Inc.*, 188 F.3d 606, 618 (5th Cir.1999).

49 *Kumho Tire Co., Ltd.,* 526 U.S. at 152, 119 S.Ct. 1167; *Moore v. Ashland Chemical Inc.,* 151 F.3d 269, 274 (5th Cir.1998) ("Fortunately, the Supreme Court recently resolved a disagreement among the circuits about the standard for reviewing a district court's admission or exclusion of expert testimony. In *General Electric Co. v. Joiner,* 522 U.S. 136, 118 S.Ct. 512, 139 L.Ed.2d 508 (1997), the Court held that we should review such decisions for an abuse of discretion.").

50 *Tucker,* 345 F.3d at 326 (citation omitted).

51 *See* FED. R. EVID. 702 advisory committee's note to 2000 amendment ("it might also be important in some cases for an expert to educate the factfinder about general principles, without ever attempting to apply these principles to the specific facts of the case ... The amendment does not alter the venerable practice of using expert testimony to educate the factfinder on general principles."); *see also Daubert,* 509 U.S. at 591–92, 113 S.Ct. 2786 (discussing how expert testimony must "fit" the facts of the case).

52 *See* Tr. Trans. 511:24 (Rubenstein) ("I'm not opining on what the Wylys did.").

53 *See* Tr. Trans. 513:23–514:22 (Rubenstein).

54 *Cf. Daubert,* 509 U.S. at 491–92, 113 S.Ct. 2711 (describing relevance under Federal Rule of Evidence 702 as whether the testimony is helpful to the trier of fact).

55 *See* Wyly Ex. QN (Rubenstein's CV detailing his extensive experience); Hr'g Trans. January 5, 2016 46:1–51:20 (Rubenstein's testimony at the *Daubert* hearing regarding his qualifications), 51:21–59:25, 68:8–11 (Rubenstein's testimony at the *Daubert* hearing discussing how he formed his opinions); Tr. Trans. 333:9–335:16 (additional trial testimony by Rubenstein discussing his qualifications); 418:16–22 (additional trial testimony by Rubenstein discussing how he formed his opinions).

56 *See* Tr. Trans. 499:9–15 (Rubenstein).

57 509 U.S. at 596, 113 S.Ct. 2786.

58 *See id.*

59 *Gulf State Util. Co. v. Ecodyne Corp.,* 635 F.2d 517, 519–20 (5th Cir.1981).

60 *See* Rubenstein Motion at 20–22.

61 *Roman v. Western Mfg., Inc.,* 691 F.3d 686, 692 (5th Cir.2012).

62 *Dixon v. Int'l Harvester Co.,* 754 F.2d 573, 580 (5th Cir.1985).

63 *Hidden Oaks Ltd. v. City of Austin,* 138 F.3d 1036, 1050 (5th Cir.1998).

64 *See* Wyly Ex. QN (Rubenstein's CV).

65 *See* Hr'g Trans. January 5, 2016 55:1–15 (Rubenstein) ("Well, the private annuity rules don't make any difference on the private annuity side whether you do it with an individual with a domestic trust or foreign trust. There are different estate

tax concerns when you do them with trusts, specifically foreign trusts, that make it riskier. So during that time period, I did that for people in their individual capacities as opposed to adding the estate tax complications.”).

66 Tr. Trans. 390:18–25(Sam).

67 *Id.* at 390:19–394:10(Sam).

68 *Id.* at 398:9–400:6(Sam).

69 *Id.* at 401:22–402:22(Sam).

70 *Id.* at 402:23–408:5(Sam).

71 *Id.* at 408:15–409:8(Sam).

72 *Id.* at 409:9–411:19(Sam).

73 Joint Stipulations ¶ 2.

74 *Id.*

75 *Id.* ¶ 4.

76 *Id.*

77 *Id.* ¶ 5.

78 *Id.*

79 *Id.* ¶ 3.

80 *Id.*

81 *Id.* ¶ 8.

82 *Id.* ¶ 10.

83 *Id.* ¶ 9.

84 *Id.* ¶ 6.

85 *Id.* ¶ 16.

86 *Id.* ¶ 16; Tr. Trans. 423:6–24(Sam).

87 Joint Stipulations ¶ 17.

88 *Id.*

89 *Id.* ¶ 11.

90 *Id.*

91 SEC Tr. Trans. 1697:9–12 (French).

92 *Id.* at 1697:11–12 (French).

93 *Id.* at 1698:6 (French).

94 *Id.* at 1697:9–10 (French).

95 Tr. Trans. 698:17–699:14(Sam).

96 SEC Tr. Trans. 1710:19–25, 1711:9–15 (French); IRS Ex. 1199 ¶ 25 (p. 10) (Annex A, Admissions of Defendant Michael C. French).

97 IRS Ex. 1199 ¶ 26 (p. 10) (Annex A, Admissions of Defendant Michael C. French).

98 *Id.*

99 Joint Stipulations ¶ 12.

100 Tr. Trans. 149:20–15:14(Dee).

101 *See* Appendix to Debtor Caroline D. Wyly's Motion for Partial Summary Judgement [ECF No. 880] at app. 46 (deposition excerpt).

102 Tr. Trans. 150:24–151:7(Dee) (one of the children did not survive to adulthood), 168:5–15(Dee).

103 *Id.* at 168:5–15(Dee).

104 *Id.* at 151:8–152:2(Dee).

105 *Id.* at 151:8–152:2(Dee), 168:5–15(Dee).

106 Collateral Estoppel No. 5; SEC Tr. Trans. 156:25–157:7 (Robertson); Robertson Dep. Tr. 76:19–77:2; IRS Ex. 85 (June 12, 1991 memorandum from Robertson to Sam, Charles, Evan, French, and Ethel Ketter, in-house CPA for the Wyly family office, discussing Tedder's seminar on asset protection and tax deferral).

107 IRS Ex. 85.

108 *Id.* at SEC00150261 (under section titled “Goals”).

109 At trial, Sam admitted that the term "creditor" includes the IRS, which is the largest creditor in the Cases. Tr. Trans. 1047:24–1048:8, 1364:2–4 ("Q. By 'asset protect,' you meant the risk that creditors could get to your assets, is that correct? A. Yes. Q. And one of those creditors would include the Internal Revenue Service. Is that correct? A. Yes.").

110 IRS Ex. 85 at SEC00150261.

111 *Id.* at SEC100150263 (under heading "Items to be Prepared to Do").

112 *Id.* at SEC100150281 (under heading "Problems").

113 IRS Ex. 525.

114 *Id.* at SWYLY004776.

115 Collateral Estoppel No. 5; Tr. Trans. 696:23–627:16 (Sam, however, testified that he did not attend the New Orleans conference); SEC Tr. Trans. 168:2–12 (Robertson testifying that she attended the New Orleans seminar along with Sam, Charles, and French), 1716:14–1717:3 (French testifying he attended the New Orleans seminar with Sam and Charles).

116 French Depo Tr. 1717:1–20.

117 Collateral Estoppel No. 5; Tr. Trans. 1050:19–1059:11(Sam); IRS Ex. 525; SEC Tr. Trans. 1718:4–8 (French).

118 Tr. Trans. 1050:23–1059–30(Sam); SEC Tr. Trans. 1719:7–17 (French); IRS Ex. 525.

119 Collateral Estoppel No. 6; Tr. Trans. 1050:19–1051:16(Sam), 1052:9–1059:11(Sam); SEC Tr. Trans. 1719:3–17 (French); IRS Ex. 525 (written information Sam received from Tedder titled "An Overview of Asset Protection Estate and Income Tax Reduction Using Domestic and International Structures").

120 Joint Stipulations 110–111 (stipulations as to formation and ownership structure); SEC Tr. Trans. 1008:6–1011:20 (Boucher testifying that documents were moved and kept offshore to, among other reasons, make them more difficult for third parties to obtain); IRS Ex. 1199 ¶ 61 (p. 15) (Annex A, Admissions of Defendant Michael C. French) ("One purpose of Boucher's employment was to maintain records for the Isle of Man Trusts and the Offshore Companies in the Cayman Islands so that the records would not be maintained in the United States."); Tr. Trans. 1370:1–6 (Sam testifying that one of the purposes for hiring Boucher was so that records would not be maintained in the United States); IRS Ex. 95 at SWYLY013049, § 1.C (Memorandum dated May 12, 2000 from Robertson to Sam, Evan, and others expressing a concern regarding future regulations that may require submission of audited financial statements and access to offshore trust documents, and stating the "solution" of hiring a " 'lawyer' custodian to hold the trust deeds, which disclose beneficial ownership. The lawyer would be instructed by the protectors and the trustee not to release the trust deeds to anyone without joint consent. This would slow the process of delivery of the trust deeds down, giving the ability to flee the jurisdiction if it was deemed necessary.").

121 Joint Stipulations ¶ 68; Tr. Trans. 556:24–557:12 (Evan).

122 Tr. Trans. 1744:11–16(Sam).

123 *Id.* at 556:24–557:12 (Evan).

124 *Id.* at 556:24–557:12, 559:1–14 (Evan); Joint Stipulations ¶ 113.

125 Joint Stipulations ¶ 113.

126 SEC Tr. Trans. 987:4–988:4 (Boucher).

127 *Id.* 995:25–996:17 (Boucher).

128 Tr. Trans. 787:19–21, 912:18–913:3 (Evan).

129 IRS Ex. 409.

130 *Id.* at 81822–823 (emphasis added).

131 French's concerns about the proper tax treatment of the 1992 IOM trusts and his decision to get a second opinion from Lubar's firm are discussed in detail *infra* at pp. 413–16.

132 Tr. Trans. 1925:3–1968:9 (Hennington testifying regarding the series of events that occurred after Boucher's chance meeting with Lubar at a conference in the Cayman Islands).

133 IRS Ex. 96 (memorandum dated June 30, 2003 prepared by Hennington to inform the Wyly family of the issues that Lubar had raised); Tr. Trans. 1945:17–1949:21 (Hennington prepared the memo for the purpose of "relaying all of the issues that Lubar had raised" and to provide the "worst-case scenario" to the family), 1949:22–1954:19 (Hennington recounts a meeting with the Wyly family to discuss the worst-case scenario and Lubar's recommendation that he meet with the IRS on their behalf on an anonymous basis).

134 Tr. Trans. 592:19–596:8 (Evan), 844:5–8, 960:9–17 (Evan) ("This was a surprise.... In fact, this was a surprise because it was the opposite of what we had been hearing all along."), 970:10–24 (Evan), 1776:18–24 (Cousins) ("I believe that they were very, very upset because Mr. Lubar indicated there was a problem with the '92 trusts, and they didn't know that there was going to be a problem and didn't know what to do about it."), 1944:16–19 (Hennington) ("Q: Did you understand

Mr. Lubar to be raising issues that were inconsistent with the advice previously given by Meadows Owens concerning the trusts? A: Absolutely."), 1349:20–1349:24 (Donnie Miller) ("Q. Was it fair to say that pretty much Charles Wyly, Sam Wyly, Evan Wyly, everyone intimately connected with this offshore structure was discomposed, to say the least, by this memo. A. Yeah. We were surprised."), 1358:3–1359:9 (Donnie Miller) (Surprised by memo in 2003 because "I thought we were always compliant with regulations").

135 Tr. Trans. 1409:9–1423:16 (Sam's testimony regarding IRS Ex. 96, which contains the mid–2003 memoranda in which Hennington and Boucher expressed Lubar's conclusions regarding issues surrounding the trusts). Sam's testimony consists mainly of him acknowledging that the IRS' counsel correctly read the document into the record. Although Sam claims he does not remember the memorandum, he admits that he likely would have received it due to its importance and the fact it was sent by Hennington and Boucher. Further, when asked whether French had conveyed Lubar's concerns raised in 1993 regarding the status of the 1992 trusts, Sam simply testified "I don't know." *Id.* at 1419:5–11. And, when questioned as to whether this was too important of a topic for French not to have informed Sam, Sam testified: "[i]t's certainly an important topic, but it's the sort of thing delegated to attorneys—to Mr. French and other attorneys." *Id.* at 1420:17–21. Sam, however, did not testify as to any surprise in 2003 when he heard the news; he simply testified that he could not remember whether he was previously told. Remarkably, on redirect, Sam unequivocally testified that neither Owens, French or any of Sam's lawyers or CPAs ever told him that was anything seriously wrong with the IOM trusts "as a tax matter." *Id.* 2935:12–23(Sam). This is just one example of the many times that Sam's memory on redirect was superior to that during cross.

136 *Id.* at 976:9–18 (Evan), 1936:6–1944:1 (Hennington), 1956:12–19 (Hennington).

137 *Id.* at 1956:20–1958:23 (Hennington).

138 Meadows Owens gave no formal written opinion letters to the Wylys. Rather, Meadows Owens' advice was provided orally or in less formal writings. As will be discussed in detail in connection with the Court's analysis of Sam's reasonable cause and good faith defense, he received advice from numerous lawyers and other professionals about the offshore system and the tax consequences of it to him from 1992 to the present. *See* pp. 475–513, *infra.*

139 Tr. Trans. 970:25–971:6, 976:2–8 (Evan).

140 *Id.* at 1774:4–5 (Cousins) (Owens passed away in July 2003); 1970:5–1972:13 (Hennington).

141 IRS Ex. 98 at WYLYSEC01105084 (Notes from October 8, 2003 meeting between various Meadows Owens attorneys and Hennington detailing options and recommending the filing of a Form 8275), Joint Ex. 106 (Sam's 2002 tax return) at SWYLY021498–500 (Attachment to Form 8275).

142 Joint Ex. 130 (Dee and Charles' 2003 tax return) at SWYLY029540–542 (Attachment to Form 8275).

143 Tr. Trans. 2073:21–2074:13 (Hennington) ("[The IRS] made clear that [the foreign trusts and annuities] was the focus of their audit when they started in '04.").

144 *Id.* at 2114:9–16 (Hennington).

145 *Id.* at 2114:20–2115:21 (Hennington).

146 Upon the Debtors' applications, Lan was retained as special tax counsel here, after notice and a hearing. *See* employment orders at ECF No. 261 and 367 (Kroney Morse Lan, PC employment orders) and 749 and 750 (Lan Smith Sosolik, PLLC employment orders).

147 Tr. Trans. 2076:21–2078:24 (Hennington).

148 *See* IRS Ex. 1199 (Consent of Michael C. French).

149 *SEC v. Wyly,* 56 F.Supp.3d at 434.

150 In the body of this Memorandum Opinion, the Court will refer to a specific Bankruptcy Rule of Procedure as "Bankruptcy Rule" followed by the applicable rule number.

151 FED. R. BANKR. P. 3001(f); *see In re Fidelity Holding Co., Ltd.,* 837 F.2d 696, 698 (5th Cir.1988).

152 *Fidelity Holding Co., Ltd.*, 837 F.2d at 698.

153 *Simmons v. Savell (In re Simmons),* 765 F.2d 547, 552 (5th Cir.1985); *see Southland Corp. v. Toronto–Dominion (In re Southland Corp.),* 160 F.3d 1054, 1059 (5th Cir.1998).

154 *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 17, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000).

155 *See In re 1701 Commerce, LLC,* 511 B.R. 812, 822 (Bankr.N.D.Tex.2014); *In re Aviva America, Inc.,* 2005 WL 6441404, at *3–4 (Bankr.N.D.Tex. June 21, 2005) (quoting *In re Armstrong,* 320 B.R. 97, 102–03 (Bankr.N.D.Tex.2005)).

156 Debtors' Brief in Support of Motion for Order Determining the Respective Burdens of Proof [ECF No. 936] ("**Debtor's Burden of Proof Brief** ") ¶ 3.

157 *Id.* ¶ 11.

158 *Id.* ¶ 14.

159 *Id.* ¶ 18.

160 *Id.* ¶¶ 16–17.

161 The Fifth Circuit, agreeing with many other courts that have explored the operation of burden shifting in the tax context, has pointed out that "the operation of this burden-shifting scheme is irrelevant when both parties have met their burdens of production and the preponderance of the evidence supports one party." *Brinkley v. C.I.R.,* 808 F.3d 657, 664 (5th Cir.2015) (citing *Knudsen v. C.I.R.,* 131 T.C. 185, 189 (2008) ("[A]n allocation of the burden of proof is relevant only when there is equal evidence on both sides.")). The Fifth Circuit has held that when both sides have met their burden of production and where the preponderance of evidence nevertheless favors one party, any error in the allocation of the burden of proof is harmless. *Brinkley,* 808 F.3d at 664 (citing *Whitehouse Hotel Ltd. P'ship v. C.I.R.,* 615 F.3d 321, 332 (5th Cir.2010); *Blodgett v. C.I.R.,* 394 F.3d 1030, 1039 (8th Cir.2005)). Indeed, the Fifth Circuit has gone so far as to explicitly state that "[t]he tax court need not decide whether the burden shifted where, as here, both parties offered some admissible evidence." *Whitehouse Hotel, Ltd. P'ship,* 615 F.3d at 332 (5th Cir.2010) (citing *Blodgett,* 394 F.3d at 1039). This is because "[i]n a situation in which both parties have satisfied their burden of production by offering some evidence, then the party supported by the weight of the evidence will prevail regardless of which party bore the burden of persuasion, proof or preponderance." *Id.* (quoting *Blodgett,* 394 F.3d at 1039).

The parties here have presented mountains of evidence, and so the Fifth Circuit's observations that allocation of burden of proof is sometimes unimportant may well apply here. Of course, this "it makes no difference" caveat does not apply to the IRS' burden for its assertion of fraud penalties, as the IRS must prove fraud by clear and convincing evidence, not a preponderance of the evidence. Out of an abundance of caution, however, this Court undertakes the burden of proof analysis.

162 *See* Case No. 14–35043, Claim No. 18 at 3; Case No. 14–35074, Claim No. 11 at 3.

163 *See* Case No. 14–35043, Claim No. 18 at 3; Case No. 14–35074, Claim No. 11 at 3.

164 FED. R. BANKR. P. 3001(c)(2)(D)(i).

165 Tr. Trans. 1582:23–1596:1 (Herrick).

166 *Id.* at 2766:21–2769:5 (Pfiffner).

167 FED. R. BANKR. P. 3001 advisory committee's note to 2011 Amendments (emphasis added).

168 *See, e.g.,* Tr. Trans. 1633:1–1637:23 (Carey).

169 *In re Fuller,* 204 B.R. 894, 897 (Bankr.W.D.Pa.1997) (citing *In re Schibilsky,* 185 B.R. 81 (Bankr.N.D.Ga.1995); *In re Harrison,* 177 B.R. 564 (Bankr.S.D.Ohio 1994)); *IRS Delegation Order 25–3* (available at https://www.irs.gov/irm/part1/irm 01–002–052.html#d0e534).

170 Tr. Trans. 1648:7–12 (Carey).

171 *In re Today's Destiny, Inc.,* 2008 WL 5479109, at *5 (Bankr.S.D.Tex. Nov. 26, 2008).

172 *See* Debtors' Burden of Proof Brief [ECF No. 936] ¶ 20.

173 *See Carlisle v. Dept. of Justice (In re Carlisle),* 320 B.R. 796 (M.D.Pa.2004); *Vines v. I.R.S. (In re Vines),* 200 B.R. 940, 949 (M.D.Fla.1996) (citing cases).

174 Tr. Trans. 2766:21–2769:5 (Pfiffner).

175 *In re Davis,* 2011 WL 1302222, at *10 (Bankr.E.D.Tex. March 31, 2011).

176 Debtors' Burden of Proof Brief [ECF No. 936] ¶ 4.

177 *In re Simmons,* 765 F.2d at 552; *see In re Southland Corp.,* 160 F.3d at 1059.

178 Debtors' Burden of Proof Brief [ECF No. 936] ¶ 4.

179 529 B.R. 213, 220 (Bankr.W.D.Tex.2015).

180 *Id.*

181 *In re Margaux City Lights Partners, Ltd.,* 2014 WL 6668982, at *3 (Bankr.N.D.Tex. Nov. 20, 2014) (quoting *In re Rally Partners, L.P.,* 306 B.R. 165, 168–69 (Bankr.E.D.Tex.2003)).

182 The Internal Revenue Code imposes obligations on U.S. taxpayers to report certain information about certain foreign business entities that they control. The failure to timely file these information returns on, as relevant here, Forms 3520, 3520–A, and 5471, results in the imposition of penalties for the taxpayer's failure to file the required form. *See* pp. 550–76, *infra.*

183 *See, e.g.,* Tr. Trans. 627:7–628:2 (Evan), 632:3–628:16 (Evan), 1515:14–1519:1 (Laurie), 1565:21–1566:13 (Laurie), 2141:13–2142:15 (Hennington), 2185:4–2192:6 (Hennington).

184 *See* pp. 385–86, *infra.*

[185] *See* pp. 475–513, *infra.*

[186] *See, e.g.,* Debtors' Post–Trial Brief [ECF No. 1118] at 51–87.

[187] *Raleigh,* 530 U.S. at 17, 120 S.Ct. 1951.

[188] While the Court acknowledges that the parties have stipulated to the amount of the income tax deficiencies, thus mooting the burden of proof dispute as to these deficiencies, this analysis would have applied to them if the dispute remained live.

[189] *Helvering v. Taylor,* 293 U.S. 507, 515, 55 S.Ct. 287, 79 L.Ed. 623 (1935).

[190] *Yoon v. C.I.R.,* 135 F.3d 1007, 1012 (5th Cir.1998) (internal citation omitted).

[191] *Neilson v. U.S. (In re Olshan),* 356 F.3d 1078, 1084 (9th Cir.2004) (quoting *Palmer v. U.S.,* 116 F.3d 1309, 1312 (9th Cir.1997)).

[192] 932 F.2d 1128, 1132 (5th Cir.1991) (citing *Donley v. C.I.R.,* 791 F.2d 383 (5th Cir.1986)).

[193] *Data Indus. Corp. of Texas v. I.R.S. (In re Data Indus. Corp. of Texas)*, 489 F.2d 1038, 1039 (5th Cir.1974) (per curium).

[194] The Court notes that the parties have not argued to the contrary.

[195] *See* Debtors' Burden of Proof Brief [ECF No. 936] 19–22.

[196] 356 F.3d at 1084 (internal citations and quotations omitted).

[197] *Portillo,* 932 F.2d at 1132–33.

[198] *In re Olshan,* 356 F.3d at 1084 (internal marks omitted) (quoting *U.S. v. Stonehill,* 702 F.2d 1288, 1294 (9th Cir.1983)).

[199] *Id.* at 1084–85.

[200] *Portillo,* 932 F.2d at 1133; *Felt v. C.I.R.,* 98 T.C.M. (CCH) 372, 2009 WL 3460725, at *11 (2009) (quoting *Portillo* for this proposition).

[201] 932 F.2d 1128 (5th Cir.1991).

[202] *Id.* at 1131.

[203] *Id.*

[204] *Id.*

[205] *Id.* at 1134.

[206] *Id.* at 1133.

[207] *Id.* at 1134

[208] *U.S. v. Janis,* 428 U.S. 433, 442, 96 S.Ct. 3021, 49 L.Ed.2d 1046 (1976) ("Certainly, proof that an assessment is utterly without foundation is proof that it is arbitrary and erroneous."); *Portillo,* 932 F.2d at 1132–33.

[209] The Debtors rely upon *Pearce v. C.I.R.,* 946 F.2d 1543 (5th Cir.1991) (per curiam) (unpublished) and provided the Court with a copy of the opinion. Debtors' Burden of Proof Brief [ECF No. 936] ¶¶ 19–20. However, *Pearce* is distinguishable because, in that case, the IRS failed to actually review the underlying return, which is clearly not the case here. The record clearly shows that the IRS carefully reviewed all of the Wyly tax returns prior to filing its Proofs of Claim. *See Scar v. C.I.R.,* 814 F.2d 1363, 1368 (9th Cir.1987) (holding "the IRS must consider information that relates to a particular taxpayer before it can be said that the [IRS] has 'determined' a 'deficiency' in respect to that taxpayer.").

[210] *See Stobie Creek Inv., LLC v. U.S.,* 82 Fed.Cl. 636, 664 n. 20 (2008), *aff'd,* 608 F.3d 1366 (Fed.Cir.2010); *Estate of Morgens v. C.I.R.,* 133 T.C. 402, 409, 2009 WL 4980468 (2009); *In re Waters,* 2008 WL 384571, at *7 (Bankr.D.Conn. Feb. 8, 2008).

[211] *See Southgate Master Fund, LLC ex rel. Montgomery Capital Advisors, LLC v. U.S.*, 651 F.Supp.2d 596, 649 (N.D.Tex.2009), *aff'd*, 659 F.3d 466 (5th Cir.2011).

[212] *See* pp. 513–50, *infra.*

[213] H.R. CONF. REP. 105–599, 241, 1998 U.S.C.C.A.N. 288, 310; *see also Southgate Master Fund, L.L.C.,* 651 F.Supp.2d at 649 (using legislative history to interpret § 7491).

[214] *Southgate Master Fund, L.L.C.,* 651 F.Supp.2d at 649 (analyzing these two elements under the same framework and using the same evidence).

[215] *See e.g.,* IRS Exs. 412 (fax dated July 10, 1995 from French to Buchannan stating "[p]lease dispose of this fax after reading, as there will be ample documentation as needed") and 413 (fax dated July 10, 1995 from French to Cairns stating "[a]s with my other fax, I suggest that you dispose of this one as there will be adequate subsequent documentation of any transaction").

[216] Tr. Trans. 638:3–14 (Evan), 639:6–9 (Evan), 1895:12–1897:5 (Hennington).

[217] *See* p. 394 n. 261 & p. 550, *infra.*

[218] S. REP. NO. 105–174, 45, 1998 WL 197371 (1998).

219 Tr. Trans. 1759:6–1763:25 (Cousins generally discussing his strategy for representing clients during the IRS audit process, including steps to keep the audit focused), 1794:7–1798:25 (Cousins discussing Meadows Owens' involvement in the 2004 audit, including responses to IRS document requests).

220 *Id.* at 1578:10–1583:4 (Herrick).

221 *Brinkley,* 808 F.3d at 663–64 (IRS' deficiency determination upheld when it was supported by a preponderance of the evidence); *Leland v. C.I.R.,* 110 T.C.M. (CCH) 586, 2015 WL 8981508, at *2 (2015) (tax deficiencies are determined based on a preponderance of the evidence standard); *Estate of Mitchell v. C.I.R.,* 101 T.C.M. (CCH) 1435, 2011 WL 1598623, at *5 (2011) (valuation for gift tax purposes decided based on a preponderance of the evidence).

222 *See* 26 U.S.C. § 7454(a) ("In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary."); Tax Court Rule 142(b) ("In any case involving the issue of fraud with intent to evade tax, the burden of proof in respect of that issue is on the respondent, and that burden of proof is to be carried by clear and convincing evidence.").

223 *See, e.g., Estate of Lisle v. C.I.R.,* 341 F.3d 364, 368 (5th Cir.2003), *mandate recalled and modified on other grounds by* 431 F.3d 439 (5th Cir.2005); *Patton v. C.I.R.,* 799 F.2d 166, 171 (5th Cir.1986) ("[t]he Commissioner bears the burden of proving fraud, which must be established by clear and convincing evidence."); *Toussaint v. C.I.R.,* 743 F.2d 309, 312 (5th Cir.1984) ("The Commissioner has the burden of proving, by clear and convincing evidence, that some portion of the deficiency assessed was produced by fraud with intent to evade taxes."); *Goldberg v. C.I.R.,* 239 F.2d 316, 320 (5th Cir.1956) (IRS must establish fraud by clear and convincing evidence).

224 *See, e.g., Maciel v. C.I.R.,* 489 F.3d 1018, 1026 (9th Cir.2007); *Carreon v. C.I.R.,* 107 T.C.M. (CCH) 1040, 2014 WL 91959, at *6 (2014); *Garavaglia v. C.I.R.,* 102 T.C.M. (CCH) 286, 2011 WL 4448913, at *25 (2011), *aff'd,* 521 Fed.Appx. 476 (6th Cir.2013); *Prowse v. C.I.R.,* T.C. Memo. 2006–120, 2006 WL 1593998, at *7 (2006).

225 26 U.S.C. § 7454(a); *Putnam v. C.I.R.,* 110 T.C.M. (CCH) 199, 2015 WL 4880980, at *9 (2015) (citing *Clayton v. C.I.R.,* 102 T.C. 632, 646–53, 1994 WL 135337 (1994)); *George v. C.I.R.,* 110 T.C.M. (CCH) 190, 2015 WL 4747544, at *7 (2015); *Caton v. C.I.R.,* 103 T.C.M. (CCH) 1488, 2012 WL 1034062, at *2 (2012) ("In deciding whether a failure to file is fraudulent under section 6651(f), we consider the same elements that are considered in imposing the addition to tax for fraud under former section 6653(b) and present section 6663.").

226 *See Carreon,* 2014 WL 91959, at *6; *Hatling v. C.I.R.,* 104 T.C.M. (CCH) 475, 2012 WL 5199405, at *8 (2012); *Norris v. C.I.R.,* 102 T.C.M. (CCH) 26, 2011 WL 2670580, at *4–5 (2011); *DiLeo v. C.I.R.,* 96 T.C. 858, 873, 1991 WL 108769 (1991) ("Respondent has the burden of proving by clear and convincing evidence that some part of an underpayment for each year in issue was due to fraud.").

227 *Brown v. C.I.R.,* 106 T.C.M. (CCH) 630, 2013 WL 6244549, at *45 (2013) (citing *Gleis v. C.I.R.,* 24 T.C. 941, 952, 1955 WL 784 (1995), *aff'd,* 245 F.2d 237 (6th Cir.1957); *Holmes v. C.I.R.,* T.C. Memo. 2012–251, at *37).

228 26 U.S.C. § 6663(b); *cf. Toussaint,* 743 F.2d at 312 (interpreting § 6653) (citing *Webb v. C.I.R.,* 394 F.2d 366, 378 (5th Cir.1968)); *Loftin & Woodard, Inc.,* 577 F.2d 1206, 1236 (5th Cir.1978).

229 26 U.S.C. § 6663(c).

230 Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 138 ("The IRS has the burden of proving exceptions to the general limitations period. To meet this burden, the IRS must, again, satisfy the two-prong fraud test for each year. Thus, the IRS again must prove (1) that the Wylys underpaid their tax for that year, and (2) that some part of that underpayment for that year was due to intentional wrongdoing with the specific purpose to evade a tax believed to be owing." (internal quotation marks omitted)); IRS' Pre–Trial Brief [ECF No. 1018] at 3 ("The United States asserts that the statute of limitations for the income and gift tax periods at issue is open due to the fact that the Wylys committed civil tax fraud."); *see Jacoby v. C.I.R.,* 109 T.C.M. (CCH) 1365, 2015 WL 1518058, at *5 (2015) ("The Commissioner has the burden of proving exceptions to the general limitations period. To satisfy his burden in this case, respondent must show by clear and convincing evidence that: (1) an underpayment exists; and (2) Mr. Jacoby intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes. This is the same as his burden under section 6663 to prove applicability of the civil fraud penalty ..." (internal citations omitted)); *Potter v. C.I.R.,* 107 T.C.M. (CCH) 1101, 2014 WL 289021, at *3 n. 3 (2014) ("Because we conclude that petitioner's underpayments were due to fraud, there is no period of limitations."); *Seiffert v. C.I.R.,* 107 T.C.M. (CCH) 1017, 2014 WL 92058, at *8 (2014) ("Respondent's burden of proof under section 6501(c)(1) is the same as that imposed under section 6663."); *see also Payne v. C.I.R.,* 224 F.3d 415, 423–24 (5th Cir.2000) (using fraud penalty standards and concepts in order to determine whether the statute of limitations remained open under § 6501(c)(1)).

231 26 U.S.C. § 7491(c); *accord McLauchlan v. C.I.R.,* 558 Fed.Appx. 374, 380 (5th Cir.2014) (unpublished); *Rhodes v. C.I.R.,* 152 Fed.Appx. 340, 342 (5th Cir.2005) (unpublished); *see also Juha v. C.I.R.,* 103 T.C.M. (CCH) 1338, 2012

WL 833226, at *6 (2012) ("The Commissioner has the initial burden of producing evidence to support the applicability of a section 6662(a) penalty. Sec. 7491(c). To meet this burden, the Commissioner must come forward with sufficient evidence to show that it is appropriate to impose the penalty.").

[232] 26 U.S.C. § 6664(c)(1) provides that "[n]o penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."

[233] *Id.* at § 6677(d) provides that "[n]o penalty shall be imposed by this section on any failure which is shown to be due to reasonable cause and not due to willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause."

[234] *Id.* at § 6038(c)(4)(B) provides that "[f]or purposes of this subsection and subsection (b), the time prescribed under paragraph (2) of subsection (a) to furnish information (and the beginning of the 90–day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary) reasonable cause existed for failure to furnish such information."

[235] *See Moore v. U.S.,* 2015 WL 1510007, at *4 (W.D.Wash. April 1, 2015).

[236] *Klamath Strategic Inv. Fund ex rel. St. Croix Ventures v. U.S.*, 568 F.3d 537, 548 (5th Cir.2009) (citing *Montgomery v. C.I.R.*, 127 T.C. 43, 66 (2006)).

[237] *See CNT Investors, LLC v. C.I.R.,* 144 T.C. 161, 223 (2015) (citing *Neonatology Assocs., P.A. v. C.I.R.,* 115 T.C. 43, 99, 2000 WL 1048512 (2000), *aff'd,* 299 F.3d 221 (3d Cir.2002)); *McClellan v. C.I.R.,* 106 T.C.M. (CCH) 492, 2013 WL 5849873, at *12 (2013); *Lehrer v. C.I.R.,* 92 T.C.M. (CCH) 81, 2006 WL 2129797, at *2 (2006). Although no case that the Court was able to locate states that specific reasonable cause provisions in §§ 6038 and 6677 must be proven by a preponderance of the evidence, the above-cited cases make it clear that reasonable cause defenses in general must be proven by this standard.

[238] *See* 26 U.S.C. § 6013(d)(3) ("if a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several."); *Cheshire v. C.I.R.,* 282 F.3d 326, 331 (5th Cir.2002). As was pointed out previously, Dee and Charles filed joint tax returns throughout their marriage until Charles' death in 2011.

[239] *Cheshire,* 282 F.3d at 331.

[240] 26 U.S.C. § 6015; *Cheshire,* 282 F.3d at 331–32.

[241] 26 U.S.C. § 6015(c)(1) (referring to subsection (d) for instructions on how to calculate this separate amount); *Cheshire,* 282 F.3d at 332.

[242] *Cheshire,* 282 F.3d at 332.

[243] *Hollimon v. C.I.R.,* 110 T.C.M. (CCH) 187, 2015 WL 4747779, at *2 (2015); *Stergios v. C.I.R.,* 97 T.C.M. (CCH) 1057, 2009 WL 151485, at *4 (2009).

[244] *Richard v. C.I.R.,* 101 T.C.M. (CCH) 1689, 2011 WL 2553379, at *2 (2011); 26 C.F.R. § 1.6015–3(c)(2)(i).

[245] Given the SDNY Court's determinations that the relevant IOM trusts were grantor trusts to Sam and Charles, and subject to (i) that decision being affirmed on appeal, and (ii) this Court's decision to apply collateral estoppel effect to that determination not being overturned on appeal, the Debtors, the probate estate of Charles, and the IRS have stipulated to the amounts of income tax underpayments and gift tax underpayments (assuming this Court finds that gifts were made) that are owing to the IRS. As a result, only the second prong (that the underpayment(s) for each relevant year was due to fraud) must be proven by the IRS here.

[246] *Gagliardi v. U.S.,* 81 Fed.Cl. 772, 777 (2008) ("The term 'fraud,' as used in the statutory provisions authorizing the assessment of civil fraud penalties against taxpayers, means intentional wrongdoing on the part of a taxpayer motivated by a specific purpose to evade a tax known or believed to be owing.); *Pesky v. U.S.,* 2013 WL 97752, *3 (D.Idaho Jan. 7, 2013) ("fraud is intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be owing").

[247] That Sam loves his family, and vice versa, is obvious. The same is true for Dee. Throughout trial, the courtroom has been filled with a combination, albeit sometimes different combinations, of the Debtors' children and perhaps grandchildren. Two of Sam's children testified at trial, Evan and Laurie, and their love and respect for their father was clear. It is also clear that Sam has instilled in his children the importance of family remaining close through family trips, periodic but regular family meetings, a focus of which is simply staying in touch and letting each other know what is going on in their respective lives, and the like. Dee's son-in-law, Donnie Miller, who is married to Dee's eldest daughter, Martha, and who is the executor of Charles' probate estate, also testified at trial and it is clear that Donnie was close to Charles and is close to Dee.

248 Sam told a story of making a modest and innocent mistake on an early tax return he filed which taught him that the tax laws were complicated and that he should hire professionals to assist him in complying with them, which he has done ever since. The mistake there cost him $134. Tr. Tran. 379:5–388:1; 694:4–11(Sam).

249 As used here "wishes" is a term of art and much evidence will be discussed throughout this Memorandum Opinion about how Sam and Charles made their "wishes" known to the trustees of the IOM trusts, who then implemented those "wishes" even when sound business judgment might have suggested it was imprudent to do so.

250 Collateral Estoppel No. 43; *see also* IRS Exs. 396 (February 2, 2004 audit letter from the IRS to Dee and Charles referencing the transfer of stock options to foreign trusts), 380 (email dated February 3, 2004 from Hennington to Boucher and Pulman stating "Sam really wants us to explore what happens if he is not a U.S. citizen—we can discuss tomorrow, I just did not want to forget."), 381 and 382 (internal Meadows Owens memoranda dated February 4 and 28, 2004, respectively, analyzing taxation of expatriates); Tr. Trans. 1018:17–1025:3(Sam).

251 *Cf. Richardson v. C.I.R.,* 509 F.3d 736, 743 (6th Cir.2007) ("It is the rare taxpayer who announce to the world his intent to defraud the Federal Government.").

252 Although the IRS claimed one during its closing argument through a misstatement of what eliminations on a consolidated financial statement mean.

253 *See Richardson,* 509 F.3d at 743–44; *Carreon,* 2014 WL 91959, at *6.

254 *See, e.g., Estate of Trompeter v. C.I.R.,* 279 F.3d 767, 773 (9th Cir.2002) (quoting *Bradford v. C.I.R.,* 796 F.2d 303, 307–08 (9th Cir.1986)); *Hatling,* 2012 WL 5199405, at *10–11. The implication of these varied lists of badges of fraud is that these lists are illustrative, rather than exhaustive. *See Niedringhaus v. C.I.R.,* 99 T.C. 202, 211 (1992); *Miller v. C.I.R.,* 94 T.C. 316, 334 (1990); *see also Webb,* 394 F.2d at 378 ("A summary of the above standards demonstrates their tutorial limitations: We must determine whether it is clearly erroneous that the taxpayer's intent to defraud the government was proven, as to any part of the deficiency, by clear and convincing evidence. Our path in fraud determinations is even more obstacle-pocked because we have no cinematography of the mind nor do we have books approaching impeccable accuracy. Nevertheless, courts have attempted to avoid deciding each case viscerally and have established certain factual checklists.").

255 *See Richardson v. C.I.R.,* 91 T.C.M. (CCH) 981, 2006 WL 931912, at *22 (2006) ("In examining these factors [badges of fraud], this and other courts have further noted that the taxpayer's background, his or her level of education, and prior history of filing proper returns, and the context of the events in question are relevant to the inquiry.").

256 *Prowse,* 2006 WL 1593998, at *7 (citing cases); *Inner–City Temp., Inc. v. C.I.R.,* 60 T.C.M. (CCH) 726, 1990 WL 130150 (1990) ("This and other courts frequently list various factors or 'badges of fraud,' but such lists of various kinds of circumstantial evidence from which fraudulent intent can be inferred are nonexclusive. The fact finder must weigh all of the evidence of record, and not merely check off the presence or absence of the various possible kinds of circumstantial evidence.") (internal citations omitted). *Cf. Spies v. U.S.,* 317 U.S. 492, 499, 63 S.Ct. 364, 87 L.Ed. 418 (1943) (fraud may be inferred from "any conduct, the likely effect of which would be to mislead or conceal.").

257 26 U.S.C. § 6662(b)(6) states that: "[a]ny disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(*o*)) or failing to meet the requirements of any similar rule of law."

258 The Court does not accept the Debtors' argument that reliance on the advice of counsel can negate fraudulent intent as a matter of law if there is clear and convincing circumstantial evidence of sufficient badges of fraud to prove fraudulent intent indirectly. If the Debtors' argument were true, there would be no need for the reliance on advice of counsel defense set forth in the statute. That reliance would simply be used to negate fraudulent intent as a matter of law as the Debtors assert here, precluding the IRS from carrying its burden of proof in every such case.

259 Almost all of the badges of fraud found applicable to Sam are equally applicable to Charles since his actions offshore are virtually in lockstep with Sam's actions. Although Charles' probate estate is not a formal party to the Motions, its counsel was present throughout the trial as was its executor, Donnie Miller, after he provided this Court with his testimony and was released from the rule. Because Dee and Charles filed joint tax returns until his death in 2011, and because Dee asks this Court to determine her liability to the IRS during those joint return years and thereafter, the Court has concluded that it must decide if Charles committed tax fraud for at least two reasons: (i) to decide if the statute of limitations on those years (1992–2011) remains open given the IRS' assertion of tax fraud against Dee and Charles, and (ii) to decide the extent to which Dee participated in Charles' alleged fraud.

260 *See Niedringhaus,* 99 T.C. at 211; *Miller,* 94 T.C. at 334.

261 The other "usual" badges of fraud are simply not present here. Specifically, there is no credible evidence in the record that the Wylys (i) failed to keep adequate records or kept a double set of books and records, (ii) failed to file tax returns or make estimated tax payments, (iii) engaged in criminal activities, and/or (iv) dealt in cash. The fact that these badges

of fraud are not present supports a finding of no fraudulent intent. However, as the case law makes clear, the use of badges of fraud is not a simple process of counting up the badges and seeing how many are on each side of the fraud or no fraud equation. Rather, the presence of several badges suggesting fraudulent intent can outweigh those that do not. *Cf. Sanchez v. C.I.R.,* 108 T.C.M. (CCH) 216, 2014 WL 4251054, at *6 (2014) ("Although no single factor is necessarily sufficient to establish fraud, a combination of several of these factors may be persuasive evidence of fraud."); *Prowse,* 2006 WL 1593998, at *7 (citing *Petzoldt v. C.I.R.,* 92 T.C. 661, 700, 1989 WL 27845 (1989)); *Paschal v. C.I.R.,* 68 T.C.M. (CCH) 366, 1994 WL 424015, at *12 (1994).

262 Joint Stipulations ¶ 18.

263 *See* pp. 513–50, *infra.*

264 Joint Stipulations ¶ 19.

265 Joint Ex. 1 (Trust Agreement of the Bulldog Non–Grantor Trust) ¶ 5.9(a) (stating the trustee shall not "[k]knowingly take any action or do any act which may cause this Trust to become a grantor trust for United States income tax purposes.").

266 Joint Stipulations ¶ 19.

267 Joint Ex. 1 ¶¶ 1(a), 5.2(a) & Schedule A.

268 Joint Stipulations ¶ 21.

269 *Id.* ¶ 22.

270 Joint Ex. 2 (Trust Agreement of the Lake Providence International Trust) ¶ 5.9(a) (stating the trustee shall not "[k]knowingly take any action or do any act which may cause this Trust to become a grantor trust for United States income tax purposes.").

271 Joint Stipulations ¶ 22.

272 Joint Ex. 2 ¶¶ 1(a), 5.2(a) & Schedule A.

273 Joint Stipulations ¶ 24.

274 *Id.* ¶ 25.

275 Joint Ex. 3 (Trust Agreement of Delhi International Trust) ¶ 5.9(a) (stating the trustee shall not "[k]knowingly take any action or do any act which may cause this Trust to become a grantor trust for United States income tax purposes.").

276 Joint Stipulations ¶ 25.

277 Joint Ex. 3 ¶¶ 1(a), 5.2(a) & Schedule A.

278 Joint Stipulations ¶ 27.

279 *Id.* ¶ 28, Joint Ex. 4.

280 SEC Trial Tr. 3751:24–3752:4, 3752:15–18 (French); IRS Ex. 806 at WYLYSEC00010968 (February 16, 1994 memorandum from Lubar to French "Re: Foreign Trusts" in which Lubar states that trusts settled by nonresident aliens —*i.e.,* King and Cairns—"will be 'grantor trusts' for all U.S. federal income tax purposes ... [but] because the Grantor [King and/or Cairns] is a nonresident alien as to the United States ..., the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.").

281 Joint Exs. 4 ¶ 1(2)(e) & Schedule 3 (SWYLY053814), 5, 6, 8, and 10.

282 Joint Stipulations ¶ 36. The other corporations wholly owned by Bessie IOM Trust are Mi Casa Limited (IOM), Cottonwood I Limited (IOM), Cottonwood II Limited (IOM), Spitting Lion Limited (IOM), and Rosemary's Circle R Ranch Limited (IOM).

283 Tr. Trans. 2091:6–2092:19 (Hennington). That the liquidation occurred in 2006 is reflected in the demonstrative exhibits submitted by the parties. *See* Memorandum Opinion Exhibits D–G. The charts attached to this Memorandum Opinion are, for the most part, agreed demonstrative exhibits. Although the Debtors and the IRS submitted competing charts regarding the Cottonwood Ventures properties and Stargate Horse Farm, the exhibits agreed as to the basic ownership structure of the properties, which is the purpose for which they are being used here.

284 Joint Stipulations ¶ 43.

285 *See* Memorandum Opinion Exhibit D.

286 Joint Stipulations ¶ 44.

287 *See* Memorandum Opinion Exhibit E.

288 Joint Stipulations ¶ 45.

289 *See* Memorandum Opinion Exhibit F.

290 Joint Stipulations ¶ 46.

291 *Id.*

292 *See* Memorandum Opinion Exhibit G.

293 Joint Stipulations ¶ 47.

294 *Id.*

295 *Id.*

296 *See* Memorandum Opinion Exhibit H.

297 Joint Stipulations ¶ 48, Joint Ex. 17.

298 SEC Trial Tr. 3751:24–3752:4, 3752:15–18 (French); IRS Ex. 806 at WYLYSEC00010968 (February 16, 1994 memorandum from Lubar to French “Re: Foreign Trusts” in which Lubar states opines that trusts settled by nonresident aliens—*i.e.,* King and Cairns—“will be ‘grantor trusts' for all U.S. federal income tax purposes ... [but] because the Grantor [King and/or Cairns] is a nonresident alien as to the United States ..., the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.”).

299 Joint Exs. 17 ¶ 1(2)(e) & Schedule 3 (SWYLY053860), 19, 20, 21, and 23.

300 Joint Stipulations ¶ 56.

301 *See* Memorandum Opinion Exhibit B. The date Relish Limited (IOM) was formed is not in the record.

302 Joint Stipulations ¶ 57.

303 *Id.*

304 *Id.*

305 Joint Ex. 25 ¶ 1(2)(f) & Schedule 3 (SWYLY001310).

306 Joint Stipulations t 60.

307 *Id.*

308 *Id.*

309 Joint Ex. 26 ¶ 1(2)(f) & Schedule 3 (SWYLY053892).

310 Joint Stipulations ¶ 62.

311 *Id.*

312 *Id.*

313 Joint Ex. 27 ¶ 1(2)(f) & Schedule 3 (SWYLY00887).

314 Joint Stipulations ¶ 64.

315 *Id.*

316 Joint Ex. 28 ¶ 1(2)(f) & Schedule 3 (SWYLY000942).

317 Joint Stipulations ¶ 75.

318 Joint Ex. 35 (Trust Agreement of Pitkin Non–Grantor Trust) ¶ 5.9(a) (stating the trustee shall not “[k]knowingly take any action or do any act which may cause this Trust to become a grantor trust for United States income tax purposes.”).

319 Joint Stipulations ¶ 75.

320 Joint Ex. 35 ¶¶ 1(a) & Schedule A at § 2.

321 Joint Stipulations ¶ 77.

322 *Id.* ¶ 78.

323 Joint Ex. 36 (Trust Agreement of the Lake Providence International Trust); *id.* at ¶ 5.9(a) (stating the trustee shall not “[k]knowingly take any action or do any act which may cause this Trust to become a grantor trust for United States income tax purposes.”).

324 Joint Stipulations ¶ 78.

325 Joint Ex. 36 ¶¶ 1(a) & Schedule A at § 2.

326 Joint Stipulations ¶ 80.

327 *Id.* ¶ 81, Joint Ex. 37.

328 SEC Trial Tr. 3751:24–3752:4, 3752:15–18 (French); IRS Ex. 806 at WYLYSEC00010968 (February 16, 1994 memorandum from Lubar to French “Re: Foreign Trusts” in which Lubar states opines that trusts settled by nonresident aliens—*i.e.,* King and Cairns—“will be ‘grantor trusts' for all U.S. federal income tax purposes ... [but] because the Grantor [King and/or Cairns] is a nonresident alien as to the United States., the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.”).

329 Joint Exs. 37 ¶ 1(2)(e) & Schedule 3 (SWYLY016442), 38, 40, and 41.

330 Joint Stipulations ¶ 87.

331 The date Jourdan Way Limited (IOM) was formed is not in the record. Per the agreed demonstrative exhibit submitted by the parties, Jourdan Way Limited (IOM) was never funded. *See* Memorandum Opinion Exhibit C.

332 Joint Stipulations ¶ 88, Joint Ex. 42.

333 SEC Trial Tr. 3751:24–3752:4, 3752:15–18 (French); *see* IRS Ex. 806 at WYLYSEC00010968 (memorandum to French dated February 16, 2004 in which Lubar opines that trusts settled by nonresident aliens—*i.e.,* King and Cairns—"will be 'grantor trusts' for all U.S. federal income tax purposes ... [but] because the Grantor [King and/or Cairns] is a nonresident alien as to the United States., the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.").

334 Joint Exs. 42 ¶ 1(2)(e) & Schedule 3 (SWYLY000763), 44, and 46.

335 Joint Stipulations ¶ 94.

336 *Id.* § 95.

337 *Id.*

338 Joint Ex. 48 ¶ 1(2)(f) & Schedule 3 (SWYLY000252).

339 Joint Stipulations ¶ 98.

340 *Id.*

341 Joint Ex. 49 ¶ 1(2)(f) & Schedule 3 (SWYLY000183).

342 Joint Stipulations ¶ 100.

343 Joint Ex. 50 ¶ 1(2)(f) & Schedule 3 (SECI0017268).

344 Joint Stipulations ¶ 119; Joint Ex. 58 (Private Annuity Agreement) § 3.1 ("The parties hereby agree that there is and shall be no security or collateral for the payment of the Annuity hereunder.") and § 2.4(a) ("The parties further acknowledge that the Obligor [East Baton Rouge Ltd. (Nevada)] presently lacks the liquidity to easily make the annuity payments that would be required hereunder if the annuity payment commencement were not deferred."); Lubar Depo. Tr. 39:7–40:5 (discussing his concerns that the annuities were being issued by companies that had no other assets).

345 Joint Stipulations ¶ 119; Lubar Depo. Tr. 39:7–40:5

346 *Id.* ¶¶ 21, 119.

347 *Id.* ¶¶ 121, 123, 125, 127, and 129. *See also* Wyly Ex. B.

348 Although certain annuity transactions were initiated in late December 2015, this Memorandum Opinion classifies them as part of the 1996 annuity transactions for ease of reference.

349 Joint Stipulations ¶¶ 131, 133, 137, 139, and 141. *See also* Wyly Ex. B.

350 Joint Stipulations ¶¶ 145, 147, 149, and 151.

351 *Id.* ¶¶ 153, 155, 157, and 159.

352 *See* Joint Exs. 59, 61, 63, 65, 67, and 69, whereby Sam deferred annuity payments scheduled to commence on his 65th birthday to his 70th birthday, and 71, 73, 75, 77, and 79, whereby Sam deferred annuity payments scheduled to commence on his 68th birthday to his 73rd birthday. Although the record reflects that Sam entered into six annuity transactions in each of the relevant years, the record does not contain the Private Annuity Agreement or an Amendment to Private Annuity Agreement related to Yurta Faf Limited (IOM).

353 Joint Stipulations ¶ 175 (annuity payments by year); Joint Exs. 58–79 (Annuity Agreements and Amendments to Annuity Agreements).

354 *See* Joint Exs. 81, 82, and 85, whereby Charles deferred annuity payments scheduled to commence on his 65th birthday to his 70th birthday, and 89, 91, 93, and 95, whereby Charles deferred annuity payments scheduled to commence on his 68th birthday to his 73rd birthday. Dee similarly extended annuity payments that were scheduled to commence on her 65th birthday to her 70th birthday. Joint Ex. 87.

355 Joint Stipulations ¶ 173 (annuity payments by year); Joint Exs. 80–95 (Annuity Agreements and Amendments to Annuity Agreements). Then, beginning in late 1999, Dee and Charles undertook a further highly complicated transaction in which all of the annuity agreements they had entered into which were held by an IOM corporation were transferred to Stargate Investments, Ltd, a Texas limited partnership ("Stargate Investments (Texas)"). A chart prepared by the parties depicting this transaction is attached as Exhibit K to this Memorandum Opinion. The evidentiary record is largely silent as to the reasons for the complexity of this further transaction. To date, in exchange for approximately $55 million worth of options, Dee and Charles have received—and paid tax on—approximately $112 million in annuity payments. As noted previously, Charles died in the summer of 2011, after which annuity payments on his life ceased. Dee continues to receive some annuity payments. More precisely, Stargate Investments (Texas) received all of the annuity payments, but Dee and Charles reported all of the annuity payments received by Stargate Investments (Texas) as ordinary income and as self-

employment income on their joint federal income tax returns for the 2003 through 2011 tax years. Dee reported all of the annuity payments received by Stargate Investments (Texas) as ordinary income and as self-employment income on her individual federal income tax returns for 2012 and 2013. *See* Joint Stipulations §§ 161–162, 173, 174.

356 Joint Stipulations ¶ 175.

357 These corporations are (i) Tensas Limited (IOM), of which Sam forgave $14,913,153.13 in annuity payments, (ii) East Baton Rouge Limited (IOM), of which Sam forgave $20,947,937.97 in annuity payments, and (iii) East Carrol Limited (IOM), of which Sam forgave $25,111,130.26 in annuity payments.

As to Tensas Limited (IOM), *see* IRS Ex. 1131 at 582 (letter agreement whereby Sam agrees to accept Tensas Limited (IOM)'s assets valued at $2,068,000 in forgiveness of all past due annuity payments totaling $5,403,975 in principal, plus $787,742.13 in interest, and all future annuity payments) and IRS Ex. 1132 at 1495 (Tensas Limited (IOM)'s unaudited financial statement valuing future annuity payments owing to Sam, prior to forgiveness, at $10,789,436).

As to East Baton Rouge Limited (IOM), *see* IRS Ex. 1135 at 855 (letter agreement whereby Sam agrees to accept East Baton Rouge Limited (IOM)'s assets valued at $1,987,646 in forgiveness of all past due annuity payments totaling $3,416,187, plus interest of $252,553.97, and all future annuity payments) and IRS Ex. 1136 at 527 (East Baton Rouge Limited (IOM)'s unaudited financial statements valuing future annuity payments owing to Sam, prior to forgiveness, at $19,266,843).

As to East Carrol Limited (IOM), *see* IRS Ex. 1134 at 4427 (letter agreement whereby Sam agrees to accept East Carrol Limited (IOM)'s assets valued at $1,283,807.74 in forgiveness of all past due annuity payments totaling $3,142,095 and all future annuity payments) and IRS Ex. 1133 at 607 (East Carrol Limited (IOM)'s unaudited financial statements valuing future annuity payments owing to Sam, prior to forgiveness, at $23,252,843). *See* Tr. Trans. 2647:23–2671:70(Sam).

358 *See* Amended Bankruptcy Schedule B, Exhibit B–16 [ECF No. 472] at p. 55 of 94. However, at trial, Sam testified he was not expecting any further payments from those entities at all. Tr. Trans. 2941:1–8(Sam). *See also* pp. 431–41, *infra.*

359 IRS Ex. 96 at WYLYSEC01112402 (memorandum dated June 20, 2003 from Hennington and Boucher to, among others, Sam and Charles).

360 Tr. Trans. 2671:3–7(Sam) ("Q. And the funds in the offshore system, including East Carroll, Tensas, and East Baton Rouge, funds were spent at your direction to buy homes, art, and invest in Wyly-related businesses. Correct? A. That sounds—that sounds correct.").

361 As will be further discussed, the IRS contends that the record supports a finding that the Wylys never intended for the annuities to be paid. According to the IRS, the Wylys didn't need for the money to come back to the United States through annuity payments that would be taxed to them as ordinary income when received, after they and their lawyers had devised complicated structures that enabled the family to enjoy the benefits of their offshore wealth in the United States tax-free. *See* pp. 423–31, *infra.*

362 The Nevada entities were used to avoid payment of excise taxes on the transfers of the options and warrants. *See* Tr. Trans. 1203:2–11) (Chatzky) ("the primary reason why the Nevada corporation was used is because it was believed ... that if a foreign corporation issued an annuity, that there would be an excise tax imposed on the foreign corporation in the amount of 1 percent of the consideration for the annuity. Subsequent research showed that that wasn't the case."). While the Court is not troubled by the use of a Nevada corporation to avoid excise tax, the use of so many and the reason that so many were used—*i.e.,* to attempt to avoid SEC reporting requirements by keeping each entity's ownership below the required reporting threshold as discussed *infra* at pp. 407–13—is more problematic and indicative of fraud.

363 Tr. Trans. 1269:20–25 (Chatzky).

364 *See* pp. 407–13, *infra.*

365 *See* pp. 513–36, *infra.*

366 Joint Stipulations ¶ 36.

367 *Id.* ¶ 87.

368 *See, e.g.,* Tr. Trans. 934:1–14 (Evan), 1561:11–1563:22 (Laurie), 2259:14–2262:6 (Hennington); Wyly Exs. QF (Possession Agreement dated April 2, 2004 between Laurie and her husband, on the one hand, and Audubon Asset Limited (IOM), on the other, permitting Laurie to hang various pieces of art, including Audubon plates and a Picasso painting, in her home); IRS Exs. 20, 22, 24, and 25 (invoices detailing substantial amounts of jewelry, art, antiques, and home furnishings purchased by Soulieana Limited (IOM) for use by Dee and Charles); IRS Ex. 21 at WYLYSEC00130636 (fax coversheet from Amy Browning of the Wyly family office to Huntsman Gallery directing that invoices for purchases by Dee be issued to Soulieana Limited (IOM) and that "[t]he Wyly name should not be noted on the invoices"); IRS Ex. 203 at 145098 (letter dated December 1, 2000 from Trident Trust to Man & Partners discussing drafting of Possession Agreements for assets owned by Soulieana Limited (IOM) and used by Dee and Charles, explaining that: "[w]e should

appreciate your assistance in the preparation of a Possession Agreement Letter in respect of personal chattels, owned by [Soulieana Limited (IOM)], presently in the possession of individuals on an informal basis. * * * The schedule of chattels will be extensive and comprise items of antiques, furniture, paintings and prints, silverware, glassware, porcelain and ceramics, miscellaneous objects of art and jewelry. The value in total is in excess of $4 million."). As reflected on IRS Ex. 444, sometime around December 2000, Charles agreed to purchase from Soulieana Limited (IOM) all items it purchased on his and Dee's behalf with a cost of $10,000 or less, which totaled "around $381K," and setting a minimum cost threshold of $10,000 for future purchases by Soulieana Limited (IOM). IRS Ex. 444 at SEC/ITC0104002; Tr. Trans. 2386:18–2390:18 (Hennington discussing Charles' purchase of the assets from Soulieana Limited (IOM)).

369 *See* pp. 446–47 n. 573–75, *infra.*

370 Collateral Estoppel No. 1; Joint Stipulations ¶¶ 18–74 (Sam IOM entities), 75–109 (Charles IOM entities), 68 (Sam protectors), 104 (Charles protectors); SEC Tr. Trans. 1731:24–1732:1 (French discussing being a protector with Robertson); 1736:9–1737:15 (French testifying that the IOM trustees never refused a direction), 294:17–23 (Robertson testifying she does not recall an instance where an IOM trustee refused a recommendation), 555:3–8 (Robertson testifying that no material securities transactions were initiated without Sam's or Charles' input), 997:5–10 (Boucher testifying all securities transactions were initiated by Charles or Sam), 1114:20–23 (Boucher testifying she does not recall a single instance between 1995 and 2005 where a trustee refused to implement a recommendation).

371 Collateral Estoppel No. 2; Joint Stipulations ¶¶ 3–4, 8–10, and 13–14, (discussing positions the Wylys held with various companies) and 119–176 (discussing annuity and stock transactions); Tr. Trans. 1692:6–1694:24 (Sam testifying that trust holdings were kept below 5% to avoid SEC filing requirements), 1696:7–1697:5 (Sam testifying that it wasn't until 2005, and after the SEC investigation began, that he and Charles filed documents with the SEC disclosing that either of them beneficially owned securities in Michaels Stores, Sterling Software, Sterling Commerce, or Scottish Re), 1914:4–1915:8 (Hennington discussing compensatory nature of the options transferred to the IOM corporations).

372 Collateral Estoppel No. 3.

373 Collateral Estoppel No. 4.

374 Collateral Estoppel No. 5; SEC Tr. Trans. 156:25–157:7 (Robertson); Robertson Depo. Tr. 76:19–77:2; IRS Ex. 85 (June 12, 1991 memorandum from Robertson to Sam, Charles, Evan, French, and Ethel Ketter, in-house CPA for the Wyly family office, discussing Tedder's seminar on asset protection and tax deferral); Tr. Trans. 696:23–627:16 (Sam, however, testified that he did not attend the New Orleans conference); SEC Tr. Trans. 168:2–12 (Robertson testifying that she attended the New Orleans seminar along with Sam, Charles, and French); SEC Tr. Trans. 1716:9–1718:8 (French testifying regarding the various seminars and meetings); Tr. Trans. 1050:19–1059:11 (Sam testifying regarding the various seminars and meetings); IRS Ex. 525 (written information Sam received from Tedder titled "An Overview of Asset Protection Estate and Income Tax Reduction Using Domestic and International Structures").

375 Collateral Estoppel No. 6; Tr. Trans. 1050:19–1051:16(Sam), 1052:9–1059:11(Sam); SEC Tr. Trans. 1719:3–17 (French); IRS Ex. 525 (written information Sam received from Tedder titled "An Overview of Asset Protection Estate and Income Tax Reduction Using Domestic and International Structures").

376 Collateral Estoppel No. 7; IRS Exs. 130 (November 11, 1991 memorandum from French to Sam discussing tax benefits of foreign trusts), 93 (tax savings chart reflecting a fax date of November 1, 1996 and bearing the notation "Sam likes the # 's!"), 85 (June 12, 1991 communication from Robertson to Sam, Charles, and others) at SEC100150261 (listing the six "goals" of the Tedder tax scheme, three of which are to avoid taxes—"(1) Never pay probate.... (2) Whenever possible eliminate inheritance tax.... (3) Wherever possible reduce income tax—both domestically and foreign.").

377 Collateral Estoppel No. 8; SEC Tr. Trans. 1719:7–1721:6 (French); IRS Ex. 1199 ¶ 9(p.7) (Annex A, Admissions of Defendant Michael C. French).

378 Collateral Estoppel No. 9.

379 Collateral Estoppel No. 10.

380 Collateral Estoppel No. 11; Tr. Trans. 727:5–14(Sam); IRS Ex. 86 (email from Robertson to Evan dated November 3, 2000 and stating "[r]emember that it is critical from a U.S. tax standpoint that there is no appearance that the Wyly's [*sic*] are in control of the trusts or protectors.").

381 While this may appear to be a formatting error in this Memorandum Opinion, it is not. Rather, when the IRS submitted its proposed collateral estoppel findings from the SEC Action, it submitted findings made by the SDNY Court in footnotes as well as in the body of the court's opinion. So, footnote 91 as quoted here is footnote 91 in the SDNY Court's opinion, which is Collateral Estoppel No. 12 on Exhibit A to this Memorandum Opinion. Anytime a footnote is quoted in this body of this Memorandum Opinion, it is a footnote finding of the SDNY Court in the SEC Action, to which this Court has given collateral estoppel effect.

382 Collateral Estoppel No. 12; Tr. Trans. 727:5–14(Sam); IRS Ex. 86 (November 3, 2000 email from Boucher to Evan).

383 Collateral Estoppel No. 13; SEC Tr. Trans. 246:11–248:2 (Robertson testifying regarding tracking ownership of stock among trust management companies, transferring stock between companies, and hiring new trust management companies to avoid any single company owning more than 5% of the issuer which triggers mandatory reporting); *accord* Harris Depo. Tr. 89:6–91:10 (reading from his dictated notes from a February 14, 1996 meeting with French and Robertson held in Dallas—"[o]ne of the reasons they [the Wylys] have a variety of offshore trusts is that holdings in Sterling Software or [Sterling Commerce] held by a trust company for various trusts ... are amalgamated for SEC purposes and any trust company holding an aggregate of more than 5% of any one class of shares in a company has certain fairly onerous filing requirements with the SEC. [French and Robertson] confirmed that they were always aware of this as far as the various Wyly entities were concerned and that we need not review this, but we might just need to think about other trusts possibly holding these stocks."). Tr. Trans. 1382:8–1384:21 (Sam being impeached with his testimony from the SEC trial that ownership levels were kept under 5% in order to avoid reporting requirements).

384 Collateral Estoppel No. 14; IRS Ex. 372 (February 26, 2002 email from Hennington and Boucher to Sam) at SEC/ITC0105445 ("There needs to be a good answer to the increase in shares from what was publicly represented during the CA proxy fight. I think that those watching this will raise this issue and there needs to be an answer that does not jeopardize the offshore system.").

385 Collateral Estoppel No. 15; IRS Ex. 372 (February 26, 2002 email from Hennington and Boucher to Sam) at SEC/ITC0105445.

386 Collateral Estoppel No. 16; SEC Tr. Tran. 169:10–12 (Robertson). *See, e.g.,* Joint Ex. 1 (Trust Agreement of the Bulldog Non–Grantor Trust) ¶¶ 1(a) (definition of "Beneficiaries"), 4.2(b), 5.2(a).

387 Collateral Estoppel No. 17; SEC Tr. Tran. 169:10–12 (Robertson). *See, e.g.,* Joint Ex. 1 (Trust Agreement of the Bulldog Non–Grantor Trust) ¶¶ 1(a) (definition of "Beneficiaries"), 4.2(b), 5.2(a).

388 *See* p. 410 n. 376, *supra.*

389 *See* p. 410 n. 377, *supra.*

390 Tr. Trans. 547:25–548:23, 553:11–23 (Evan testifying that the Wylys "always went to Mike first," and that "Mike would be kind of the lead, but he would bring in whatever specialist he needed. And if there wasn't someone at Jackson Walker that could do it, then he would bring in, you know, an outside attorney.")

391 A letter agreement dated January 24, 1997 signed by Sam and French set forth "certain arrangements with respect to (i) my retention by you as legal counsel in connection with all family and family-related business activities; (ii) my interest in the investment management business ... [Maverick Fund]; and (iii) an overall guaranteed level of income that I will have going forward from various activities on behalf of your families, and certain related or associated activities." SEC Tr. Trans. 1706:11–20 (French). The letter stated that French was retained as "legal counsel for the Wylys" because Sam "insisted" that their conversations be subject to attorney/client privilege, "whatever I did." *Id.* 1706:2–10 (French). *See also* Tr. Trans. 699:15–21(Sam) ("Q. Okay. What role did Mr. French play in setting up the Isle of Man trusts? A. Well, he was the chief—chief lawyer, chief architect, who—I mean, there were others who worked on it, but he was the—I would say the leader of a team of lawyers and certified public accountants who worked on it."), 709:1–20 (Sam explaining how French was charged to oversee and recruit the legal specialists hired to establish the trusts); Joint Stipulations ¶ 11 ("Mr. French served as primary counsel for Sam Wyly and Charles Wyly until early 2001 when the relationship was severed.").

392 Joint Stipulations ¶ 11; p. 413 n. 391, *supra.*

393 Collateral Estoppel No. 18. These facts were established here by clear and convincing evidence with the exception of whether French was given the Lubar memorandum. While the record here is clear that Lubar discussed its contents with French, it is equivocal on whether French was actually given a copy of the memorandum in 1993. *See* Lubar Depo. Tr. 93:13–25 (Lubar testifying that he had discussed the issues with French, but could not remember if he provided French with a copy of the memorandum).

394 Lubar Depo. Tr. 13:10–14:6, 16:11–19:5 (discussing his initial contact with French and the results of his analysis). Although the underlying memorandum was not admitted into the record here, it is thoroughly discussed in deposition testimony given by Lubar, which was admitted into the record by agreement of the parties. *See id.* at 17:6–19:5, 93:5–95:18.

395 *Id.* at 9:12–18.

396 *Id.* at 15:4–8.

397 *Id.* at 15:12.

398 Tr. Trans. 548:13–16 (Evan discussing how French was authorized to seek out other attorneys to give advice), 549:8–22 (Evan discussing how the Wylys perceived no material difference when French moved from Jackson Walker to Jones

Day in 1995 "[a]nd while the secondary attorneys might have changed ... we still looked to him [French] first as kind of our trusted counsel on who should be the best person. And he continued to find outside attorneys if there wasn't a specialist inside Jones Day that could handle the situation."), 553:19–23 (Evan) ("And Sam was in a really good—kind of at a high level, and so if Mike needed some kind of high-level direction, he would come and ask Sam, but then, you know, Mike would go off and, you know, handle the details."), 709:1–20 (Sam explaining how French was charged to oversee and recruit the legal specialists hired to establish the 1994 and 1995 trusts); Joint Stipulations ¶ 11 ("Mr. French served as primary counsel for Sam Wyly and Charles Wyly until early 2001 when the relationship was severed.").

399 *See* pp. 417–23, *infra,* for a discussion of imputation.

400 As discussed previously in this Memorandum Opinion, Lubar was consulted again in 2003—this time by Hennington and Boucher acting as Sam's and Charles' agents—and he reconfirmed his 1993 conclusions then after reanalyzing the legal issues. *See* pp. 371–72, *supra.*

401 Collateral Estoppel No. 19. Lubar Depo. Tr. 27:4–23; IRS Ex. 806 (February 15, 1994 memorandum from Lubar to French regarding "Tax Consequences of Grantor Trusts) at SYLYSEC00010967–0968.

402 Collateral Estoppel No. 20; Joint Exs. 4 (Deed of Settlement, Bessie IOM Trust), 37 (Deed of Settlement, Tyler IOM Trust); SEC Tr. Trans. 3755:10–3757:22 (French testifying regarding King's failure to fund); IRS Exs. 214 (November 16, 1995 fax from French to Buchanan regarding Boucher's inability to find any records that King ever funded the Bessie IOM Trust, the Tyler IOM Trust, and the South Madison IOM Trust, and noting similar issues with the La Fourche IOM Trust and Red Mountain IOM Trust), 178 at 02517 (November 26, 1995 faxes from Buchanan to French regarding funding issues, stating the Bessie IOM Trust and Tyler IOM Trust had each been funded with "a factual Dollar bill").

403 Collateral Estoppel No. 21.

404 Collateral Estoppel No. 22; Joint Exs. 17 (Deed of Settlement, La Fourche IOM Trust), 42 (Deed of Settlement, Red Mountain IOM Trust); IRS Ex. 414 (letter from Cairns to Sam dated July 18, 1995); Cairns Depo. Tr. 43:3–18 (French prepared the letter), 46:5–8; 56:9–12 (discussing Cairns' failure to fund the trusts with $25,000), 46:18–47:4; 158:6–7 (Cairn's admitting he did not know Sam and that the letter was provided to him by French); Joint Stipulations ¶¶ 66 and 102 (showing that Cairn's company, Wychwood Trust Limited, served as trustee for Delhi IOM Trust, La Fourche IOM Trust, and Red Mountain IOM Trust).

405 Collateral Estoppel No. 23; p. 414 n. 404, *supra* (as to Cairns); p. 414 n. 402, *supra* (as to King); Tr. Trans. 583:23–584:7 (Evan testifying that King was a stockbroker who had done some, but not a lot, of business with Maverick).

406 Collateral Estoppel No. 24; Joint Stipulations ¶¶ 66 and 102 (showing that Cairn's company, Wychwood Trust Limited, served as trustee for Delhi IOM Trust, La Fourche IOM Trust, and Red Mountain IOM Trust); Cairns Depo. Tr. 46:5–8; 56:9–12 (discussing his failure to fund the trusts with $25,000); IRS Exs. 214 (November 16, 1995 fax from French to Buchanan regarding Boucher's inability to find any records that King ever funded the Bessie IOM Trust, the Tyler IOM Trust, and the South Madison IOM Trust, and noting similar issues with the La Fourche IOM Trust and Red Mountain IOM Trust) and 178 at 02517 (November 26, 1995 faxes from Buchanan to French regarding funding issues, stating the Bessie IOM Trust and Tyler IOM Trust had each been funded with "a factual Dollar bill"); Tr. Trans. 583:23–584:7 (Evan testifying that King was a stockbroker who had previously done some, but not a lot, of business with Maverick); SEC Tr. Trans. 3753:5–14 (French testifying that he believed that King had made substantial money previously dealing with the Wylys in South African bonds).

407 Tr. Trans. 709:1–20 (Sam explaining how French was charged to oversee the legal specialists hired to establish the trusts), 703:11–25 (Sam explaining that "he [French] was sort of the coordinator or the commander of the lawyers who—who worked on it" while Sam considered himself more the "leader of the companies."). Sam's approach of letting French handle his transactions was confirmed by Evan. *See id.* 548:13–16 (Evan discussing how French would seek out other attorneys to give advice—"So Mike would be kind of the lead, but he would bring in whatever specialist he needed. And if there wasn't someone at Jackson Walker that could do it, then he would bring in, you know, an outside attorney."), 549:14–22 (Evan discussing how the Wylys perceived no material difference when French moved from Jackson Walker to Jones Day in 1995 "[a]nd while the secondary attorneys might have changed ... we still looked to him [French] first as kind of our trusted counsel on who should be the best person. And he continued to find outside attorneys if there wasn't a specialist inside Jones Day that could handle the situation."), 553:19–23 (Evan) ("And Sam was in a really good—kind of at a high level, and so if Mike needed some kind of high-level direction, he would come and ask Sam, but then, you know, Mike would go off and, you know, handle the details.").

408 *Davis–Lynch, Inc. v. Asgard Tech., LLC,* 472 S.W.3d 50, 60 (Tex.App.—Houston [14th Dist.] 2015, no pet. h.) (citing *Walker Ins. Servs. v. Bottle Rock Power Corp.,* 108 S.W.3d 538, 549 (Tex.App.—Houston [14th Dist.] 2003, no pet. h));

see Welch v. Coca–Cola Enter., Inc., 36 S.W.3d 532, 539 (Tex.App.—Tyler 2000, pet. withdrawn) ("An 'agent' is one who is authorized by another to transact business or manage some affair for him.") (citing cases).

409 *Welch,* 36 S.W.3d at 540.

410 Joint Stipulations ¶ 11; p. 417 n. 407, *supra.*

411 Tr. Trans. 570:4–11 (Evan).

412 *Id.* at 587:12–588:3 (Evan).

413 *Id.* at 703:4–25(Sam).

414 Annotation, Imputing Agent's Knowledge to Principal, 104 A.L.R. 1246.

415 Restatement (Third) of Agency § 5.03 (2006).

416 *Minter v. Great American Ins. Co. of New York,* 423 F.3d 460, 472 (5th Cir.2005) (citing *Elite Towing, Inc. v. LSI Fin. Group,* 985 S.W.2d 635, 642–43 (Tex.App.—Austin 1999, no pet. h.)); *see also Berkley Reg. Ins. Co. v. Philadelphia Indem. Ins. Co.,* 600 Fed.Appx. 230, 235 (5th Cir.2015) ("In Texas, it is well settled that if an agent's acts are within the scope of his authority, then notice to the agent of matters over which the agent has authority is deemed notice to the principal.") (quotations and citations omitted).

417 *Victory v. State,* 158 S.W.2d 760, 764 (Tex.1942) ("[t]he knowledge of the agent is imputed to the principal."); *see also Goldstein v. Union Nat. Bank,* 213 S.W. 584, 587 (Tex.1919) ("Under general and well-settled principles of law and equity the acts of a duly authorized agent within the scope of his authority bind the principal, and carry to him, constructively, notice of all material facts comprised in the transaction."). *See also Berkley Reg. Ins. Co.,* 600 Fed.Appx. at 235.

418 *Preston Farm & Ranch Supply, Inc. v. Bio–Zyme Enterprises,* 625 S.W.2d 295, 300 (Tex.1981) (citing *Victory v. State,* 158 S.W.2d 760 (1942)); *see also Trevino v. HSBC Mortg. Serv., Inc. (In re Trevino),* 535 B.R. 110, 133 (Bankr.S.D.Tex.2015) ("It is a basic tenet of agency law that knowledge of an agent may be imputed to the principal.").

419 *See, e.g., Standard Sav. & Loan Ass'n v. Fitts,* 39 S.W.2d 25, 26, (Tex.1931) (knowledge of agent obtained in scheme to defraud principal not imputed to principal); *Askanase v. Fatjo,* 828 F.Supp. 465 (S.D.Tex.1993) ("An agent's knowledge is not imputed to his principal if he acts entirely for his own or another's purpose.") (citing *FDIC v. Shrader & York,* 991 F.2d 216, 223 (5th Cir.1993)).

420 Debtors' Post–Trial Reply [ECF No. 1121] at 16 (emphasis in original).

421 Debtors' Post–Trial Brief [ECF No. 1117] at 15.

422 *Id.*

423 170 F.3d 1217, 1220–21 (9th Cir.1999).

424 469 U.S. 241, 251, 105 S.Ct. 687, 83 L.Ed.2d 622 (1985).

425 *Henry,* 170 F.3d at 1220–21 (quoting *Boyle,* 469 U.S. at 251, 105 S.Ct. 687).

426 184 F.2d 86 (10th Cir.1950).

427 *Id.* at 88.

428 178 F.2d 769 (2d Cir.1950).

429 Debtors' Post–Trial Brief [ECF No. 1117] at 29.

430 *Id.*

431 *Id.* at 30.

432 *See* Tr. Trans. 1394:16–24 (Sam testifying that French was a securities lawyer and that "I don't recall him [French] being concerned about tax things); SEC Tr. Trans. 3758:7–8 (French) ("I'm not the tax lawyer. I'll take that disclaimer again.").

433 *See* IRS Ex. 806 at WYLYSEC00010967 (¶ 1). The facts that French told Lubar to assume were true were not true—King and Cairns had not known Sam and Charles "for a considerable period of time;" King and Cairns did not establish his respective trusts as "an entirely gratuitous act;" and Cairns did "receive consideration, reimbursement or other benefits" for settling these trusts.

434 King was a stock broker that had previously done some, but not a lot, of business with Maverick. Tr. Trans. 583:23584:12 (Evan); SEC Tr. Trans. 3753:5–14 (French).

435 Cairns Depo. Tr. 46:22–47:4, 158:6–7.

436 *See* IRS Ex. 92 (letter dated July 18, 1995 from Cairns to Sam).

437 Collateral Estoppel Nos. 22–24; Joint Stipulations ¶¶ 66 and 102, (showing that Cairn's company, Wychwood Trust Limited, served as trustee for Delhi IOM Trust, La Fourche IOM Trust, and Red Mountain IOM Trust).

438 Tr. Trans. 583:23–584:7 (Evan).

439 SEC Tr. Trans. 3753:5–14 (French).

440 Tr. Trans. 549:15–19 (Evan), 789:16–20 (Evan agreeing that French was one of the Wylys' "most trusted advisors"), 1420:8–10(Sam). Joint Stipulations ¶ 11.

441 IRS Ex. 1199 ¶ 26 (p. 10) (Annex A, Admissions of Defendant Michael C. French).

442 IRS Ex. 364 at IOM 37827.

443 *Id.* at IOM 37820 (emphasis in original).

444 *Id.* at IOM 37826 (emphasis added). Recall the earlier meeting where French and Robertson instructed Webb, another IOM trustee, to deal through Boucher to keep communications offshore. *See supra* at pp. 373–74. The Court reasonably infers that French and Robertson had a similar conversation with all the Wyly IOM trustees when Boucher was hired, including in this instance, Buchanan.

445 Although the overnight fax was from French, not Boucher.

446 IRS Ex. 364 at IOM 37824–25.

447 *Id.* at IOM 37825.

448 *Id.*

449 *Id.* at IOM 37813.

450 Joint Stipulations ¶ 36.

451 *Id.* ¶ 66.

452 Tr. Trans. 2037:17(Sam).

453 *See* Notice of Funds Received from Dallas Auction Gallery Sale [ECF No. 921–1] at p. 1 of 13.

454 SEC. Tr. Trans. 1004:1–3 (Boucher) (Q: Do you recall Sam Wyly joking, "Well, we'll just fire the trustees if we [*sic*] don't do what they [*sic*] tell them? A: Yes.").

455 IRS Ex. 87 at WYLYSEC01112940 (emphasis added).

456 *Id.*

457 *Id.* at WYLYSEC01112942 (emphasis added).

458 *Id.* at WYLYSEC01112941.

459 This transaction will be explained more fully when analyzing the IRS' claim that this transaction gives rise to a gift. *See* pp. 516–36, *infra.*

460 Tr. Trans. 2542:1–2543:10 (Pulman).

461 *Id.* at 2556:14–19.

462 IRS Ex. 87 at WYLYSEC01112940.

463 Other Wyly family members also use the apartment and office.

464 These transactions are discussed in more detail later in this Memorandum Opinion. *See* pp. 516–36, *infra.*

465 Collateral Estoppel No. 26; *see also* IRS Ex 1245 (email chain regarding sale of 169,000 shares of Tyco stock).

466 Joint Stipulations ¶¶ 434, 437, 439, 440, and 442. Emily and Jennifer share a home on the ranch. Tr. Trans. 2187:2188:6 (Hennington).

467 Joint Stipulations ¶¶ 378–380, 384, 387, and 410; Tr. Trans. 2184:6–2185:19 (Hennington). Although the Joint Stipulations state that Stargate Horse Properties, Inc. (Nevada) was the 98% owner, while Stargate Sport Horse Management LLC (Texas) was the 2% owner, the agreed demonstrative chart provided to the Court states that Stargate Horse Properties, Inc. (Nevada) was the 91.21% owner, while Stargate Sport Horse Management LLC (Texas) was the 8.79% owner. Although the Court notes this discrepancy, it is not material to its decision.

468 IRS Ex. 18 at RDE 26.

469 *Id.*

470 Tr. Trans. 231:1–16(Dee).

471 *See, e.g.,* IRS Ex. 20; Tr. Trans. 240:15–18(Dee).

472 Like the jewelry Charles gave her, there is no evidence that Dee knew the items were paid for by an IOM corporation. The payment arrangements were taken care of by someone in the Wyly family office—in this instance Amy Browning—at Charles' direction. Dee considers the items to be hers.

473 Tr. Trans. 266:24–267:2 (Dee confirming that Ms. Browning worked in the Wyly family office).

474 IRS Ex. 21 (emphasis added).

475 Tr. Trans. 262:24–263:1–2(Dee).

476 Again, without evidence that Dee knew who paid for the items. *See, e.g.,* IRS Ex. 25. The record contains many other examples where Soulieana Limited (IOM) paid for personal property used by the Wyly family. *See* IRS Exs. 22 (February

22, 1997 invoice from Huntsman Gallery of Fine Art indicating that several works were sold to Dee but invoiced to Soulieana Limited (IOM)), 433 (May 29, 1997 fax and attached invoices, sent to Buchanan from Boucher, stating that "[t]he protectors for Tyler recommend that Soulieana acquire the following art work ... Bank wiring instructions are as follows."), 1240 (January 22, 1997 handwritten note to Buchanan from Robertson stating "[w]e are recommending the purchase of investment grade collectibles, antiques and art for Soulieana[.] We recommend purchases totaling approximately $3,500,000 ... Invoices and photos of all art work will be forwarded thru Michelle Boucher. The 'collection' will be located at 5906 Deloache, Dallas, TX.").

477 Although a signed copy of IRS Ex. 26 is not in the record, Hennington testified that the agreement or a very similar one was executed. Tr. Trans. 2267:3–6 (Hennington). *See also* Wyly Ex. QF (executed Possession Agreement dated April 2, 2004 permitting Laurie to possess various art, including Audubon plates and a Picasso painting purchased by Audubon Asset Limited (IOM)).

478 Dee repeatedly, and credibly, testified that she was unaware of the source of the funds used to purchase the furnishings, art, and antiques in her homes. *See, e.g.,* Tr. Trans. 264:19–20, 263:23–25, 264:12–20, 268:5–18, 270:8–15, 274:16–22, 274:17–22; 279:5–17, 281:6–14, 289:11–14. This is the same for jewelry that she considers herself the owner of. *See* p. 431 n. 480, *infra.*

479 Tr. Trans. 155:3–10 (Dee testifying she and Charles moved to Highland Park in 1970), 155:16–25 (Dee and Charles moved to the house on Deloache in the mid–1970s), 158:11–14 (Dee considered herself wealthy when she lived in the Deloache house), 158:15–18 (Dee and Charles owned a home in Aspen in the 1970s), 319:16–18(Dee) (receiving jewelry after the IOM trusts were formed did not change her lifestyle), 1327:18–23 (Donnie Miller) (the family used private and charter aircraft as early as the 1960s), 1334:1–17 (Donnie Miller) (family was wealthy decades before the IOM structure was established in the 1990s, and there was no significant change in lifestyle after 1992), Wyly Exs. PX (1988 Form 1040 showing adjusted gross income of $909,959), PY (1989 Form 1040 showing adjusted gross income of $3,388,981), QB (1990 Form 1040 showing adjusted gross income of $740,173), and PZ (Charles' personal balance sheet as of December 31, 1991 showing total assets (at fair market value) of $57,415,111); Tr. Trans. 2141:1–9 (Hennington) (Charles and Dee's net worth exceeded $50 million in 1991, the year before the first offshore trust was settled).

480 *See, e.g.,* Tr. Trans. 231:1–16, 238:7–11, 240:15–18, 244:18–24 (Dee testifying regarding jewelry given to her by Charles, but paid for by Soulieana Limited (IOM), of which she considers herself the owner), 251:4–19 (Dee was unaware that Soulieana Limited (IOM) paid for jewelry she believes she owns).

481 *See* Joint Exs. 58, 60, 62, 64, 66, and 68 (Sam), 86 (Dee), and 80, 83, and 84 (Charles).

482 *See* Joint Exs. 70, 72, 74, 76, and 78(Sam) and 88, 90, 92, and 94 (Charles). Although the record reflects that Sam entered into six annuity transactions in each of the relevant years, the record does not contain the Private Annuity Agreement or an Amendment to Private Annuity Agreement related to Yurta Faf Limited (IOM).

483 Dee and Charles assigned their rights to receive annuity payments to Stargate Investments (Texas), an entity they wholly-owned and controlled. *See* pp. 542–50, *infra.*

484 Joint Stipulations ¶¶ 173–174.

485 *Id.* ¶¶ 175–176.

486 IRS Ex. 1131 at EOI–IOM–SW–0000017582.

487 *Id.*

488 *Id.*

489 *Id.*

490 IRS Ex. 1132 at EOI–IOM–SW–000001493, § 1.2 ("Discussions are on going with the annuitant in order to agree [to] a scheme of arrangement which would allow the remaining assets of the company to be offset against current and future obligations of the company to the annuitant so that the company can be liquidated shortly thereafter.").

491 *Id.* at 495.

492 Sam's testimony was in rounded amounts, and resulted in his estimate of approximately $14 million in annuity payments being forgiven by Tensas Limited (IOM). Tr. Trans. 2657:19–2658:6(Sam).

493 IRS Ex. 1135 at EOI–IOM–SW–0000013855.

494 *Id.*

495 *Id.*

496 *Id.*

[497] IRS Ex. 1136 at EOI–IOM–SW–0000000527. Sam's testimony was in rounded amounts, and resulted in his estimate of approximately $20.5 million in annuity payments being forgiven by East Baton Rouge Limited (IOM). Tr. Trans. 2665:18–24(Sam).

[498] IRS Ex. 1136 at EOI–IOM–SW–0000000526 § 1.2 (Discussions are on going with the annuitant in order to agree [to] a scheme of arrangement which would allow the remaining assets of the company to be offset against current and future obligations of the company to the annuitant so that the company can be liquidated shortly thereafter.").

[499] IRS Ex. 1134 at EOI–IOM0SW00000014427.

[500] *Id.*

[501] IRS Ex. 1133 at EOI–IOM0SW–0000000607 (line item "Waiver of annuity payable").

[502] The Court reasonably presumes this liquidation, despite the absence of language in its financial statements similar to that found in Tensas Limited (IOM)'s and East Baton Rouge Limited (IOM)'s financial statements. Whether the company was liquidated, however, is not material to this Court's decision.

[503] *See, e.g.,* IRS Ex. 96 at WYLYSEC011112396 (July 30, 2003 memorandum from Hennington and Boucher to Sam, Charles, Evan, and Donnie Miller discussing concerns regarding payment of upcoming annuity obligations, including: (i) "[t]he annuity payments will bankrupt several of the IOM companies, which could bring the validity of the annuity transaction into question," (ii) "[a]fter a few years of payments, the companies will be left with non-liquid assets," and (iii) "[t]he possibility of in-kind payments ... may call into question the validity of the transaction and the 'arms-length' nature of the transactions."

[504] IRS Ex. 1266 (October 18, 2007 Meeting Minutes, Audubon Assets Limited (IOM) regarding loans from Katy, Orange, and Balch).

[505] IRS Ex. 1267 (October 18, 2007 Meeting Minutes, Moberly Limited (IOM)) §§ 2.1, 2.2, and 3.

[506] *See SEC v. Wyly,* 56 F.Supp.3d at 401 ("I presided over a jury trial on nine of the ten claims from March 31 to May 7, 2014. On May 12, 2014, the jury returned a verdict against both Sam and Charles Wyly on all nine claims.").

[507] *See* Post–Fact Discovery Scheduling Order at 3 (Case No. 10–cv–05760 at ECF No. 196) (setting the start of trial as Monday, March 31, 2014).

[508] *See* Amended Bankruptcy Schedule B, Exhibit B–16 [ECF No. 472] at p. 55 of 94 (listing the annuity payments and stating "no payment expected in the near term").

[509] Tr. Trans. 2941:1–8(Sam).

[510] *See* IRS Ex. 1267 (meeting minutes for Moberly Limited (IOM) discussing loans from Morehouse Limited (IOM) to fund annuity payments).

[511] *See* IRS Ex. 1268 §§ 3.1–3.4 ("The Chairman [of Moberly Limited (IOM), Anna Kawalek] reminded the Meeting that the Company [Moberly Limited (IOM)] had loaned funds of $26,508,820 to Greenbriar Limited [(IOM)] ("Greenbriar"). The Chairman advised that the Company had received a letter from Greenbriar enquiring as to whether the Company intended to make a formal demand for repayment of any part of the loaned funds prior to 2018. After due consideration, it is resolved—THAT the Company does not intend to make a formal demand for any part of the loan due from Greenbriar before 2018 and that the Company will write to the directors of Greenbriar to confirm this formally.").

[512] IRS Ex. 1266 (October 18, 2007 meeting minutes for Audubon Asset Limited (IOM) discussing loans from various Cayman LLCs to fund annuity payments). Sam expressed no surprise that Audubon Asset Limited (IOM) needed to borrow money to make the annuity payments owing to him. Tr. Trans. 2041:11–12(Sam) ("It's not a surprising thing.").

[513] *See, e.g.,* Joint Stipulations ¶¶ 332, 334, and 337 (funds transferred from Audubon Asset Limited (IOM) related to the Cottonwood Ventures I property); Wyly Ex. QF (Possession Agreement dated April 2, 2004 permitting Laurie to possess various art, including Audubon plates and a Picasso painting purchased by Audubon Asset Limited (IOM)); IRS Ex. 364 (documenting circumstances surrounding purchase of Noon Day Rest by Fugue Limited (IOM) n/k/a Audubon Asset Limited (IOM)).

[514] IRS Ex. 1269 (Locke Limited (IOM)'s unaudited Directors' Report and Financial Statements for the Year Ended 31 December 2013) at 6 (showing a loan to Bulldog IOM Trust of $3,055,728 and to Moberly Limited (IOM) of $8,028,596).

[515] *Id.* at 7 (showing a $69,183,748 annuity obligation as of December 31, 2013).

[516] IRS Ex. 96.

[517] *Id.* at WYLYSEC011112396 (emphasis added).

[518] Joint Stipulations ¶¶ 285–286. Although the exact ownership structure was never clearly established on the record, Boucher testified that "Security Capital was established and managed by a trust company group in Cayman that was familiar with Maverick and another group of funds that the [Wyly] family had been involved with, and with Irish Trust and

the Wyly group. They had an understanding and knowledge of the family group as a whole." SEC Tr. Trans. 1075:7–11 (Boucher).

[519] *See* Tr. Trans. 2347:6–12 (Hennington testifying that Security Capital was the entity that facilitated the loans); IRS Ex. 712 (undated correspondence from Hennington to Charles discussing a loan of offshore funds to Charles—"He [Owens] is more comfortable making a loan to you from an IOM Company. To add another layer we will have the IOM Company loan to Security Capital and Security Capital will loan to you. Security Capital is a company we set up to administer these types of transactions and Michelle [Boucher] and I like having another company in the middle."); IRS Ex. 212 (January 29, 2002 email from Boucher to Hennington titled "Security Capital loan to Sam" and stating "I had to move money around to get it in the right place to fund this. So Devotion is buying $15Million of Ranger from Sarnia, to get the money to Sarnia who will loan it to Greenbriar, who will loan it to Security Capital etc ... "); IRS Ex. 213 (September 25, 2002 email from Hennington to Owens discussing structure of a $6 million loan from Security Capital to Charles utilizing funds from Gorsemoor Limited (IOM), which was a subsidiary of Tyler IOM Trust).

[520] SEC Tr. Trans. 1071:16–18 (Boucher); IRS Ex. 91 (chart prepared by Wyly counsel Bickel & Brewer showing "pass-through loans" involving IOM corporations and Security Capital).

[521] SEC Tr. Trans. 1071:22–1074:24 (Boucher).

[522] *Id.* at 1077:10–22 (Boucher) ("Q: A person on the street couldn't just walk in to Security Capital and get a loan for their mortgage, correct.? A: No. Q: It was money that was borrowed, largely borrowed, from the Isle of Man subsidiary companies and then loaned out based on recommendations, correct? A: Of course." *See* IRS Ex. 91.

[523] *See* IRS Ex. 91 (chart prepared by Wyly counsel Bickel & Brewer showing "pass-through loans" involving IOM corporations and Security Capital); Joint Stipulations ¶¶ 292 (detailing assets transferred from IOM corporations to Greenbriar Limited IOM, which were then loaned to Security Capital), 303–306 (detailing the loan of these funds to the Cayman LLCs); Tr. Trans. 2688:3–2691:20 (counsel stipulating to the flow of assets from the IOM corporations to Greenbriar, to Security Capital, to the Cayman LLCs), 2693:20–2694:2 (Sam testifying that millions of dollars in offshore funds were invested into Green Mountain and Ranger, a Wyly-related business and investment fund, respectively).

[524] *See, e.g.,* Tr. Trans.2022:19–22, 2024:19–2026:7 (Sam explaining that real estate, furnishings, art, and jewelry were purchased by IOM entities for his and his family's use), 2671:3–7 (Sam agreeing that funds in the offshore system, including those of IOM corporations who were ultimately unable to make annuity payments, were used at Sam's direction to buy homes, art, and invest in Wyly-related businesses).

[525] Tr. Trans. 2929:2930:5 (Sam testifying that offshore funds were used to make investments in Wyly-related businesses through letters of wishes).

[526] IRS Ex. 96 at WYLYSEC01112402 (no. 1 under "other factors to consider").

[527] But the Court rejects outright the argument made in closing that the elimination of the annuity payments on a consolidated Wyly family financial statement was, as was argued, the Perry Mason moment in our trial. Such eliminations are commonplace on consolidated financials and are simply immaterial to any issue before this Court in this trial.

[528] IRS Ex. 93 at SEC/ITC01388418.

[529] Tr. Trans. 3531:14–3540:10 (closing argument).

[530] The Court is not using the word "tracing" in a formal sense of tracking receipt of funds and expenditures of funds to the penny. It just wanted some reasonably detailed explanation of where the money went. The silence was deafening.

[531] Tr. Tran. 2150:1–2151:4 (Hennington); Wyly Ex. OW (Partnership Agreement for Stargate Investments, Ltd.) at Exhibit A; Joint Stipulations ¶ 161.

[532] Wyly Ex. OW § 2.2; Joint Stipulations ¶ 162.

[533] *See* Wyly Ex. OW at § 3.1; Caroline D. Wyly's Motion for an Order Approving the Allocation of Future Payments Made on Past–Due Annuity obligations and Providing Notice of the Sale of the Underlying Assets Related Thereto [ECF. No. 634] (hereinafter "Annuity Allocation Motion"), Order Granting Annuity Allocation Motion [ECF 721].

[534] *See* Wyly Ex. OW at Exhibit A.

[535] Joint Ex. 86 (Private annuity agreement entered into between Dee and Maroon Limited, a Nevada Corporation); Joint Stipulations ¶¶ 151–52, 161 (The private annuity agreement was transferred from Maroon Limited, a Nevada Corporation to Rugosa Limited (IOM), and Charles and Dee transferred all of their private annuity agreements to Stargate Investments (Texas)); Wyly Ex. OW.

[536] IRS Ex. 401 at CW–IDR–0000000112.

[537] *Id.* at CW–IDR–0000000131.

[538] *Id.* at CW–IDR–0000000119.

539 *Id.*

540 *Id.* at CW–IDR–0000000123.

541 *See* Joint Stipulations ¶ 173.

542 *See* IRS Ex. 401 at 119.

543 Tr. Trans. 314:10–316:8(Dee).

544 *Id.* Dee was not asked any questions about the Scheme of Arrangement on redirect.

545 The parties stipulated that annuity payments were not made during certain years by at least one offshore entity on an annuity payable to Charles. *See* Joint Stipulations ¶ 173 (Roaring Creek Limited (IOM) did not make payments in 2005–2008).

546 Computation Stipulations at Attachment A. This agreement is contingent upon (i) the SDNY Court's determination of foreign grantor trust status being affirmed on appeal, which appeal is currently pending before the Second Circuit Court of Appeals, and/or (ii) this Court's collateral estoppel decision being affirmed on appeal, assuming such an appeal is taken.

547 *Id.* at Attachment B. This agreement is subject to the same contingencies as stated in the immediately preceding footnote.

548 Even without this badge of fraud, the IRS has carried its burden of proof regarding Sam's liability for fraud penalties under 26 U.S.C. § 6663.

549 Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 121.

550 *Webb,* 394 F.2d at 378 n. 11 (emphasis added) (citing Balter, Tax Fraud and Evasion, pp. 8–54 and 8–55 (3 ed.1963)); *see also Loftin & Woodard, Inc.,* 577 F.2d at 1239 (listing the same badges of fraud as *Webb)* ; *Hatling,* 2012 WL 5199405, at *2 (“Fraud ‘does not include negligence, carelessness, misunderstanding or unintentional understatement of income.’ ” (quoting *U.S. v. Pechenik,* 236 F.2d 844, 846 (3d Cir.1956)). The Fifth Circuit has also been clear that understatement of income, standing alone, is not enough to prove fraud, but that consistent and substantial understatement of income is by itself strong evidence of fraud. *Webb,* 394 F.2d at 378; *Merritt v. C.I.R.,* 301 F.2d 484, 487 (5th Cir.1962).

551 *See, e.g., Estate of Trompeter,* 279 F.3d at 773 (quoting *Bradford,* 796 F.2d at 307–08).

552 *DiLeo,* 96 T.C. at 873 (§ 6653 case); *see Morse v. C.I.R.,* 419 F.3d 829, 832 (8th Cir.2005); *Carreon,* 2014 WL 91959, at *6.

553 *See Garavaglia,* 2011 WL 4448913, at *26 (letter from accountant to taxpayer discussing intentional writing down of tax liabilities was direct evidence of fraud).

554 *Webb,* 394 F.2d at 377 (quoting *Mitchell v. C.I.R.,* 118 F.2d 308, 310 (5th Cir.1941)).

555 More fully, the Supreme Court stated in *Spies,* 317 U.S. 492, 499, 63 S.Ct. 364 (1943) that:

> Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished and perhaps did not define lest its effort to do so result in some unexpected limitation. Nor would we by definition constrict the scope of the Congressional provision that it may be accomplished ‘in any manner.’ By way of illustration, and not by way of limitation, we would think affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries of alterations, or false invoices or documents, destruction of books or records, concealment of assets or 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. If the tax-evasion motive plays any part in such conduct the offense may be made out even though the conduct may also serve other purposes such as concealment of other crime.

556 *Webb,* 394 F.2d at 378 n. 11.

557 Tr. Trans. 719:15–20(Sam).

558 *See* pp. 431–41, *supra.*

559 *See* pp. 423–31, 431–41, *supra.*

560 *See* pp. 516–36, *infra.*

561 *See* Joint Exs. 59, 61, 63, 65, 67, and 69, whereby Sam deferred annuity payments scheduled to commence on his 65th birthday to his 70th birthday, and 71, 73, 75, 77, and 79, whereby Sam deferred annuity payments scheduled to commence on his 68th birthday to his 73rd birthday.

562 Tr. Trans. 2039:9–2052:23 (Sam describing on cross examination how, beginning as early as 2007 it became necessary to move money around the offshore system in order to meet annuity payment obligations); IRS Exs. 1131 at E0I–I0M–SW–0000017582 (letter dated May 31, 2013 from Tensas Limited (IOM) to Sam stating that Tensas Limited (IOM) “has not made full payments to you since 2010”); however, ¶ 175 of the Joint Stipulations shows that the last full payment from Tensas Limited (IOM) was received in 2008, 1135 at EOI–IOM–SW–0000013854 (letter dated May 31, 2013 from East Baton Rouge Limited (IOM) to Sam stating that East Baton Rouge Limited (IOM) “has not made full payments to

you since 2011"); Amended Bankruptcy Schedule B, Exhibit B–16 [ECF No. 472] at p. 55 of 94 (indicating that, as of September 30, 2014, $70,544,877 in annuity payments from the offshore system were outstanding as to Sam with "no payment expected in the near term").

563 *See* pp. 431–41, *supra.*

564 *See* Amended Bankruptcy Schedule B, Exhibit B–16 [ECF No. 472] at p. 55 of 94. Although Sam scheduled these obligations as not paying in the near term, at trial he testified that he expects no further payments at all. Tr. Trans. 2941:1–8(Sam).

565 *See* pp. 431–41, *supra.*

566 *See* Joint Exs. 59, 61, 63, 65, 67, 69, 71, 73, 75, 77, and 79.

567 *See* IRS Ex. 96 at WYLYSEC01112396 (memorandum drafted by Hennington to Sam, Charles, Evan, and Donnie: "As you are aware, we have been planning for some time for the commencement of the annuity payments. As we have studied the impact of these payments we have become increasingly concerned with the logistical problems of paying the annuities.... 1. When the payments are reported on your 1040, they will be on a separate line on page one for annuity payments. It is almost certain given the large amount of these payments that the reporting will result in an IRS audit. There is also a high likelihood that as a result of this audit the entire structure of the foreign system will be audited by the IRS.").

568 IRS Exs. 59, 61, 63, 65, 67, 69, 71, 73, 75, 77, and 79 (1998 private annuity amendments for Sam, all attesting that "WHEREAS, the intent of a deferred Private Annuity was to provide payment upon the retirement of Mr. Sam Wyly; and WHEREAS, Mr. Sam Wyly warrants that he does not anticipate retiring on the stated annuity commencement date ... Whereas, Mr. Sam Wyly desires the deferral of the private annuity until his anticipated retirement; and Whereas, the obligor ... agrees to defer the Private Annuity."); IRS Exs. 59, 61, 63, 65, 67, and 69 (deferred annuities scheduled to begin paying on Sam's 65th birthday until his 70th birthday) and IRS Exs. 71, 73, 75, 77, and 79 (deferred annuities scheduled to begin paying on Sam's 68th birthday until his 73rd birthday); *see also* Tr. Trans. 1239:1–9 (Chatzky testifies that the annuities were deferred because "it was explained to me that originally Sam Wyly had intended to retire at the age of 68, and then I guess as time marched on, he enjoyed working, and he wanted to work for another five years; and, therefore, he—he had other sources of income than the annuity payment.").

569 *See* Wyly Exs. B ($15 million promissory note by Sam in favor of Security Capital effective January 30, 2002), E ($25 million promissory note by Sam in favor of Security Capital effective March 1, 2003), and F ($10 million promissory note by Sam in favor of Security Capital effective July 15, 2003).

570 Joint Stipulations 43–47 (referring to the creation of Rosemary's Circle R Ranch Limited (IOM) in 1999; Cottonwood I Limited (IOM), Cottonwood II Limited (IOM), Spitting Lion Limited (IOM) in 2000; and Mi Casa Limited (IOM) in 2001); 306–320 (describing the Rosemary's Circle R Ranch structure), 321–377 (describing the Cottonwood I Limited (IOM) and the Cottonwood II Limited (IOM) structures), 465–432 (describing the Spitting Lion Limited (IOM) structure). Recall that the Cayman LLCs that owned Rosemary's Circle R Ranch Limited (IOM), Cottonwood I Limited (IOM), Cottonwood II Limited (IOM), Mi Casa Limited (IOM), and Spitting Lion Limited (IOM) were all funded with money that originated from the offshore system and was routed through Security Capital. Joint Stipulations ¶¶ 292, 303–305. *See also* pp. 423–31, *supra;* 516–36 , *infra.*

571 As French testified, the first large purchase of personal property occurred in mid–1996 with the purchase of Noon Day Rest by Sam's wife, Cheryl. And, while expensive, that item pales in comparison to the expense associated with the real estate purchases. *See* SEC Tr. Trans. 1947:12–1949:7 (French referring to the purchase of Noon Day Rest: "Q. This was the first time the trusts in the Isle of Man, that you remember, were used to buy some kind of personal property, right? A. That is, I believe, correct."); *see also* IRS Ex. 364 (documenting circumstances surrounding purchase of Noon Day Rest and its purchase price of £ 155,000.). *See also* pp. 423–31, *supra;* 516–36, *infra.*

572 *See* Joint Exs. 81, 82, and 85, whereby Charles deferred annuity payments scheduled to commence on his 65th birthday to his 70th birthday, and 89, 91, 93, and 95, whereby Charles deferred annuity payments scheduled to commence on his 68th birthday to his 73rd birthday. Dee similarly extended annuity payments that were scheduled to commence on her 65th birthday to her 70th birthday. *See* Joint Ex. 87.

573 The evidence shows that Dee relied entirely on Charles regarding all business, tax, and legal matters throughout their marriage. Tr. Trans. 159:20–160:15(Dee) (relied entirely on husband throughout marriage); 159:18–19(Dee) ("Q. Have you ever prepared a tax return? A. Oh, heavens no."); 172:17–19(Dee) (never discussed tax matters with husband).

574 *Id.* at 322:6–14 (Dee testifying that she does not know what a limited partner, general partner, limited partnership, or annuity is), 188:22–189:9 (Dee testifying she had never heard of Lincoln Creek IOM Trust), 192:8–11 (Dee testifying that she had never heard of Maroon Limited (IOM)).

575 *See id.* at 1026:11–25 (Sam denies knowing that the offshore system was aggressive, but then admitting he recalls hearing “that word” from either French or another lawyer with respect to the offshore system, but qualifying it with “I don't recall for what particular purpose they were speaking of its being seen as aggressive.”); 1034:7–9 (Sam testifying he did not know if Robertson also warned him the offshore system was aggressive) and 1034:10–1044:4 (Sam being impeached with IRS Ex. 85, a memo from Robertson containing her notes from a Tedder seminar stating the strategy was aggressive, to which Sam responds “[t]hat's what it says” and, when pressed for a yes or no answer, admitting “[i]f I had to choose between no and yes, I would go with yes.”), 1035:6–8 (Sam did not recall testifying that he would read anything Robertson copied him on) and 1037:7–17 (Sam's prior deposition testimony that “[y]eah, yeah, I read anything that Shari Robertson copied me on. I mean, I would see it.”); 1364:10–19 (Sam denying the offshore system was helped by secrecy, claiming “[i]t was an open book”) and 1367:15–19 (impeaching Sam with his testimony from the SEC Action —“Question: And that goal, making it harder for people to get to your money in the Isle of Man, was helped by secrecy. Right? Answer: Yes.”); 1382:20–24 (Sam testifying that he did not know that his lawyers, with his knowledge, tried to keep the IOM trusts' ownership of securities under 5% to minimize SEC reporting requirements) and 1382:25–1392:10 (impeaching Sam with his testimony from the SEC Action); 2052:9–14 (Sam stating he does not remember personally writing off annuity payments) and 2647:23–2670:17 (impeaching Sam with letters he personally signed forgiving past due and future annuity payments). These are just a few of many examples of Sam being impeached while testifying before the Court.

576 This is also true with respect to the badge of fraud of offering implausible or inconsistent explanations of behavior, to which we will apply the same timing analysis. *See* pp. 449–53, *infra.*

577 *Toussaint v. C.I.R.,* 743 F.2d 309 (5th Cir.1984).

578 *Id.*

579 *Id.* at 312.

580 *Id.* at 312–13.

581 *Id.* at 309–13.

582 *Id.* at 312 (internal citation omitted).

583 *Delvecchio v. C.I.R.,* 2001 WL 617192, at *7 (2001) (“Joseph's lack of credibility is evidence of his fraudulent intent.”); *In re Tandon,* T.C. Memo. 1998–66, 1998 WL 130148, at *13 (1998) (“Petitioner's lack of credibility is a factor in considering the fraud issue. As we stated earlier, petitioner's testimony was at times questionable, vague, conclusory, not credible, and unsupported by the evidence in the record. This is evidence of fraud.” (internal citation omitted)); *Welker v. C.I.R.,* 74 T.C.M. (CCH) 956, 1997 WL 633257, at *4 (1997) (“A taxpayer's lack of credibility, inconsistent testimony, or evasiveness are factors in considering the fraud issue.”); *Ferry v. C.I.R.,* 70 T.C.M. (CCH) 1102, 1995 WL 634440, at *8 (1995) (“The taxpayer's evasiveness on the stand, inconsistencies in his testimony, and the lack of credibility of such testimony are heavily weighted factors in considering the fraud issue.”).

584 *See* pp. 413–23, *supra.*

585 The outcome here might have been different if the IOM corporations owing the annuity obligations had simply been left alone to invest the money they realized from the exercise of the options and sale of the associated stock—even in investments Sam “wished” the IOM trustees to make, as he is a savvy and successful businessman after all—and then those IOM corporations simply transferred the realized profits to other IOM entities to do with what the trustees decided (again, even consistent with Sam's “wishes”). In other words, had the IOM corporations owing the annuity obligations not been raided to support the families' lifestyles, leaving them unable to satisfy their annuity obligations to Sam (and Charles until his death) as they came due, and income tax had been paid on all of that income when received, we might not be here today. And, even after the offshore entities were raided to support the families' lifestyles, Sam could have “wished” for assets to be liquidated so that loans could be repaid and/or solvency could be restored and his annuities paid per the agreements with him. But, he didn't “wish” for that. And, as a result, it didn't happen. Why? Because Sam (and Charles) got greedy and were prepared to “risk” litigation with the IRS once the offshore system was fully exposed because, as businessmen who had taken business risks all their lives, they expected to be able to settle with the IRS for “pennies on the dollar.” IRS Ex. 1199 ¶ 57 (p. 15) (Annex A, Admissions of Defendant Michael C. French) (“Sam Wyly said if the IRS challenged his use of the Offshore Trusts, he would litigate with the IRS for years and then settle for pennies on the dollars. French knew that Sam Wyly previously litigated against the IRS for years and then settled.”). Sam was questioned regarding his pennies-on-the-dollar statement during cross examination. He testified he did not recall the statement, and IRS' counsel sought to impeach him with French's Consent. Tr. Trans. 1027:1–16(Sam). Sam's counsel objected on hearsay grounds and, since the IRS did not have a persuasive response, that objection was sustained. *Id.* at

1027:17–1034:5. The Court notes, however, that a redacted copy of French's Consent, which still includes the pennies-on-the-dollar statement, was subsequently admitted into evidence by agreement of the parties. *Id.* at 2900:9–13.

586 Collateral Estoppel No. 56.

587 SEC. Tr. Trans. 1004:1–3 (Boucher) (Q: Do you recall Sam Wyly joking, “Well, we'll just fire the trustees if we [*sic*] don't do what they [*sic*] tell them? A: Yes.”). *See, e.g.,* pp. 423–25, *supra.*

588 Lisa, Laurie, and Kelly built homes on the Colorado property. Tr. Trans. 931:17–932:15 (Evan), 1514:24–1515:2 (Laurie) (“I live in a house here in Dallas on Crooked Lane that is owned by—by an Isle of Man trust, and I also have a second home I—that I go to in Colorado on the ranch). The record is unclear, however, whether Laurie's sisters share a home or enjoy separate homes on the ranch.

589 Recall that Laurie was required to put in 1% in order to be a co-owner, who then has the legal right, according to Meadows Owens, to use and enjoy the asset without paying for the fair rental value of the asset. Tr. Trans. 2542:1–2543:10 (Pulman).

590 Wyly Ex. G (Financial Statements) at HST_PSI230623 (FloFlo balance sheet under category “Loans & Advances Receivable” showing Mi Casa Limited (IOM) with a book and fair market value of $3,215,000 each).

591 The Court concludes that this badge of fraud is established for each of the years at issue in the Motions for the same reasons explained in connection with the Court's analysis of the badge of fraud of offering false or incredible testimony. *See* pp. 446–49, *supra.*

592 A Form 3520 is an information return filed with the IRS annually to report certain transactions with foreign trusts. Form 3520–A is the “Annual Information Return of Foreign Trust with a U.S. Owner.”

593 *See, e.g.,* IRS Ex. 163 (Sam 2013 tax return) at 17 (Schedule B, Part III, Question 8). For tax years 1992 through 1995, the question was “[w]ere you the grantor of, or transferor to, a foreign trust that existed during [relevant year], whether or not you have any beneficial interest in it?” *See, e.g.,* Joint Ex. 97 (Sam 1993 tax return) at SWYLY020260 (Schedule B, Part III, Question 12). Since both questions ask whether the taxpayer is a grantor of a foreign trust that existed during the relevant year, the two versions of the question are not materially different for our current purpose.

594 *See, e.g.,* IRS Ex. 159 at 1.

595 *See, e.g., id.* (Schedule C begins 53 pages into the exhibit, which is not Bates numbered).

596 Tr. Trans. 2215:5–2217:19 (Hennington); Joint Ex. 108 (Sam 2004 tax return) at SWYLY021663 (Question 16a) and SWYLY021723 (Form 1040 Pensions and Annuities).

597 *See* Joint Exs. 110 (Sam 2006 tax return) at SWYLY022259 (Schedule C) and SWYLY022351 (Schedule C, Statement 16), 111 (Sam 2007 tax return) at SWYLY022974 (Schedule C) and SWYLY023031 (Schedule C, Statement 19), 112 (Sam 2008 tax return) at SWYLY023109 (Schedule c) and SWYLY023174 (Schedule C, Statement 23); IRS Exs. 74 (Sam 2004 tax return) at pp. 4 and 120, 75 (Sam 2005 tax return) at pp. 13 and 90, 159 (Sam 2009 tax return) at pp. 33, 53, 160 (Sam 2010 tax return) at pp. 9 and 60, 161 (Sam 2011 tax return) at 8 and 66, 162 (Sam 2012 tax return) at pp. 9 and 65, 163 (Sam 2013 tax return) at pp. 9 and 69. The referenced tax returns that are IRS exhibits are neither consecutively nor Bates numbered, so the Court's pin cite is to the number of pages into the exhibit the referenced information may be found.

598 Tr. Trans. 1592:20–1593:4 (Herrick).

599 *Id.* Slightly over half of the income adjustments in the Computation Stipulations were due to the fact that this annuity income had, in fact, been reported. *Id.* at 1594:21–1595:11 (Herrick).

600 *Id.* at 2202:19–2217:19 (Hennington).

601 *Id.*

602 *Id.* at 2217:3–7 (Hennington).

603 IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] at 202–203 (§ VIII, ¶¶ 112–119).

604 Tr. Trans. 2202:19–2217:19 (Hennington).

605 *Id.* at 2507:4–2508:2, 1914:4–1915:14 (Hennington).

606 26 U.S.C. §§ 1401, 1402. Net earnings from self-employment also include some partnership income. 26 U.S.C. § 1402(a).

607 *Dillon v. C.I.R.,* 902 F.2d 406, 408 (5th Cir.1990).

608 IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] at 202–03 (§ VIII, ¶ 114) (citing *Newberry v. C.I.R.,* 76 T.C. 441, 444 (1981); *Wuebker v. C.I.R.,* 205 F.3d 897, 901 (6th Cir.2000), *abrogated on other grounds*; *Schelble v. C.I.R.,* 130 F.3d 1388, 1391–1392 (10th Cir.1997); *Harris He Wang v. C.I.R.,* 2014 WL 1612333, *3, 2014 Tax Ct. Summary LEXIS 42, *9–10 (unpublished)).

609 *Schelble,* 130 F.3d at 1392 (quoting *Newberry,* 76 T.C. at 446).

[610] Tr. Trans. 3103:23–3106:7 (Dubinsky).

[611] Form 5471 is another information return to be filed by U.S. taxpayers with respect to certain foreign corporations.

[612] *See* Computation Stipulations ¶¶ 7.A–12.B, 20.A–25.B.

[613] As will be explained in the International Penalties section of this opinion, the Wylys successfully structured certain offshore transactions in a way that did not require the filing of these forms. *See* pp. 550–76, *infra.*

[614] *Spies,* 317 U.S. at 499, 63 S.Ct. 364.

[615] *See* pp. 550–76, *infra;* IRS Ex. 567 at SWYLY007639 (email dated December 9, 2002 from Hennington to Alan Stroud, a lawyer at Meadows Owens, stating: "I am sure I read this at the time and overlooked or did not pay attention to the 3520 filing requirement. It seems that we would have preferred to not have anything reportable on the note if that was a possibility."); IRS Ex. 570 (email dated January 9, 2003 between Hennington and Boucher where Hennington expresses concern that certain loans may be subject to reporting requirements); SEC Tr. Trans. 1720:14–1721:6 (French) (Tedder told Sam that making SEC filings could jeopardize the tax status of the offshore system). In addition, a revenue agent involved in Sam's and Charles' audit testified that he had still not received certain audited financials that the Isle of Man corporations were under an obligation to prepare, and that this did "seem a little disconcerting." Tr. Trans. 1625:23–1627:1 (Herrick). The revenue agent also admitted "we're at about 94 percent that we have now" and that "given the dollar amount in question here, it's not going to make a material difference in the number ... we're at trial now. We aren't going to change the number anymore." *Id.*

[616] *See* Joint Exs. 142–175, which are all of the Forms 3520 and Forms 3520–A in the record. For example, Forms 3520 and 3520–A were filed for the grantor trusts that Sam settled through which the 1996 annuity transactions were undertaken —*i.e.,* Sitting Bull IOM Trust, Crazy Horse IOM Trust, Arlington IOM Trust, and Tallulah IOM Trust. Joint Exs. 145–162. The only Form 3520 filed for the Bulldog IOM Trust was signed and dated by Sam as the settlor on June 6, 1992, was filed on a whitepaper schedule despite the existence of an IRS form that could have been used, and shows that $100 was transferred into the trust. Joint Ex. 142. Likewise, the only Form 3520 filed for the Lake Providence IOM Trust was signed and dated by Sam as the settlor on January 25, 1993, was filed on a whitepaper schedule despite the existence of an IRS form that could have been used, and shows that $100 was transferred into the trust. Joint Ex. 144. The singular Form 3520 for Delhi IOM Trust was signed by Sam on the same date and was also a whitepaper schedule that showed $100 being transferred into the trust. Joint Ex. 145. No Forms 3520 or 3520–A were filed for Bessie IOM Trust or La Fourche IOM Trust.

[617] *See* Joint Exs. 150, 153–157, and 160–162.

[618] *See* Joint Exs. 146 and 147.

[619] *See* Joint Exs. 148, 149, 151, and 152.

[620] *See, e.g.,* Joint Ex. 150.

[621] *See* 26 U.S.C. § 6048, Joint Exs. 146 (Form 3520 filed and signed by Sam as grantor of Tallulah IOM Trust showing transfer of $61,770,607 involving Tallulah IOM Trust. This form is not dated, and although the transfer is listed as occurring on September 8, 1992 the form itself indicates in its upper left-hand corner that it was revised in June of 1995. According to Statement 3 attached to this form, the transfer consisted of an investment in a limited partnership interest in "Tallulah Limited."), 147 (Form 3520 filed and signed by Sam as grantor of Tallulah IOM Trust showing transfer of $5,265,566 involving Tallulah IOM Trust. This form is not dated, and although the form lists the transfer as occurring on April 30, 1993, the form itself indicates in its upper left-hand corner that it was revised in June of 1995. According to Statement 3 attached to this form, the transfer consisted of an investment in a limited partnership interest in "Tallulah Limited").

[622] Joint Exs. 146 and 147.

[623] *See* Joint Stipulations ¶¶ 223–256; Joint Exs. 142–175. The fact that these forms had to have been filed years late is of no economic consequence here, however, as the IRS is not seeking to recover penalties from the Wylys for any late filing of a form that the parties stipulated was filed.

[624] Joint Ex. 142.

[625] Joint Ex. 163.

[626] *See* pp. 556–57, *infra.*

[627] This finding applies to years 1992 through 2013, even though the IRS does not seek International Penalties for years 1992 through 1995. The IRS does not seek penalties for 1992 through 1995 presumably because during these years, the penalties under § 6677 and § 6038 were relatively de minimis and increased in 1996 and 1997 respectively. *See* Small Business Job Protection Act of 1996, Pub.L. No. 104–188, § 6677, 110 Stat. 1755 (increasing penalties under § 6677); Taxpayer Relief Act of 1997, Pub.L. No. 105–34, § 6038, 111 Stat. 788 (increasing penalties under § 6038). Nevertheless,

§ 6038 still required that Sam and Charles file Forms 5471 in years 1992 through 1995. *See, e.g.,* 26 U.S.C. § 6038(a), (e)(1) (1994). This is because the relevant definitions of control under § 6038(e)(1) and "the rules prescribed by section 318(a) for determining ownership of stock" to which subsection (e)(1) refers—and by which the Court concludes that Sam and Charles were required to file Forms 5471—have not been amended from 1992 to date. *See* 26 U.S.C. §§ 318(a), 6038(e)(1). Since Sam and Charles did not file any Forms 5471 from 1992 through 1995, the badge of fraud of filing false or misleading documents still exists for these years due to the absence of Forms 5471 during those years. This badge of fraud also exists during 1994 and 1995 as to Sam and Charles for an additional reason. Section 6048(a)(1) required a Form 3520 to be filed upon "the creation of any foreign trust by a United States person." 26 U.S.C. § 6048(a)(1) (1994). Thus, when the Bessie IOM Trust and the Tyler IOM Trust were created in 1994 and the La Fourche IOM Trust and Red Mountain IOM Trust were created in 1995, Sam and Charles should have filed Forms 3520 documenting these events. *See* Joint Stipulations 28, 48, 81, 88. This means that the badge of fraud of filing false or misleading documents exists in 1994 and 1995 by virtue of the fact that these Forms 3520 were not filed.

628 Charles and Dee checked the box "yes" on their 1992 joint tax return. IRS Ex. 27A at SECI00028718 (Question 12).

629 *See* Joint Exs. 97 (Sam 1993), 103 (Sam 1999), 104 (Sam 2000), 110 (Sam 2006), 111 (Sam 2007), 112 (Sam 2008), 120 (Dee and Charles 1993), 127 (Dee and Charles 2000), 128 (Dee and Charles 2001), 129 (Dee and Charles 2002), 130 (Dee and Charles 2003), 133 (Dee and Charles 2006), 134 (Dee and Charles 2007), 135 (Dee and Charles 2008), IRS Exs. 29A (Dee and Charles 1994), 30 (Dee and Charles 1995), 31 (Dee and Charles 1996), 32 (Dee and Charles 1997), 33 (Dee and Charles 1998), 34 (Dee and Charles 1999), 40 (Dee and Charles 2004), 42 (Dee and Charles 2005), 50 (Dee and Charles 2009), 52 (Dee and Charles 2010), 54 (Dee and Charles 2011), 55 (Dee 2012), 56 (Dee 2013), 71 (Sam 2002), 135 (Sam 1992), 140 (Sam 1994), 141 (Sam 1995), 142 (Sam 1996), 151 (Sam 1997), 152 (Sam 1998), 154 (Sam 2001), 74 (Sam 2004), 75 (Sam 2005), 155 (Sam 2003), 159 (Sam 2009), 160 (Sam 2010), 161 (Sam 2011), 162 (Sam 2012), 163 (Sam 2013). Charles and Dee checked "Yes" in response to this question on their 1992 tax return. IRS Ex. 27A (Dee 1992). There is no explanation in the record as to why they checked the box "Yes" in 1992, but "No" thereafter.

630 *See* Joint Exs. 110 (Sam 2006), 111 (Sam 2007), 112 (Sam 2008); IRS Exs. 71 (Sam 2002), 74 (Sam 2004), 75 (Sam 2005), 155 (Sam 2003), 159 (Sam 2009), 160 (Sam 2010), 161 (Sam 2011), 162 (Sam 2012), 163 (Sam 2013).

631 *See* Joint Exs. 130 (Dee and Charles 2003), 133 (Dee and Charles 2006), 134 (Dee and Charles 2007), 135 (Dee and Charles 2008), 141 (Dee 2013); IRS Exs. 40 (Dee and Charles 2004), 42 (Dee and Charles 2005), 50 (Dee and Charles 2009), 52 (Dee and Charles 2010), 54 (Dee and Charles 2011).

632 *See, e.g.,* IRS Ex. 155 (Sam 2003 tax return) at 47–50.

633 *See* Joint Ex. 38 (Dee and Charles 2003) at SWYLY029539, 71 (Sam 2002) at 78–81, 155 (Sam 2003) at 47–146.

634 *See, e.g.,* IRS Exs. 40 (Dee and Charles 2004) at 65, 74 (Sam 2004) at 86.

635 *See* IRS Exs. 71 at 80 (Sam 2002, estimating $13 million), 155 at 49 (Sam 2003, estimating $6 million); Joint Ex. 130 at SWYLY029541 (Dee and Charles 2003, estimating $7 million), Note that, according to the Computation Stipulations, Sam owes a little over $16 million in income tax for 2002 and a little over $5 million in income tax in 2003. Dee and Charles owe a little over $3.25 million for 2003. *See* Computation Stipulations at Attachments A and B.

636 *See, e.g.,* IRS Exs. 42 (Dee and Charles 2005) at 62–69, 75 at 69–105 (Sam 2005).

637 *See* Joint Exs. 111 at SWYLY023014–23015 (Sam 2007), 134 at SWYLY030969 (Dee and Charles 2007).

638 IRS Ex. 163 at pp. 43, 45, 47 (Sam 2013).

639 563 U.S. 754, 131 S.Ct. 2060, 179 L.Ed.2d 1167 (2011).

640 *Id.* at 2070.

641 *Id.* at 2070–71.

642 *See Fiore v. C.I.R.,* 105 T.C.M. (CCH) 1141, 2013 WL 195628 at *8 (2013); *Fields v. C.I.R.,* 72 T.C.M. (CCH) 675, 1996 WL 530108, at *14 (1996).

643 *Fiore,* 2013 WL 195628, at *1 ("Owen Fiore was a tax lawyer with a small but prominent practice.").

644 *Fields,* 1996 WL 530108, at *1.

645 *Fiore,* 2013 WL 195628, at *8.

646 *U.S. v. Faulkner,* 17 F.3d 745, 766 (5th Cir.1994).

647 *U.S. v. Jones,* 664 F.3d 966, 979 (5th Cir.2011) (quoting *U.S. v. Mendoza–Medina,* 346 F.3d 121, 132 (5th Cir.2003)).

648 *Id.* at 979 n. 3.

649 Tr. Trans. 2114:9–16 (Hennington).

650 There is no innocent spouse relief for gift tax liability. The innocent-spouse provisions apply only to income taxes imposed by subtitle A of the Internal Revenue Code, plus any related interest or penalties. *See* 26 C.F.R. § 1.6015–1(a)(3).

651 26 U.S.C. § 6015(b)(1)(A)–(E).

652 The IRS asserts that innocent spouse relief is only available through 2009 because Charles did not sign the 2010 through 2013 tax returns. However, the Court disagrees with the IRS and concludes that the returns for 2010 and 2011 are joint returns notwithstanding the lack of Charles' signature and that Charles died in 2011. *See* 26 U.S.C. § 6013(a)(2) ("no joint return shall be made if the husband and wife have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or both, then the joint return may be made with respect to the taxable year of each."). Dee's 2010 and 2011 tax returns were filed as joint returns. IRS Exs. 52 (Dee and Charles' original 2010 joint return), 53 (Dee and Charles' amended 2010 joint return), 54 (Dee and Charles' 2011 joint return), 55 (Dee's 2012 single return), 56 (Dee's 2013 single return).

653 *See* pp. 474–76, *infra.*

654 *See* pp. 388–89, *supra.*

655 26 U.S.C. § 6015(b)(1)(B).

656 *Id.* §§ 6015(b)(3), 6662(d)(2)(A).

657 26 C.F.R. § 1.6015–1(h)(4).

658 *Id.*

659 *Id.*

660 *Id.*

661 *Id.*

662 *Id.*

663 This agreement is contingent upon (i) the SDNY Court's determination of foreign grantor trust status being affirmed on appeal, which appeal is currently pending before the Second Circuit Court of Appeals, and/or (ii) this Court's collateral estoppel decision being affirmed on appeal, assuming such an appeal is taken.

664 Indeed, Dee credibly testified that every penny of the income that was earned during her marriage was earned by her husband Charles. Tr. Trans. 164:2–4(Dee).

665 26 C.F.R. § 1.6015–2(c).

666 *Id.*

667 282 F.3d 326 (5th Cir.2002).

668 *Id.* at 333–34 & n. 16.

669 *Id.* at 330.

670 *Id.* at 331 (the amounts in dispute "roughly correspond to the improperly deducted amounts that the Cheshires used to pay off their mortgage").

671 *Id.* at 334–35. ("Appellant's defense consists only of her mistaken belief that money spent to pay off a mortgage is properly deductible from retirement distributions. Ignorance of the law cannot establish an innocent spouse defense to tax liability.").

672 81 T.C.M. (CCH) 1380, 2001 WL 283021 (2001).

673 *Id.* at *1–2.

674 *Id.* at *6.

675 *Id.*

676 3 F.3d 1342 (9th Cir.1993).

677 *Id.* at 1344–46.

678 *Id.* at 1346.

679 *Id.*

680 *Cheshire,* 282 F.3d at 333 ("courts have agreed that in omitted income cases, the spouse's actual knowledge of the underlying transaction that produced the income is sufficient to preclude innocent spouse relief (the 'knowledge-of-the-transaction test'); *Reser v. C.I.R.,* 112 F.3d 1258, 1265 (5th Cir.1997) ("Courts have generally agreed that when the substantial understatement of tax liability is attributable to an *omission of income* from the joint return, the relevant inquiry is whether the spouse seeking relief knew or should have known of an income-producing *transaction* that the other spouse failed to report. In short, in omission of income cases, the spouse's knowledge of the underlying transaction which produced the omitted income is alone sufficient to preclude innocent spouse relief." (emphasis in original) (footnote omitted)); *Penfield v. C.I.R.,* 84 T.C.M. (CCH) 424, 2002 WL 31239480 at *4 (2002) ("When the substantial understatement of tax liability is attributable to an omission of income from the joint return, the spouse's

knowledge or reason to know of the underlying transaction which produced the income is sufficient to preclude relief under section 6015(b)(1).”). In *Cheshire,* the taxpayer knew about the entire amount of retirement distributions even though she did not know the distributions were taxable.” (internal citation omitted)).

681 2002 WL 31239480, at *5.

682 *Id.*

683 26 C.F.R. § 1.6015–2(c).

684 *See* pp. 389–464, *supra.*

685 26 U.S.C. § 6015(b)(1)(D).

686 26 C.F.R. § 1.6015–2(d).

687 *Cheshire,* 282 F.3d at 338 (internal marks omitted) (quoting *Reser,* 112 F.3d at 1270). Although the Fifth Circuit made this statement in the context of innocent spouse relief under § 6015(f) rather than § 6015(b), the language of § 6015(f) is largely identical to that of § 6015(b)(1)(D) (the subsection at issue here) and tax courts have indicated that it is appropriate to treat the considerations under these two subsections as identical. *See, e.g., Scott v. C.I.R.,* 2015 WL 5730002, at *6 (2015) (implying that considerations under the two subsections are the same); *Alt v. C.I.R.,* 119 T.C. 306, 316 (2002) (“The language of section 6015(f)(1) ... does not differ significantly from the language of section 6015(b)(1)(D) ... Further, the equitable factors we considered under section 6015(b)(1)(D) are the same equitable factors we consider under section 6015(f).”). The tax court has also held that cases interpreting the inequity factors under the predecessor statute to § 6015(b)(1)(D)—§ 6013(e)(1)(D)—are relevant to the inequity factors under § 6015(b)(1)(D). *Campbell v. C.I.R.,* 91 T.C.M. (CCH) 735, 2006 WL 345827, at *8 (2006); *McClelland v. C.I.R.,* 89 T.C.M. (CCH) 1329, 2005 WL 1220492, at *6 (2005).

688 *Cheshire,* 282 F.3d at 338.

689 *Id.*

690 *Id.*

691 509 F.2d 162, 168 (5th Cir.1975).

692 69 T.C.M. (CCH) 1873, 1995 WL 49287 (1995). Although *Kistner* was decided under a precursor to the current innocent spouse statute, the *Kistner* court based its decision on the following factors: “[i]n determining whether it is inequitable to hold a spouse jointly liable, we should take the following into account: (1) [w]hether the spouse significantly benefited from the items omitted from gross income, (2) whether the spouse is deserted, divorced or separated, and (3) all other relevant facts and circumstances.” *Id.* at *6 (internal citations omitted). These are among the factors that are discussed in the current IRS regulations governing the innocent spouse inequity inquiry. *See* 26 C.F.R. § 1.6015–2(d).

693 *Id.* at *6–7.

694 *Id.* at *7.

695 *Id.*

696 *Hall v. C.I.R.,* 108 T.C.M. (CCH) 199, 2014 WL 4119029, at *13 (2014) (emphasis added) (citing *Alt,* 119 T.C. at 314); *Johnson v. C.I.R.,* 97 T.C.M. (CCH) 1860, 2009 WL 1855767, at *6 (2009).

697 *See Varela v. C.I.R.,* 108 T.C.M. (CCH) 483, 2014 WL 5365663, at *5 (2014); *Johnson,* 2009 WL 1855767, at *6; *Alt,* 119 T.C. at 314.

698 *Haltom,* 2005 WL 2132599, at *7.

699 *Becherer v. C.I.R.,* 2004 WL 2930977, at *3 (2004) (quoting *Purcell v. Commissioner,* 826 F.2d 470, 475 (6th Cir.1987)).

700 *See* pp. 389–462, *supra.*

701 *See* pp. 461–64, *supra.*

702 *See* pp. 389–462, *supra.*

703 *See Haltom,* 2005 WL 2132599, at *7.

704 26 C.F.R. § 1.6015–2(d).

705 *Id.*

706 Those tax courts who analyze the desertion factor tend to group it with the factor of whether the spouses are divorced or separated. *See Hall,* 2014 WL 4119029, at *13. As the Court explains below, under the analysis that the tax court applies to the divorce or separation factor, the fact that Dee is a widow is treated as a neutral factor in the Court's inequity analysis.

707 *Haggerty v. C.I.R.,* 102 T.C.M. (CCH) 563, 2011 WL 6029929, at *4 (2011).

708 *Von Kalinowski v. C.I.R.,* 81 T.C.M. (CCH) 1081, 2001 WL 77034, at *8 (2001).

709 Rev. Proc.2013–34, 2013–43 I.R.B. 397.

710 *Haggerty,* 2011 WL 6029929, at *4 (2011).

[711] Rev. Proc.2013–34, 2013–43 I.R.B. 397.

[712] *See Agudelo v. C.I.R.,* 110 T.C.M. (CCH) 24, 2015 WL 4086310, at *9 (2015).

[713] *See Hopkins v. C.I.R.,* 121 T.C. 73, 82–86 (2003).

[714] *Id.*

[715] Rev. Proc.2000–15, 2000–1 C.B. 447 (superseded by Rev. Proc.2013–34, 2013–43 I.R.B. 397).

[716] Rev. Proc.2013–34, 2013–43 I.R.B. 397.

[717] *Hall,* 2014 WL 4119029, at *13 (citing *Cutler v. C.I.R.,* 105 T.C.M. (CCH) 1704, 2013 WL 1875975, at *3 (2013)).

[718] *Haggerty,* 2011 WL 6029929, at *4.

[719] Rev. Proc.2013–34, 2013–43 I.R.B. 397.

[720] *See Cutler,* 2013 WL 1875975, at *7 (interpreting predecessors to the most current Revenue Procedures and labeling the abuse factor as neutral in a case where there were no allegations of abuse); Rev. Proc.2013–34, 2013–43 I.R.B. 397 (stating that "[f]or purposes of this revenue procedure, if the requesting spouse establishes that he or she was the victim of ... then depending on the facts and circumstances of the requesting spouse's situation, the abuse may result in certain factors weighing in favor of relief when otherwise the factor may have weighed against relief." but remaining silent on the effect of there not being abuse.).

[721] *See* pp. 465–68, *supra.*

[722] Tr. Trans. 159:20–160:15(Dee) (relied entirely on husband throughout marriage).

[723] *Id.* at 164:5–165:3(Dee) (first heard the name Soulieana at her deposition in July 2015, never discussed IOM structure with anyone before bankruptcy case filed), 165:22–166:23; 174:16–24(Dee) (didn't ever see Eiseman or Marguerite Green invoices at the time purchases were made), 182:10–183:3; 183:18–20(Dee) (never heard of Tyler IOM Trust or Keith King), 184:20–185:11, 186:12–15(Dee) (never heard of Red Mountain IOM Trust or Shaun Cairns), 322:6–14(Dee) (does not know what a limited partner, general partner, limited partnership, or annuity is), 188:22–189:9(Dee) (never heard of Lincoln Creek IOM Trust), 192:8–11(Dee) (never heard of Maroon Limited (IOM)).

[724] Rev. Proc.2013–34, 2013–43 I.R.B. 397 ("If the requesting spouse did not know and had no reason to know of the item giving rise to the understatement, this factor will weigh in favor of relief.").

[725] *Haggerty,* 2011 WL 6029929, at *5 (citing *Bland v. C.I.R.,* 101 T.C.M. (CCH) 1023, 2011 WL 94742 (2011); *Akopian v. C.I.R.,* 102 T.C.M. (CCH) 350, 2011 WL 4550127 (2011)).

[726] *See* pp. 468–70, *supra.*

[727] *See Wang v. C.I.R.,* 108 T.C.M. (CCH) 394, 2014 WL 4976232, at *15 (2014) (tax court case interpreting most recent Revenue Procedures Factors and not analyzing this factor); *Hall,* 2014 WL 4119029, at *13–*17 (same); Rev. Proc.2013–34, 2013–43 I.R.B. 397 (most recent Revenue Procedures, which do not analyze this factor as a part of the inequity analysis).

[728] *See* IRS Ex. 55 (Dee 2012) at 8, 56 (Dee 2013) at 4. The Court concludes elsewhere in the Memorandum Opinion that Dee is in fact a grantor of the various Isle of Man trusts that make up Charles' offshore system. *See* pp. 553–57, *infra.*

[729] *Haggerty,* 2011 WL 6029929, at *6; Rev. Proc.2013–34, 2013–43 I.R.B. 397.

[730] 26 U.S.C. § 6015(b)(1)(D).

[731] Tr. Trans. 160:10–161:14(Dee).

[732] 26 C.F.R. § 1.6015–5(b)(1).

[733] *Id.* § 1.6015–5(b)(2)(i). One of the examples laid out under § 1.6015–5(b)(4) specifically discusses a proof of claim: "**Example 5.** W files a Chapter 7 bankruptcy petition on July 10, 2000. On September 5, 2000, the United States files a proof of claim for her joint 1998 income tax liability. W elects relief with respect to the 1998 liability on August 20, 2002. The election is timely because it is made within two years of the date the United States filed the proof of claim in W's bankruptcy case." 26 C.F.R. § 1.6015–5(b)(4).

[734] 26 U.S.C. § 6664.

[735] For example, Sam relies on the definition of "advice" in § 1.6664–4(c)(2) in support of his argument that he need not have read the opinions or memoranda that contained the advice he received. *See* Debtors' Post–Trial Brief [ECF No. 1117] at 49. The Debtors cite to § 1.6664–4 at other points as well. *See* Debtors' Amended Proposed Findings of Fact and Conclusions of Law [ECF No. 1102] at 180 n.723; Debtors' Post–Trial Brief [ECF No. 1117] at 31 n.41, 40 n.64, 47 n.82, 50; Debtors' Post–Trial Reply [ECF No. 1121] at 24–25, 36 n.92, 41, 43, 45.

[736] *See, e.g.,* IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] 243, 245, 246; IRS Pre–Trial Brief [ECF No. 1018] at 120–21. IRS Post–Trial Brief [ECF No. 1118] at 6–9, 13, 17, 19; IRS Post-Trial Reply [ECF No. 1120] at 19, 22, 23.

737 The Court acknowledges that 26 C.F.R. § 1.6664–4(c) was not in effect for all of the years at issue, and again stresses that it is using this regulation only as a guide when engaging in an analysis of all of the facts and circumstances surrounding Sam's reasonable cause and good faith defense/attempted negation of fraudulent intent. Section 1.6664–4(c)'s explanation of reliance on the advice of a professional was first added to the regulation in 1995, *see* T.D. 8617, 1995–2 C.B. 274, and underwent some language tweaks in 2003, *see* T.D. 9109, 2004–1 C.B. 519.

738 26 C.F.R. § 1.6664–4(a); *see, e.g., Sanchez,* 2014 WL 4251054, at *9 (citing to § 1.6664–4 when assessing reasonable cause in a fraud context); *McClellan v. C.I.R.,* 106 T.C.M. (CCH) 492, 2013 WL 5849873, at *11 (2013) (same).

739 *Brinkley v. C.I.R.,* 808 F.3d at 669 (internal marks omitted) (quoting *Klamath,* 568 F.3d at 548); *see Whitehouse Hotel Ltd. P'ship v. C.I.R.,* 755 F.3d 236, 249 (5th Cir.2014) ("Different facts in these reliance-on-advice cases certainly can lead to different results. We determine whether a taxpayer acted with reasonable cause on a case-by-case basis, evaluating the totality of the facts and circumstances." (citation and quotation marks omitted)); *Southgate Master Fund, L.L.C.,* 659 F.3d at 493 ("We determine whether a taxpayer acted with reasonable cause on a case-by-case basis, evaluating the totality of the facts and circumstances."); *see also American Boat Co., LLC v. U.S.,* 583 F.3d 471, 481 (7th Cir.2009) ("Relying on a professional, however, will not always get a taxpayer off the hook. To constitute reasonable cause, the reliance must have been reasonable in light of the circumstances."). Of course, in asserting that reasonable cause depends on the quality of the professional advice that is received, the Court does not imply that Sam may not rely on advice merely because it turned out to be wrong. As the Supreme Court has pointed out in *U.S. v. Boyle,* when a professional advises a taxpayer on a matter of tax law, such as whether a liability exists or whether a return must be filed, it is reasonable for the taxpayer to rely on that advice without seeking a second opinion, even if that advice turns out to be wrong. *See Boyle,* 469 U.S. at 251, 105 S.Ct. 687; *Whitehouse Hotel Ltd. P'ship,* 755 F.3d at 249; *Stanford v. C.I.R.,* 152 F.3d 450, 461–62 (5th Cir.1998). This is because "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney." *Whitehouse Hotel Ltd. P'ship,* 755 F.3d at 249 (quoting *Boyle,* 469 U.S. at 251, 105 S.Ct. 687).

740 *Thomas v. C.I.R.,* 105 T.C.M. (CCH) 1403, 2013 WL 690599, at *3 (2013).

741 *See, e.g., Sanchez,* 2014 WL 4251054, at *9.

742 *See, e.g., Grossman v. C.I.R.,* 182 F.3d 275, 278 (4th Cir.1999) ("A taxpayer's reliance on his or her accountant to prepare accurate returns may indicate an absence of fraudulent intent. However, as the tax court noted, a taxpayer can only rely on an accountant when that accountant has been supplied with all the information necessary to prepare the returns accurately" (internal citations and quotation marks omitted)); *Alexander Shokai, Inc. v. C.I.R.,* 34 F.3d 1480, 1486 (9th Cir.1994) ("Taxpayers also contend that they properly relied on Edward Bartelt's expertise in preparing their tax returns. Although Taxpayers made their U.S. bank records available to Edward Bartelt, they failed to disclose the Gosen payments, the Gosen agreements or the oral contingent agreement to him. Taxpayer's failure to make a 'full' disclosure precludes their reliance on Edward Bartelt's preparation of their tax returns."); *Biaggi v. C.I.R.,* 79 T.C.M. (CCH) 1488, 2000 WL 146797, at *5 (2000) ("Since petitioner admits that he never told his accountants that he owned the Wedtech stock, his reliance on his accountants is not a defense to fraud."); *Hill v. C.I.R.,* 74 T.C.M. (CCH) 673, 1997 WL 582148, at *7 (1997) (reliance on advice of professional no defense to fraud when advisor did not have all of taxpayer's income information); *Scallen v. C.I.R.,* 54 T.C.M. (CCH) 177, 1987 WL 49208 (1987) ("While a taxpayer's reliance upon his accountant to prepare accurate returns may indicate an absence of fraudulent intent, this is true in the first instance only if the accountant has been supplied with all the information necessary to prepare the returns." (quoting *Temple v. C.I.R.,* 67 T.C. 143, 162 (1976)); *Whyte v. C.I.R.,* 52 T.C.M. (CCH) 677, 1986 WL 21695 (1986) (taxpayer could not rely on advisor when they did not provide "all of the necessary tax information"); *Lamb v. C.I.R.,* 50 T.C.M. (CCH) 1209, 1985 WL 15133 (1985) (taxpayer attempted to rely on professional to negate fraudulent intent but could not because all information not provided to professional).

743 *See Richardson,* 509 F.3d at 740 (taxpayer ignored advice of independent attorney who advised that trust arrangement was illegal, and instead followed advice of trust management company that promoted the trust arrangement); *Sanchez,* 2014 WL 4251054, at *9 (tax advisor not competent because she did not finish college and was not a CPA); *Tarpo v. C.I.R.,* 98 T.C.M. (CCH) 282, 2009 WL 3048627, at *8 (2009) ("James asserts that he had reasonable cause for his return position and that he acted in good faith. Sec. 6664(c). He claims that the entire fiasco is Mattatall's fault, and that his good faith reliance on Mattatall reasonably caused him to act the way he did. While that excuse might work when a licensed and reputable tax professional offers the advice, it doesn't work here.").

744 *See Richardson,* 509 F.3d at 740 (taxpayer ignored advice of independent attorney who advised that trust arrangement was illegal, and instead followed advice of trust management company that promoted the trust arrangement); *Alexander Shokai, Inc.,* 34 F.3d at 1486 ("Kenneth Bartelt advised Taxpayers that the Gosen payments were not taxable until they were brought to the United States. We agree with the tax court that Mr. Alexander did not rely on that advice because

he failed to report the Gosen payments as income even after he had partially transferred them to accounts in the United States."); *Graham v. C.I.R.,* 2005 WL 730078, at *17 (2005) (taxpayers ignored advice that income was taxable); *Davis v. C.I.R.,* 78 T.C.M. (CCH) 178, 1999 WL 549152, at *14 (1999) (Taxpayer's actual, good faith reliance on members of his staff and professionals negated fraudulent intent); *Hill,* 1997 WL 582148, at *7 (reliance on advice of professional no defense to fraud when taxpayer did not follow advisor's advice); *Watson v. C.I.R.,* 54 T.C.M. (CCH) 1601, 1988 WL 4340 (1988) (same); *Hinojosa v. C.I.R.,* 44 T.C.M. (CCH) 216, 1982 WL 10649 (1982) ("If petitioners had given Mr. Ibanez the correct figures, they would have appeared on the appropriate return. We recognize that petitioners had some difficulty with the language. However, they are intelligent, competent, and experienced business people whom we believe were sophisticated enough to realize what was transpiring. Accordingly, we find for respondent on the fraud issue ...").

745 *See, e.g.,* Debtors' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1102] at 154–55 ("The Wylys never intentionally failed to pay any tax they believed they owed. At all times, the Wylys acted on the advice of competent tax advisors, and they paid all taxes they believed were due. The IRS has no evidence that the Wylys believed that the conclusions of their advisors on these complex and uncertain issues were wrong. Thus the IRS cannot carry its burden as to fraud.").

746 *See* p. 389, *supra.*

747 *Davis,* 78 T.C.M. (CCH) 178, 1999 WL 549152, at *14 ("Petitioner's reliance upon third parties to keep his books and records and to prepare his returns indicates the absence of fraudulent intent. Petitioner, in good faith, relied on members of his staff to turn over all of his books and records and otherwise make a full and complete disclosure to his third party return preparers." (internal citations omitted)); *Garcia v. C.I.R.,* 103 T.C.M. (CCH) 1829, 2012 WL 1957703, at *8 (2012) ("As a result of Mr. Garcia's failure to supply Mr. Ostrem with information necessary to accurately prepare his personal tax returns (or notify Mr. Ostrem that the information supplied by California Radomes was incorrect), Mr. Garcia's purported reliance on Mr. Ostrem does not prove his lack of fraudulent intent. Indeed, Mr. Garcia's efforts to conceal information from Mr. Ostrem is evidence of Mr. Garcia's intent to conceal and deceive." (internal citations omitted)); *Medieval Attractions N.V. v. C.I.R.,* 72 T.C.M. (CCH) 924, 1996 WL 583322, at *59 (1996) ("We agree that there are many badges of fraud present in these cases. We conclude, however, that respondent has not negated the alternative explanation, petitioners' reliance on C & L, by clear and convincing evidence."); *Lamb v. C.I.R.,* 50 T.C.M. (CCH) 1209, 1985 WL 15133 (1985) (taxpayer attempted to rely on professional to negate fraudulent intent).

748 *See, e.g., Durrett v. C.I.R.,* 71 F.3d 515, 518 (5th Cir.1996) ("Good faith reliance on professional advice concerning tax laws is a defense."); *Sanchez,* 2014 WL 4251054, at *9; *Price v. C.I.R.,* 87 T.C.M. (CCH) 1239, 2004 WL 859198, at *15 (2004) (evaluating reliance on a professional as a defense to fraud); *Hill,* 1997 WL 582148; *see also Davis,* 1999 WL 549152, at *14 (reliance on a professional negated fraudulent intent because it was reasonable); *Gruber v. C.I.R.,* 69 T.C.M. (CCH) 2718, 1995 WL 315694, at *11 (1995) (evaluating badges of fraud and then discussing whether reliance on an accountant could establish a defense to fraudulent intent); *Whyte,* 1986 WL 21695 (discussing reliance on a professional alternatively as a matter of negating fraudulent intent and as a defense to fraud). Some courts also seem to consider a reliance on counsel that was not in good faith to actually support a finding of fraudulent intent. *See, e.g., Merritt,* 301 F.2d at 487 ("Consistent and substantial understatement of income is by itself strong evidence of fraud. This proof, coupled with the showing that the records were both incomplete and inaccurate, and that the petitioner did not supply the bookkeeper with all of the data necessary for maintaining complete and accurate records, is enough to warrant the Tax Court in finding fraud."); *Houser v. C.I.R.,* 70 T.C.M. (CCH) 131, 1995 WL 432633, at *13 (1995) (fact that taxpayer misled person who prepared his taxes indicated fraudulent intent); *Watson,* 1988 WL 4340 ("We do not rely solely on Joann's testimony as evidence of petitioner's fraudulent intent to evade taxes. Petitioner testified that he asked Mrs. Proctor, his tax return preparer, whether he needed to report hobby income and that she replied 'no.' Mrs. Proctor took the stand and directly contradicted petitioner's testimony. She stated that at no time had petitioner discussed any fur trading activities or any other income producing hobby, and that had she been aware of such a hobby she would have included income derived from the activity on petitioner's returns.").

749 In so finding, the Court acknowledges that at least some tax courts have held that while reliance on a promoter cannot establish reasonable cause, it can in some circumstances negate fraudulent intent. *See Carreon,* 2014 WL 91959, at *7; *Alexander v. C.I.R.,* 106 T.C.M. (CCH) 198, 2013 WL 4606105, at *16 (2013). Nevertheless, the Court finds that Sam's reliance on Tedder's law firm, under the facts and circumstances here, did not negate Sam's fraudulent intent.

750 26 C.F.R. § 1.6664–4(c).

751 Sam received some advice that is not relevant to the issues we will discuss here in detail. For example, Sam received twelve written opinions from Chamberlain, Hrdlicka, White, Williams, & Martin dated October 15, 2003, each one addressing whether each of the twelve annuity transactions that Sam undertook in 1992 and 1996 were listed transactions

mandating disclosure under 26 C.F.R. § 1.6011–4(a). The firm concluded that they were not. *See* Wyly Exs. DM–DX. Similarly, Sam received twelve substantively identical opinion letters from De Castro, West, Chodorow, Glickfeld, & Ness, Inc. dated October 15, 2003 addressing whether each of the twelve private annuity transactions was a "reportable transaction" under 26 U.S.C. § 6011; while worded differently, the same question addressed by the Chamberlain Hrdlicka firm. The De Castro West firm reached the same conclusion that the Chamberlain, Hrdlicka firm reached—the annuity transactions were not subject to disclosure as a reportable transaction. *See* Wyly Exs. DM–DX. The fact that the private annuity transactions were not a listed transaction is not in dispute among the parties here; thus, these opinions are not relevant to any issue in dispute.

752 In their pre-trial briefing, the Debtors argue that they have established reasonable cause for two reasons: (i) because they relied on the advice of their counsel, and (ii) because there was an honest difference of opinion as to the proper application of the tax law at issue here. The Court analyzes the Debtors' honest difference of opinion argument in the context of the Debtors' reasonable cause defenses to the imposition of International Penalties, and ultimately concludes that the Debtors' honest difference of opinion argument is identical to their reliance on the advice of counsel argument. *See* pp. 580–83, *infra.* The observations that the Court makes regarding the interchangeability of these two arguments apply with equal force to all of the Debtors' reasonable cause arguments, in both the International Penalties context and the tax fraud context.

753 Wyly Ex. BO. Dee and Charles received identical opinion letters from Pratter, Tedder & Graves. *See* Wyly Exs. BP (Charles), BQ (Dee).

754 Wyly Ex. BO at 6221.

755 *Id.* at 6222.

756 *Id.* at 6222–6224.

757 *Id.* at 6225 (opinion A).

758 *Id.* at 6226 (opinion B).

759 *Id.* at 6239 (opinion H).

760 *Id.* at 6240 (opinion I), although this transfer never occurred.

761 *Id.* at 6242.

762 As did the four Nevada corporations that acquired the options and warrants from Charles. *See* Wyly Exs. BS, BU, BV, and BZ.

763 *See* Wyly Exs. BR, BT, BW, BX, BY, and CA.

764 Wyly Ex. BR at WYLYSEC01103165.

765 *Id.* at WYLYSEC01103167.

766 Chatzky testified that he worked with Tedder's firm from time to time on particular clients, but that at some point in time they became partners in the same firm. While Chatzky could not be precise as to the timing, they became partners sometime between the April 1992 opinion letters just discussed and the May 19, 1993 opinion letters. Tr. Trans. 1134:12–1136:24 (Chatzky). Moreover, by February 22, 1996, Tedder and Chatzky were no longer law partners because Tedder "had a penchant for making statements to people that were either questionable or flatly untrue...." *Id.* at 1137:15–17. According to Chatzky, this made him uncomfortable, so the firm dissolved and Chatzky returned to practicing law through his own firm, Chatzky & Associates. *Id.* at 1138:18–1139:9. After the dissolution of their law firm, Chatzky testified that he no longer worked on common clients with Tedder, *id.* at 1139:16–20, and has never seen him again, *id.* at 11411–5.

767 *See* Wyly Exs. CB (Lake Providence IOM Trust) at SWYLY005378 and CC (Delhi IOM Trust) at SWYLYSEC01100186. The letters are identical and, based on the factual assumptions contained in the letters, the firm opines that "it is more likely than not that the trust will be construed to constitute a valid non-grantor trust for United States taxation purposes provided that the trust operates in accordance with the terms and provisions contained in the Trust Agreement."

768 Tr. Trans. 1170:9–11 (Chatzky).

769 In fact, while Debtors' counsel attempted to refresh Chatzky's recollection using a draft opinion letter dated February 2, 1992, that draft is unsigned and was not offered into evidence. Accordingly, there is no evidence in the record as to whether an opinion regarding the Bulldog IOM Trust was ever finalized, signed and issued to Sam. It goes without saying, therefore, that we have no idea on this record what such an opinion, if ever finalized, signed and issued, would have said.

770 *Neonatology Assocs.,* 115 T.C. at 98; *see also Gustashaw v. C.I.R.,* 696 F.3d 1124, 1139 (11th Cir.2012) ("Reliance is not reasonable if the adviser was a promoter of the transaction or otherwise had a conflict of interest about which the taxpayer knew or should have known."); *Stobie Creek Inv., LLC,* 608 F.3d at 1381 ("Reliance is not reasonable, for example, if the adviser has an inherent conflict of interest about which the taxpayer knew or should have known."); *American Boat Co.,*

583 F.3d at 481 ("A taxpayer is not reasonable, however, in relying on an adviser burdened with an inherent conflict of interest about which the taxpayer knew or should have known."); *Mortensen v. C.I.R.,* 440 F.3d 375, 387 (6th Cir.2006) ("advice must generally be from a competent and independent advisor unburdened with a conflict of interest and not from promoters of the investment."); *Addington v. C.I.R.,* 205 F.3d 54, 59 (2d Cir.2000) ("It is unreasonable for taxpayers to rely on the advice of someone who they know has a conflict of interest."); *Chamberlain v. C.I.R.,* 66 F.3d 729, 732 (5th Cir.1995) ("taxpayers may not rely on someone with an inherent conflict of interest"); *Goldman v. C.I.R.,* 39 F.3d 402, 408 (2d Cir.1994) (it is not reasonable for a taxpayer to rely on a professional they know is "burdened with an inherent conflict of interest.").

771 *See Neonatology Assocs.*, 115 T.C. at 98.

772 *Id.* at 99.

773 *6611, Ltd. v. C.I.R.,* 105 T.C.M. (CCH) 1309, 2013 WL 560866, at *29 (2013) (citing *106 Ltd. v. C.I.R.,* 684 F.3d 84, 90–91 (D.C.Cir.2012), *aff'g* 136 T.C. 67 (2011); *Neonatology Assocs.,* 115 T.C. at 98.

774 *106, Ltd.,* 136 T.C. at 78.

775 *Id.* at 79 (quoting *Tigers Eye Trading, LLC v. C.I.R.,* 97 T.C.M. (CCH) 1622 (2009)).

776 *Id.*; *see also Blum v. C.I.R.,* 103 T.C.M. (CCH) 1099, 2012 WL 129801, at *16 (2012), *aff'd,* 737 F.3d 1303 (10th Cir.2013) (adopting the same caveat).

777 *Paschall v. C.I.R.,* 137 T.C. 8, 23 (2011) (internal quotation marks omitted) (citing *106 Ltd.,* 136 T.C. at 79 (*quoting Tigers Eye Trading,* 97 T.C.M. (CCH) 1622 (2009)); *see also New Phoenix Sunrise Corp. v. C.I.R.,* 132 T.C. 161, 193 (T.C.2009) (reliance on Jenkins and Gilchrist who "actively participated in the development, structuring, promotion, sale, and implementation" of a transaction was unreasonable, no caveat given.); *Maguire Partners–Master Investments, LLC v. U.S.,* 2009 WL 4907033, at *21 (C.D.Cal.2009) ("Finally, the partnerships have failed to demonstrate that they sought and received disinterested and objective tax advice because the tax advice that they did receive came from Arthur Andersen, which also arranged the transactions resulting in the increased basis that is at issue in this case. Therefore, the partnerships have failed to demonstrate that they acted in good faith as required by the reasonable cause exception of I.R.C. § 6664(c)(1).").

778 *106 Ltd.,* 136 T.C. at 79 (citing *Countryside Ltd. P'ship. v. C.I.R.,* 132 T.C. 347, 352–55 (2009)).

779 *Stobie Creek Inv. LLC,* 608 F.3d at 1382 (citing cases).

780 *Chamberlain,* 66 F.3d at 732 (citing *Goldman v. C.I.R.,* 39 F.3d 402 (2d Cir.1994)); *see also Streber v. C.I.R.,* 138 F.3d 216, 219 (5th Cir.1998) (citing *Chamberlain* for this proposition).

781 Collateral Estoppel No. 5 ("In early to mid–1991, Sam Wyly asked Robertson to attend a seminar held by lawyer and *trust promoter* David Tedder on the use of foreign trusts as a method of asset protection and tax deferral) (emphasis added).

782 *See* IRS Exs. 96 (memo from Hennington and Boucher to, among others, Sam and Charles) at WYLYSEC01112395 § V.c, Ex. 97 (memo from Boucher and Hennington to, among others, Charles and Sam) at 2 ("They [the IRS] are not comfortable from a reasonable cause basis for penalties if the taxpayer relied solely on the legal opinion written by the same person who was promoting the structure (Teddar [*sic*].").

783 Tr. Trans. 1052:1–4 (Sam admitting to having referred to Tedder as "a pitchman, a salesman, and a rainmaker" and that Tedder and Chatzky were the "architects" of the offshore system). *See also* SEC Tr. Trans. 1717:4–15 (French testifying that Tedder "had something to sell and he was a little bit of a salesman"), 3773:5–11 (French testifying he thought of Tedder as "a little bit of like a hustler"); Wyly Ex. OB at WYLYSEC01112416–2417 (Lubar referring to Tedder as a promotor).

784 Tr. Trans. at 1137:15–17 (Chatzky).

785 *Id.* at 1137:18–1138:21 (Chatzky).

786 *Id.* at 1138:18–1139:9 (Chatzky).

787 *Id.* at 1190:17–23 (Chatzky).

788 Sam confirms that Tedder "pitched" his offshore system to Sam and Charles at a meeting at Sam's home in Malibu in 1992. Tr. Trans. 1050:23:21–25(Sam). Sam was then asked—"You've described Mr. Tedder as a pitchman, a salesman, and a rainmaker. Is that correct," to which Sam replied "yes." *Id.* at 1052:1–4. Sam was then asked "and he was the architect of this offshore system, wasn't he?" Sam's responds "[h]e and his firm, including Mr. Chatzky, were the architects of it." *Id.* at 152:5–8.

789 Tr. Trans. 1162:8–17 (Chatzky).

790 *Id.* 702:4–11 (Sam explaining that after Tedder's New Orleans seminar, "the next thing after that was I had a session with the—the two principals in the law firm in California who were out there. Michael Chatzky was sort of the legal scholar

who wrote the documents to set it up, and David Tedder was sort of the [ ]rain maker, the marketer of the—for the legal services."); 1051:23–25 (Sam stating "I think I described him [Tedder] as the rainmaker and the more scholarly attorney as Mr. Chatzky—of the partners of the firm, is my take on it."), 1074:3(Sam) ("Q. And Pratter, Tedder & Graves as Mr. Tedder's law firm. Is that correct? A. Yes, Mr. Tedder, Mr. Chatzky and others.").

791 *See id.* at 1190:18–23 (Chatzky) ("It's my understanding that the party, the client—Sam Wyly or Charles Wyly, whoever the appropriate client was at the time—engaged Pratter, Tedder, & Graves to—to draft the opinion and, therefore, the opinions were submitted to David Tedder for his signature."). In 1992, when Chatzky ghost wrote the opinion letters for Tedder, he and Tedder were not partners. *Id.* at 1135:21–11136:3 (Chatzky).

792 *See* pp. 371, 414–15, *supra*; Collateral Estoppel No. 18.

793 *See* pp. 413–16, *supra.*

794 As will be explained later, acting on Sam's behalf, Hennington received advice from Meadows Owens in October 2003 that Sam had a "reportable position" contrary to Lubar's conclusions—both those expressed originally in 1993 and those expressed in mid–2003, after Lubar did further research at Hennington's request, again acting on Sam's behalf. *See* pp. 491–93, *infra.*

795 *See, e.g.,* Wyly Ex. KL (Confidential Conference Outline dated July 14, 1999), IRS Ex. 110 (Confidential Conference Outline dated April 25, 2000), & IRS Ex. 111 (Confidential Conference Outline dated September 7, 2000).

796 Owens died in July 2003. Thus, he did not testify at trial and the IRS objected to the admission of any testimony from Sam or Evan concerning what Owens had told them on hearsay grounds. That lead to the Debtors' arguments that the purported advice was not being offered for its truth, but rather the impact the receipt of that purported advice had on Sam's state of mind.

797 As the Court stated in ruling on the IRS' objection to the admission of Evan's testimony regarding advice given by Owens to Sam, "[g]iven that it is being stipulated that the evidence is coming in not for the truth of the matter asserted but the impact that the statements, whatever they are, whether accurate or not, had on the state of mind of Sam Wyly and then, I guess as corroboration, Evan Wyly since he was also at the meeting, the Court will admit it for that limited purpose." Tr. Trans. 1674:9–20 (oral ruling).

798 Tr. Trans. 1084:16–1089:13 (Evan); Laurie recalled the family meetings covering more personal matters than financial matters, *id.* 1512:6–8, and she could not recall anything specific Owens discussed at such meetings, *id.* 1510:4–12. Hennington recalled Owens attending a family meeting that she attended, and that Owens discussed the IOM trusts and corporations "in a broad sense, Rodney gave an overview to the family." *Id.* 1922:2–14 (Hennington).

799 IRS Ex. 111 at SWYLY009417 (emphasis in original).

800 Of course, the IRS objected on hearsay grounds to Evan attempting to testify as to what Owens actually said at the family meetings. And, the Court was prepared to sustain the objection, which led to the Debtors' argument that the testimony was being offered, not for the truth of the matter asserted but for its impact on Sam's state of mind. As the Court stated in ruling on the IRS' objection to the admission of Evan's testimony, "[g]iven that it is being stipulated that the evidence is coming in not for the truth of the matter asserted but the impact that the statements, whatever they are, whether accurate or not, had on the state of mind of Sam Wyly and then, I guess as corroboration, Evan Wyly since he was also at the meeting, the Court will admit it for that limited purpose." Tr. Trans. 1674:9–20 (oral ruling).

801 *See, e.g.,* IRS Exs. KJ (a memorandum to French and Robertson regarding loans from foreign grantor and non-grantor trusts (without analyzing the Wyly trusts per se)) and KM (a memorandum to Owens and Pulman from Stroud (at Meadows Owens) discussing the disadvantages of direct foreign investments in U.S. real property).

802 Tr. Trans. 604:25–605:4 (Evan).

803 *Id.* at 752:5–754:7 (Evan).

804 IRS Ex. 96.

805 IRS Ex. 99 at WYLYSEC01109030.

806 IRS Ex. 96 at WYLYSEC01112399–2401.

807 Tr. Trans. 2561:7–11 (Pulman testifying that Hennington met with Cousins around September 19, 2003, while Pulman was out of the office); 2563:19–2564:2 (Meadows Owens was asked for advice regarding Sam's tax return that was due October 15, 2003); 2567:17–18 ("we didn't have a lot of time. Between late September and October 15th.").

808 Wyly Ex. OC. Tr. Trans. 1974:20–1983:1 (Hennington discussing Wyly Ex. OC).

809 Wyly Ex. LQ. *See also* Wyly Ex. OC (Cousins' notes from an October 8, 2003 meeting among various Meadows Owens attorneys and Hennington in which Meadows Owens explained five options to address Sam's upcoming tax filing deadline

in light of Lubar's memorandum and anonymous meeting with the IRS); Tr. Trans. 2564:6–8, 2605:20–2606:13 (Pulman discussing Wyly Ex. LQ).

810 Wyly Ex. LR; Tr. Trans. 2566:9–2571:24, 2618:16–2621:17 (Pulman discussing Wyly Ex. LR).

811 According to Pulman, a “reportable position” “means basically that the position in the tax law is arguable ... it's an arguable position that can go either way.”). Tr. Trans. 2620:6–18 (Pulman).

812 Tr. Trans. 1981:19–1982:2 (Hennington discussing October 8, 2003 meeting with various Meadows Owens lawyers where the attorneys recommended that the Wylys file Form 8275 disclosures because “it allowed us to fully report the [Lubar] issue and protect against penalties, but at the same time we had a reportable position to continue to prepare the tax returns in the manner that we always had.”); Wyly Exs. LQ (internal Meadows Owens memorandum dated October 1, 2003, analyzing 26 U.S.C. § 674 and concluding there could be two reasonable interpretations of the statute) and LR (internal Meadows Owens Memorandum dated October 19, 2003, analyzing 26 U.S.C. §§ 674 and 679 and concluding there was an arguable position that the 1992 trusts were non-grantor trusts); Tr. Trans. 2564:6–8, 2605:20–2606:13, 2566:9–2571:24, 2618:16–2621:17 (Pulman discussing Wyly Exs. LQ and LR).

813 Tr. Trans. 2587:25–2588:13 (Pulman) (“Q: You never came to a final conclusion whether the '92 trusts were non-grantor trusts. Correct? A: I didn't issue—I didn't come to an opinion whether they were foreign non-grantor. I came to a view as to whether [there] was a reportable position. Q. Right. Just for purposes of the tax return? A. Yes.”).

814 *Id.* at 1787:9–1788:8 (Cousins testifying regarding Wyly Ex. OD, a discussion points memorandum used for an October 15, 2003 meeting between Cousins, Sam, and Evan, and stating “[w]e could not tell whether or not Mr. Lubar's concerns were correct.”). *See also* 2529:16–19 (when Pulman began working on Wyly matters in 1999, Owens told him “there was an offshore trust and that it was a foreign grantor trust that had been grandfathered by the '95 legislation”); IRS Ex. 112 (Confidential Conference Outline dated September 7, 2000, which Owens used to explain the trust structure to Hennington when she was first appointed CFO of Highland Stargate) at 2 (stating the 1992 trusts are nongrantor foreign trusts) and 6 (stating the 1994 and 1995 trusts are foreign grantor trusts); Wyly Ex. LI at SWYLY09114–9117 (memorandum dated January 29, 2001 from Owens to the Wylys c/o Hennington and Boucher stating “[a]ll of the foreign trusts are currently exempted from U.S. income tax regimes based upon the non-foreign grantor trust (NFGT) and/or foreign grantor trust (FGT) characterization under the [IRC]”). However, there is no persuasive evidence in the record that Owens or any other attorney with Meadows Owens did anything other than accept the classifications stated in the Tedder opinion letters or trust documents themselves as correct.

815 Tr. Trans. 2587:24–2588:13 (Pulman testifying that he never came to an opinion regarding whether the 1992 trusts were non-grantor trusts; he only “came to a view as to whether [there] was a reportable position.”); 2620:6–18 (Pulman explaining that a “reportable position” “means basically that the position in the tax law is arguable ... it's an arguable position that can go either way.”); 2621:4–17 (Pulman testifying that Kniffen (another Meadows Owens attorney) “came to a view that there was an arguable position that [the 1992 trusts] were non-grantor trusts—foreign non-grantor trusts.”).

816 *See* pp. 415–23, *supra.*

817 *See* IRS Ex. 806.

818 *Id.* at WYLYSEC00010967.

819 *Id.* at WYLYSEC00010967–968.

820 *Id.* at WYLYSEC000100968–969 (emphasis added).

821 Tr. Trans. 583:23–584:7 (Evan); *see also* SEC Tr. Trans. 3753:5–14 (French testifying that he believed that King had made substantial money previously dealing with the Wylys in South African bonds, which is why he was recruited by French); Collateral Estoppel No. 23 (“These transactions were shams intended to circumvent the grantor trust rules. French and Buchanan, acting as the Wylys' agents, recruited King and Cairns to create a falsified record of a gratuitous foreign grantor trust.”).

822 Cairns Depo Tr. 46:18–47:4, 158:6–7.

823 Tr. Trans. 583:23–584:7 (Evan); *see also* SEC Tr. Trans. 3753:2–14 (French).

824 Collateral Estoppel No. 22 (“Shortly after these trusts were settled, Cairns's trust management company was hired to serve as trustee for some of the Wylys' IOM trusts.”) Joint Stipulations ¶¶ 66 and 102, (showing that Cairn's company, Wychwood Trust Limited, served as trustee for Delhi IOM Trust, La Fourche IOM Trust, and Red Mountain IOM Trust).

825 Collateral Estoppel No. 24; Cairns Depo. Tr. 46:5–13; 56:9–12 (discussing his failure to fund the trusts with the stated $25,000); SEC Tr. Trans. 3755:10–3757:22 (French testifying regarding King's failure to fund); IRS Exs. 214 (November 16, 1995 fax from French to Buchanan regarding Boucher's inability to find any records that King ever funded the Bessie IOM Trust, the Tyler IOM Trust, and the South Madison IOM Trust, and noting similar issues with the La Fourche IOM

Trust and Red Mountain IOM Trust), 178 at 02517 (November 26, 1995 faxes from Buchanan to French regarding funding issues, stating the Bessie IOM Trust and Tyler IOM Trust had each been funded with “a factual Dollar bill”).

826 IRS Exs. 214 (November 16, 1995 fax from French to Buchanan regarding funding issues), 178 at 02517 (November 26, 1995 faxes from Buchanan to French regarding funding issues).

827 26 C.F.R. § 1.6664–4(c)(ii).

828 *Id.* § 1.6664–4(c)(iii)(2).

829 *Id.* § 1.6664–4(c)(ii). Obviously, French is that other person. Just as advice can be received directly or indirectly under the regulation, factual assumptions can be given directly by the taxpayer or indirectly by another person acting on the taxpayer's behalf.

830 Chatzky and Tedder are no longer working together or law partners. Tr. Trans. 1136:15–1137:2 (Chatzky testifying that he had ended his partnership with Tedder by February 22, 1996). Chatzky's firm has been retained by this time to represent the Wylys. IRS Ex. 108 (fax from French to Chatzky dated February 1, 1996 discussing Chatzky's fee structure).

831 *See* Wyly Ex. CI. Chatzky and Associates also issued four substantively identical opinion letters dated November 27, 1996 to Crazy Horse IOM Trust, Arlington IOM Trust, Sitting Bull IOM Trust, and Tallulah IOM Trust. *See* Wyly Exs. CL, CN, CO, and CR. These written opinions do not change the Court's analysis of Sam's reasonable cause and good faith defense as it relates to the 1996 annuity transactions.

832 Wyly Ex. CI at SWYLY010365.

833 *Id.* at SWYLY010366.

834 *Id.* at SWYLY010367.

835 *Id.*

836 *Id.* (emphasis added).

837 *Id.* (emphasis added).

838 *Id.* at SWYLY010369.

839 *Id.* at SWYLY010371.

840 *Id.* at SWYLY010373.

841 *Id.* at SWYLY010376.

842 *Id.* at SWYLY010379.

843 *Id.* at SWYLY010381.

844 Chatzky and Tedder are no longer working together or law partners. Tr. Trans. 1136:15–1137:2 (Chatzky testifying that he had ended his partnership with Tedder by February 22, 1996). Chatzky's firm has been retained by this time to represent the Wylys. IRS Ex. 108 (fax from French to Chatzky dated February 1, 1996 discussing Chatzky's fee structure).

845 *See* Wyly Ex. CK.

846 Wyly Ex. CB at SWYLY005378.

847 *See* pp. 482–88, *supra.*

848 *See* Wyly Ex. CE.

849 SEC Trial Tr. 3751:24–3752:4, 3752:15–18 (French); IRS Ex. 806 at WYLYSEC00010968 (February 16, 1994 memorandum from Lubar to French “Re: Foreign Trusts” in which Lubar states opines that trusts settled by nonresident aliens—*i.e.,* King and Cairns—“will be ‘grantor trusts' for all U.S. federal income tax purposes ... [but] because the Grantor [King and/or Cairns] is a nonresident alien as to the United States..., the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.”). Although it was recharacterized by the SDNY Court as a foreign grantor trust as to Sam in the SEC Action.

850 *See* Wyly Ex. CF.

851 SEC Trial Tr. 3751:24–3752:4, 3752:15–18 (French); IRS Ex. 806 at WYLYSEC00010968 (February 16, 1994 memorandum from Lubar to French “Re: Foreign Trusts” in which Lubar states opines that trusts settled by nonresident aliens—*i.e.,* King and Cairns—“will be ‘grantor trusts' for all U.S. federal income tax purposes ... [but] because the Grantor [King and/or Cairns] is a nonresident alien as to the United States..., the Grantor will have no actual U.S. tax liability or obligation to file a U.S. income tax or information return.”). Although, once again, the SDNY Court recharacterized the La Fourche IOM Trust as a foreign grantor trust as to Sam in the SEC Action.

852 Each entity issuing a private annuity—whether in 1992 or in 1996—received an opinion from Chatzky and Associates dated April 15, 1998 addressing “the impact that Income Tax Regulation Section 1.1001–3 has on the modification of a private annuity agreement issued by you....” *See, e.g.,* Wyly Ex. CS at SWYLY002638. This opinion was apparently requested because Sam amended the annuity agreements to defer the commencement date of his receipt of annuity

payments. The upshot of these opinions is that (i) "it is unlikely that the modification of the timing of the private annuity payments will be considered a modification of a 'debt instrument,' " *id.* at 2643, and (ii) "it is likely that the Private Annuity will not be a debt instrument for purposes of Internal Revenue Code Section 1001, and thus this significant modification of a debt instrument analysis will be inapplicable to the transaction," *id.* at 2655. The other eleven opinion letters are identical except that the addressee is changed to be another of the IOM corporations issuing an annuity to Sam or for his benefit. *See* Wyly Exs. CT, CU, CV, CZ, DA, DB, DD, DH, DJ, DK, and DL. These twelve opinion letters have no effect on the above analysis of Sam's reasonable cause and good faith defense.

853 SEC Tr. Trans. 1707:2–4 (French).

854 *Id.* at 3758:7–8 (French).

855 *Mediaworks, Inc. v. C.I.R.,* T.C. Memo. 2004–177, 2004 WL 1682832, at *8 (2004) ("the mere fact that Jung is a certified public accountant does not necessarily make him a competent tax adviser."); *Glassley v. C.I.R.,* T.C. Memo. 1996–206, 1996 WL 208817, at *33 (1996) (taxpayers did not establish the tax expertise of their accountants or an attorney who was the brother of one of the taxpayers).

856 *See, e.g., Hermax Co., Inc. v. C.I.R.,* 11 T.C. 442, 445 (1948) ("Petitioner apparently turned over its tax matters, along with the keeping of its books of account, to a public accountant. The record does not show that he had any 'expert knowledge' of Federal tax laws. Indeed, his own testimony indicates that he had not. He testified that he consulted with Swick, who was 'the tax man' in his accounting firm, thus indicating that he, Imhoff, was not a 'tax man.' ").

857 *Mayflower Inv. Co. v. C.I.R.,* 239 F.2d 624, 627 (5th Cir.1956).

858 *See Whitehouse Hotel Ltd. P'ship*, 755 F.3d at 249; *New York Guangdong Fin., Inc. v. C.I.R.*, 588 F.3d 889, 896 (5th Cir.2009).

859 *Klamath,* 568 F.3d at 548 (5th Cir.2009) (quoting *Swayze v. U.S.,* 785 F.2d 715, 719 (9th Cir.1986)).

860 115 T.C. 43 (2000).

861 *Id.* at 97–99.

862 *Id.* at 99.

863 *Id.*

864 *Id.* at 99–100.

865 *Id.*

866 *Id.*

867 144 T.C. 161 (2015).

868 *Id.* at 166.

869 *Id.*

870 *Id.*

871 *Id.* at 168–69.

872 *Id.*

873 *Id.* at 169. Although not relevant here, Son of BOSS is a type of tax shelter that was designed and promoted by tax advisors in the 1990s to reduce federal income tax obligations on capital gains from the sale of a business or other appreciated asset. It's informal name comes from the name of an earlier tax shelter, BOSS ("Bond and Option Sales Strategy") that it somewhat resembled.

874 *Id.* at 170.

875 *Id.* at 171.

876 *Id.*

877 *Id.*

878 *Id.* at 182–83.

879 *Id.* at 223.

880 *Id.* at 223–24.

881 *Id.* at 225.

882 *Id.* at 225–26.

883 *Id.* at 226.

884 French also asked one of his partners at Jackson Walker, Larry Bean ("**Bean**"), about Tedder's proposed offshore annuity transactions and the tax consequences flowing from them to the Wylys. Bean advised French that Jackson Walker would not give the Wylys an opinion consistent with that the Wylys were to get from Tedder, but that Tedder's proposed scheme

"may work," characterizing it, however, as aggressive. SEC Tr. Trans. 3725:6–3727:6, 3737:43741:12 (French). Three things of significance flow from this: (i) once again, French himself was not competent to analyze the tax consequences, (ii) French's own law firm was unwilling to give the Wylys' a favorable legal opinion upon which they could rely with respect to the 1992 IOM trusts and annuity transactions, and (iii) Sam knew that his primary outside law firm, Jackson Walker, would not give him a legal opinion corroborating the opinion he expected to receive from the promoter of the offshore system—*i.e.,* Tedder's law firm—prior to establishing the 1992 IOM trusts and undertaking the 1992 private annuity transactions.

885 Tr. Trans. 547:5–12 (Evan) ("I've known Mike a very long time. Probably since the early 1980s he's been involved as the attorney for the family. Early on it was primarily related to securities. With the public companies and mergers and acquisitions and a lot of corporate finance activities, he was very busy with many of the companies that the family was involved in, but then also with just giving advice to the family on other activities."), 550:4–14 (Evan) (Mike French was "the general counsel of Maverick Capital as well as the general counsel for the family."), 1394:16–24(Sam) (testifying French was primarily a securities lawyer); SEC Tr. Trans. 2116:12–20 (French testifying that he was not a tax lawyer, but that as of 1991 he had been practicing securities law for about 20 years).

886 SEC Tr. Trans. 1707:2–4 (French).

887 *Id.* at 3758:7–8 (French).

888 Tr. Trans. 1394:16–24(Sam).

889 SEC Tr. Trans. 3742:8–22 (French testifying that he went to visit Lubar in 1993 regarding the 1992 trusts), 3709:183711:20 (French testifying that he consulted with Lubar again in 1997. Although French's testimony in the SEC Action indicates that French reached out to Lubar at least in part to see if Morgan Lewis would represent the Wylys in an audit unrelated to the offshore system, the grantor status of the 1992 trusts was still also clearly on French's mind. A portion of French's testimony in the SEC Action that was admitted as evidence in this proceeding discusses a fax written by Lubar on June 4, 1997, which characterizes French as "concerned" about the 1992 trusts); IRS Ex. 806 (memorandum dated February 16, 1994 from Lubar to French laying out Lubar's advice on the establishment of foreign grantor trusts as to non-US citizens—the advice purportedly followed to establish the Wyly 1994 and 1995 IOM trusts).

890 Tr. Trans. 709:1–20 (Sam explaining how French was charged to oversee the legal specialists hired to establish the trusts), 703:11–25 (Sam explaining that "he [French] was sort of the coordinator or the commander of the lawyers who—who worked on it" while Sam considered himself more the "leader of the companies."), 548:13–16 (Evan discussing how French would seek out other attorneys to give advice—"So Mike would be kind of the lead, but he would bring in whatever specialist he needed. And if there wasn't someone at Jackson Walker that could do it, then he would bring in, you know, an outside attorney.").

891 No doubt prompted in part by French's view of Tedder as something of a "hustler." SEC Trial Trans. 3773:5–11.

892 Tr. Trans. 1394:16–24(Sam).

893 *Id.* at 2116:12–14 (French); *see also id.* at 3758:7–8 (French) ("I'm not the tax lawyer. I'll take that disclaimer again, okay.").

894 SEC Tr. Trans. 1725:9–1729:7, 2067:7–2068:22, 2113:11–2116:20 (French's testimony describing a memo analyzing various securities law issues related to the then-proposed offshore system), 1761:22–1765:17 (French discussing IRS Ex. 411, a March 24, 1995 memo from French to Sam addressing some securities law issues related to Tallulah IOM Trust) and 1199 at ¶¶ 11–12 (Portion of "CONSENT OF MICHAEL C. FRENCH" entered in the SEC Action describing this memo). IRS Ex. 1199 ¶¶ 11–12 (Annex A, Admissions of Defendant Michael C. French).

895 Tr. Trans. 699:15–21(Sam) ("Q. Okay. What role did Mr. French play in setting up the Isle of Man trusts? A. Well, he was the chief—chief lawyer, chief architect, who—I mean, there were others who worked on it, but he was the—I would say the leader of a team of lawyers and certified public accountants who worked on it."), 709:1–20 (Sam explaining how French was charged to oversee and recruit the legal specialists hired to establish the trusts), 703:1125 (Sam explaining that "he [French] was sort of the coordinator or the commander of the lawyers who—who worked on it," while Sam considered himself more the "leader of the companies."), 547:25–548:23, 553:11–554:15 (Evan) (French was a competent, trusted attorney and the lead person on legal matters for the Wylys but often brought in specialists), 590:22–591:21 (Evan) (Sam "felt like Mike, you know, not only evaluated it from his own perspective, but brought in whatever experts from whatever firm—whether it was Jackson Walker, Jones Day, whether it was other attorneys, Tedder, or Chatzky—Sam relied on Mike, and I relied on Mike, you know, to be our attorney and to look out for our best interest and to make sure we were doing what was legal and appropriate and right."); SEC Tr. Trans. 1957:21–1958:8 (French) ("Q [by Wyly counsel]. When Mr. Sam Wyly got married to Cheryl Wyly, his current wife—that happened like in '94, right? A. I don't remember what year it was. Yes. Q.—he turned to you to help him get the prenuptial agreement, right? A. He asked me to get one. I got another lawyer to do it. Q. Mr. Wyly, when he needed something very personal like that, would turn to you. You weren't

a family lawyer. Not for you to do it, but to go get some other lawyer to do it, right? A. Yes. Q. You acted kind of as his interface with other lawyers? A. Yes.").

896 *See* Tr. Trans. 709:1–20(Sam); 547:25–548:23, 553:11–554:15, 590:22–591:21 (Evan testifying that Sam relied upon French "as general counsel"); SEC Tr. Trans. 1957:21–1958:8 (French).

897 *CNT Investors, LLC,* 144 T.C. at 226–27.

898 SEC Tr. Trans. 1717:1–1719:17 (French describing Tedder's foreign trust presentation), Tr. Trans. 1050:191051:16 (Sam describing meeting with Tedder where Tedder explained what would become the offshore system); 1052:9–1059:11(Sam) (same).

899 IRS Ex. 806 (Memorandum dated February 16, 1994 from Lubar to French providing advice on the creation of foreign grantor trusts to non-resident aliens of the United States—*i.e.,* the Wyly 1994 and 1995 IOM trusts).

900 Tr. Trans. 566:4–9 (Evan).

901 Tr. Trans. 565:22–566:13 (Evan testifying regarding French's role double-checking transactions), 572:4–6 (Evan) ("Q. Do you recall Mr. French ever advising your father or you not to create the '92 Isle of Man trusts? A. No. In fact, he recommended it."), 568:19–569:25 (Evan stating that he understood that French was researching the 1992 trusts and that—as the family's general counsel—he was the primary liaison between the Wyly family and Tedder and Chatzky), 582:11–583:1 (Evan), 586:15–587:11 (Evan), 588:4–18 (Evan stating that French never told Charles, Sam, or him that the IOM trusts were somehow illegal, wrong, or improper; and that the Wylys were comforted by the fact that French and some of his partners setup their own IOM trusts), 701:24–702:3 (Sam stating that French and Robertson—after attending Tedder's seminar in New Orleans—told Sam that they "thought it was a good plan."). Interestingly, however, French repatriated his Isle of Man trust in 2002. SEC Tr. Trans. 1913:9–1915:19 (French).

902 As Sam's eldest son, Evan has an interest in seeing that Sam's liability is minimized here. Moreover, Evan established his own IOM trust in 1996, and the outcome here may indirectly implicate the tax (and reporting) consequences to him of transactions he undertook through that trust. Tr. Trans. 589:9–590:10 (Evan), 660:25–664:6 (Evan); 774:9–25 (Evan testifying that he performed annuity transactions through his own IOM trust—Ginger Trust—five years after 1991—*i.e.* in 1996).

903 SEC Tr. Trans. 3738:12–14 (French) ("[Bean] thought that it might work, I believe. That was his take on it. Now, he also indicated to me, and I've said that before, that he felt like it was aggressive."); IRS Exs. 130, 1199 ¶ 10 (p. 7) (Annex A, Admissions of Defendant Michael C. French), which consists of admissions that French made in connection with the SEC Action and which were separately admitted as evidence in this proceeding, and which read in pertinent part as follows: "... Tedder provided a tax opinion in connection with the Wylys' proposed use of Isle of Man Trusts, which stated in substance that the securities held by the Trusts would not be subject to U.S. taxes. French asked a tax lawyer at Jackson Walker [Bean] to review the opinion and the lawyer subsequently informed French that the position taken in the opinion was aggressive, and that Jackson Walker would not be willing to issue a similar tax opinion. French shared this information with Sam Wyly.").

904 IRS Ex. 806 (Memorandum from Lubar to French providing Lubar's advice predicated on facts French told him to assume were true, but were not); Cairns Depo Tr. 46:18–47:4, 158:6–7 (Cairns testifies that French prepared a letter stating Cairns was a friend of Sam's, and that this was false). *See also* IRS Ex. 92 (Cairns letter). *See also* pp. 415–23, *supra.*

905 SEC Tr. Trans.1917:2–9, 1921:3–7, 1940:14–1941:5, 1952:24–1954:21 (French).

906 *Id.* at 1917:2–16 (French).

907 *Id.* at 2116:12–14 (French); *see also id.* at 3758:7–8 (French) ("I'm not the tax lawyer. I'll take that disclaimer again, okay.").

908 Computation Stipulations ¶ 3.

909 *Id.* ¶ 15.

910 *See* 26 C.F.R. § 25.2511–1 (Transfers in general); *Dickman v. C.I.R.,* 465 U.S. 330, 334, 104 S.Ct. 1086, 79 L.Ed.2d 343 (1984).

911 26 C.F.R. § 25.2512–8 (Transfers for insufficient consideration).

912 *Harwood v. C.I.R.,* 82 T.C. 239, 259, 1984 WL 15537 (1984) ("Transactions within a family group are subject to special scrutiny, and the presumption is that a transfer between family members is a gift."); *see also True v. C.I.R.,* 390 F.3d 1210, 1238 (10th Cir.2004) (citing *Harwood*).

913 371 F.3d 257, 263 (5th Cir.2004) (internal citations omitted).

914 *Wheeler v. U.S.,* 116 F.3d 749 (5th Cir.1997).

915 Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 32 (citing *Guest v. C.I.R.,* 77 T.C. 9, 15–16 (1981) (quoting *Weil v. C.I.R.,* 31 B.T.A. 899, 906 (1934), *aff'd,* 82 F.2d 561 (5th Cir.1936)); 26 U.S.C. § 2512(b); 26 C.F.R. § 25.2511–1(g)(1)).

916 *See Security Indus. Ins. Co. v. U.S.,* 702 F.2d 1234, 1244 (5th Cir.1983).

917 568 F.3d 537 (5th Cir.2009).

918 *Id.* at 544.

919 *Southgate Master Fund, L.L.C.,* 659 F.3d at 480 (footnotes, quotation marks, and internal citations omitted).

920 *Stobie Creek Inv. LLC,* 608 F.3d at 1375 (emphasis deleted).

921 *Klamath,* 568 F.3d at 543.

922 *Southgate Master Fund, L.L.C.*, 659 F.3d at 481–82.

923 *Id.*

924 659 F.3d at 481 (footnotes and internal citations omitted).

925 *Id.* at 491 (footnotes and internal quotations omitted).

926 702 F.2d at 1244–45 (quotations and internal citation omitted).

927 *Id.*

928 *Id.* (emphasis deleted) (citations and internal quotations omitted).

929 Joint Stipulations ¶ 36. Joint Exs. 11-16 (Certificate of Incorporation, Memorandum of Association, and Articles of Association for each of Orange, FloFlo, Bubba, Pops, Balch, and Katy, respectively).

930 Tr. Trans. 625:23-626:18 (Evan), 2090:12-2091:15 (Hennington). Although the Court questions why Evan, who had a Harvard MBA and had already established his own investment fund, would need a Cayman LLC to help "educate" him as to how foreign trusts and investments worked. *See id.* 523:23-524:2, 679:4-8 (Evan).

931 Joint Stipulations ¶¶ 292, 303-305.

932 The Bulldog IOM Trust owns each of these IOM corporations, except for Yurta Faf Limited (IOM), which is owned by the Bessie IOM Trust. Joint Stipulations ¶¶ 21, 36.

933 Greenbriar Limited (IOM) was established under the Delhi IOM Trust. Joint Stipulations ¶ 27.

934 Joint Stipulations ¶ 292. East Baton Rouge Limited (IOM) and East Carrol Limited (IOM) are parties to 1992 annuity transactions, *id.* ¶¶ 119-122, while Moberly Limited (IOM) and Yurta Faf Limited (IOM) are parties to 1996 annuity transactions, *id.* ¶¶ 137-138, 141-142.

935 *Id.* ¶ 303.

936 *Id.* ¶ 304.

937 Wyly Exs. 89 (showing which LLC corresponded to which child), 90 at SEC100066426 (showing the allocation of assets among the Cayman LLCs).

938 IRS Ex. 90 at SEC100066424.

939 Joint Exs. 11-16 (formation documents).

940 *See also* Wyly Ex. G (financial statements for Cayman LLCs).

941 Wyly Ex. KW at SWYLY012939 (graphic depicting ownership structure for personal use real estate); *see, e.g.,* Memorandum Opinion Exhibits D–H (showing ownership structures).

942 Joint Stipulations ¶¶ 44–47; IRS Ex. 90. The record shows that some percentage of Mi Casa Limited (IOM) was transferred from Bessie IOM Trust to FloFlo in 2001; however, the record does not disclose when that transfer occurred or what percentage was transferred. *See* Tr. Trans. 2519:24–2520:13 (Hennington); IRS Ex. 90 (showing allocation of assets); Wyly Ex. G at HST_PSI230998 (financial statement showing FloFlo holding an interest in "Mi Casa Limited" as of December 31, 2001).

943 Wyly Ex. KW at SWYLY012943 (graphic depicting ownership structure for business use real estate); *see, e.g.,* Memorandum Opinion Exhibit E (showing ownership structure).

944 *See* Wyly Exs. N (showing Kelly as the manager of Cottonwood Ventures I LLC (Colorado), the domestic LLC owned by the domestic corporation and the S corporation); Joint Stipulations ¶¶ 322–326 (detailing ownership structure). *See also* Memorandum Opinion Exhibit E.

945 Tr. Trans. 2540:1–2550:10 (Pulman) (describing general structure of real estate transactions); Wyly Ex. KW (Meadows Owens' internal memorandum detailing ownership structure for real estate, both business use and personal use).

946 Tr. Trans. 2540:20–2541:6 (Pulman).

947 *Id.* 2541:4–15 (Pulman).

948 *Id.* 2541:20–2542:1 (Pulman).

949 *See, e.g., id.* 2540:1–2543:10 (Pulman) (discussing concept in relation to the Woody Creek Ranch Management Trust); Wyly Ex. BG (Mi Casa Management Trust) § 2.1 ("This Trust is expressly designed to be a Grantor Trust, for purposes of

Sections 671 through 679 of the Code, and as such will be ignored for Federal income tax purposes as an entity separate from its Grantors. Therefore, the Trust Estate will be deemed to be owned by Grantors as tenants in common, each owning an undivided interest in the Trust Estate....).

950 Tr. Trans. 2542:4–24 (Pulman).

951 Rosemary Acton was the mother of Evan, Lisa, Laurie, and Kelly. She lived in the home until her death. The home is now occupied by Evan's daughter, McCary. Tr. Trans. 677:11–12(Sam); 1557:4–25 (Laurie); 2298:14–24 (Hennington).

952 Allocation regarding Two Mile Ranch was split evenly among all six children. IRS Ex. 90. However, only Lisa, Laurie, and Kelly built homes on the property. Tr. Trans. 931:17–932:19 (Evan); 1514:24–1515:2 (Laurie) ("I live in a house here in Dallas on Crooked Lane that is owned by—by an Isle of Man trust, and I also have a second home I—that I go to in Colorado on the ranch). The record is unclear, however, whether there was a shared home or multiple homes.

953 Tr. Trans. 1549:5–1550:2 (Laurie) ("Well, the concept was that Dad's kids could build property on—building on that property in Colorado, and each was allowed a certain amount. And I reasoned, well, I'm not in Colorado year-round. I wonder if I could do the same concept in Dallas where I live.").

954 *Id.* 1551:11–1552:25 (Laurie).

955 *Id.* 1552:11–22 (Laurie).

956 Joint Stipulations ¶ 457; Wyly Ex. BG (Trust Agreement).

957 Tr. Trans. 1550:18–1551:10 (Laurie).

958 Although the record does not divulge exactly how much in offshore funds were used to build the Mi Casa home, FloFlo's financial statements appear to value the home at a book value of $3,215,000 as of November 30, 2015. Wyly Ex. G (Financial Statements) at HST_PSI230623 (showing FloFlo holding a loan or account receivable from Mi Casa Limited IOM of $3,215,000. Since the record does not reflect such a loan or account receivable, the Court reasonably infers that the figure reflects the value allocated to the home).

959 IRS Ex. 90.

960 Tr. Trans. 2296:6–9 (Hennington); *see also* Wyly Ex. G (Financial Statements) at HST_PSI230998 (showing FloFlo holding an investment in "Mi Casa Limited" as of December 31, 2001).

961 Wyly Exs. BG (Mi Casa Management Trust) at § 1.5 (showing Laurie as the initial trustee) and BH (Articles of Organization of Mi Casa, LLC) at Article V (showing Laurie as the manager).

962 Tr. Trans. 1557:7–1558:12 (Laurie); IRS Ex. 87 at WYLYSEC01112940 ("Evan, Lisa, Laurie and Kelly are planning to purchase a house for their mother using off-shore funds. I think we would like to use the same Texas LLC, Texas Trust and off-shore corp. to get this done.").

963 Joint Stipulations ¶ 466; Wyly Ex. BK (formation documents); Tr. Trans. 2282:25–2283:2 (Hennington).

964 Joint Stipulations ¶ 46.

965 IRS Exs. 89, 90.

966 Wyly Exs. BK (The Spitting Lion Management Trust) at § 1.5 (showing Rosemary Acton and Lisa as the initial trustees); BL (Articles of Organization of Spitting Lion, LLC) at 2 (showing Rosemary Acton and Lisa as the initial managers).

967 Tr. Trans. 1567:7–13 (Laurie).

968 *See* Memorandum Opinion Exhibit G.

969 Tr. Trans. 931:7–932:15 (Evan), 1550:4–8 (Laurie). The testimony is clear that Laurie built a second home on the ranch; however, it is unclear whether each of Lisa and Kelly built a home or whether they share a home.

970 Joint Stipulations ¶ 47; IRS Ex. 90.

971 Joint Stipulations ¶ 321.

972 *Id.* ¶ 44.

973 *Id.* ¶ 322; Wyly Ex. N (Articles of Organization file stamped July 26, 2000). *But see* Wyly Ex. O (Operating Agreement of Cottonwood Ventures I, LLC dated as of August 1, 2000).

974 Wyly Ex. M (Warranty Deed).

975 Joint Stipulations ¶¶ 324–325; Wyly Exs. N (Articles of Organization for Cottonwood Ventures I, LLC), O (Operating Agreement of Cottonwood Ventures I, LLC) at SWYLY053020 (showing contribution percentages), P (Articles of Incorporation of Wyly Works, Inc. (Texas)).

976 Joint Stipulations ¶¶ 44; IRS Exs. 89, 90.

977 Computation Stipulations ¶ 4 (setting forth the amounts by tax year).

978 Joint Stipulations ¶ 45; Wyly Ex. T (Articles of Organization).

979 *Id.* ¶ 342; Wyly Ex. T (Articles of Organization file stamped July 26, 2000). *But see* Wyly Ex. U (Operating Agreement of Cottonwood Ventures II, LLC dated as of August 1, 2000).

980 Wyly Ex. S (Warranty Deed).

981 Joint Stipulations ¶ 45.

982 IRS Ex. 90.

983 Wyly Ex. U (Operating Agreement of Cottonwood Ventures II, LLC) at SWYLY053079 (Kelly and Sam signing as managers).

984 Computation Stipulations ¶ 5 (setting forth the amounts by tax year).

985 Tr. Trans. 2092:14–18 (Hennington) ("Did any of the six children receive any of the liquidation proceeds from the Cayman Islands companies when they were liquidated? No. I would know that because I do all of the accounts for the children.").

986 *Id.* at 2091:6–2092:8, 2295:3–20, 2519:14–2521:5 (Hennington).

987 *Id.* at 2295:3–20 (Hennington).

988 *Id.* at 3992:25–3993:7 (Messersmith) ("when that money hits Cottonwood Ventures I LLC, that is the time at which the gift occurs, but the gift is to Kelly Wyly because she was the one controlling the LLC and all aspects of the operation").

989 *Id.* at 3997:21–25 (Messersmith) ("The gift is when the money hits Cottonwood Ventures II LLC, and that was for the benefit—actually, it ended up being allocated among all six of the children—so—yes, all six of the children").

990 *Id.* at 4001:8–10 (Messersmith) ("The gift is the amount of money that Sam Wyly funded each of these LLCs with or the value of the assets that—that were put in.").

991 *See* Joint Stipulations ¶¶ 332–341 (detailing the direct and indirect transfer of funds to Cottonwood Ventures I LLC (Colorado) from Wyly Works, Cottonwood Gallery Inc. (Nevada), Cottonwood I Limited (IOM), Greenbriar Limited (IOM), and Audubon Asset Limited (IOM)) and ¶¶ 350–377 (detailing the direct and indirect transfer of funds to Cottonwood Ventures II LLC (Colorado) from Sam, Kelly, Cottonwood II Limited (IOM), Cottonwood Management Trust (US), Greenbriar Limited (IOM), Yurta Faf Limited (IOM), and Sarnia Investments Limited (IOM)).

992 Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 32 (citing *Guest v. C.I.R.,* 77 T.C. 9, 15–16 (1981) (quoting *Weil v. C.I.R.,* 31 B.T.A. 899, 906 (1934), *aff'd,* 82 F.2d 561 (5th Cir.1936)); 26 U.S.C. § 2512(b); 26 C.F.R. § 25.2511–1(g)(1)).

993 *Id.* ¶ 37.

994 73 T.C.M. (CCH) 2937, 1997 WL 305863 (1997).

995 *Id.* at *3.

996 *Id.* (citing cases).

997 *Id.* at *4. The Debtors also cite to *Jordahl v. C.I.R.,* 65 T.C. 92 (1975), for the proposition that retention of certain powers does not cause inclusion of the trust's assets in the grantor's estate.

998 26 C.F.R. § 25.2511–2(b).

999 *See* pp. 389–461, *supra.*

1000 26 C.F.R. § 25.2511–2(b).

1001 *Holmes v. C.I.R.,* 62 T.C.M. (CCH) 839, 1991 WL 188869 (1991) (quoting *Hite v. C.I.R.,* 49 T.C. 580, 594 (1968)).

1002 Although the Cottonwood Ventures II property was allocated to each of Sam's six children, the record shows that Kelly is the only child who made a financial contribution to Cottonwood II Management Trust (US). Joint Stipulations ¶ 350. Sam also made a small financial contribution to Cottonwood II Management Trust (US). *Id.*

1003 *See* Wyly Exs. O (Operating Agreement of Cottonwood Ventures I, LLC) at Article VIII (Company Profits, Losses, and Distributions), V (The Cottonwood Ventures II Management Trust) at Article II (Management, Use and Disposition of Trust Estate); Joint Stipulations ¶ 325. Evan, Laurie, Lisa, Andrew, and Christiana, having made no financial contribution to the Cottonwood Ventures properties, would not be entitled to any distribution under the relevant documents. *Id.*

1004 Wyly Ex. M (Warranty Deed).

1005 Wyly Ex. O § 1.12(n) & p. 40 (showing Kelly signing as Manager); Memorandum Opinion Exhibit E.

1006 Joint Stipulations ¶ 324.

1007 Wyly Ex. O § 3.1(b).

1008 *Id.* § 3.2(a).

1009 *Id.* § 3.5; *see also id.* §§ 3.3, 3.4, 3.6.

1010 *Id.* at Ex. A ("Contributions); Memorandum Opinion Exhibit E.

1011 *Id.* § 3.

1012 Wyly Ex. R § 5.05 ("Any officer or agent elected or appointed by the Board of Directors may be removed at any time by the affirmative vote of a majority of the Board of Directors. Any vacancy occurring in any office of the corporation may be filled by the Board of Directors.").

1013 *Id.* § 3.02 ("The Shareholders shall have the right at any special meeting to remove any Director of this corporation, with or without cause by majority vote of the issued and outstanding shares of capital stock entitled to vote on the election of Directors.").

1014 Joint Stipulations ¶ 326; Memorandum Opinion Exhibit E.

1015 Joint Stipulations ¶ 44; Memorandum Opinion Exhibit E. Although the evidence shows that at some point Bubba was transferred at least some interest in Cottonwood I Limited (IOM) in 2001, these shares were returned to Bessie IOM Trust in 2006. *Id.* In addition, the evidence in the record shows that such appointments to the Cayman LLCs were not "formal appointments out of the overall trust and will be revocable. They exist as a sub-fund via an informal understanding with the trustee whereby we account for these entities separately and liaise with particular family members regarding the underlying assets." IRS Ex. 90 at SEC100066424. In addition, Bessie IOM Trust wholly owned these Cayman LLCs. Memorandum Opinion Exhibit B.

1016 Wyly Ex. S (Warranty Deed).

1017 Wyly Ex. U (Operating Agreement of Cottonwood Ventures II, LLC) § 1.12(g) & p. 18 (showing Kelly and Sam as Managers).

1018 *Id.* §§ 1.12(h), 2.1, & p. 18 (showing Cottonwood II Management Trust (US) as the "original Member entitled to vote").

1019 *Id.* § 3.1(b).

1020 *Id.* § 3.2(a).

1021 *Id.* §§ 3.3, 3.4, 3.5, 3.6.

1022 *Id.* at 18 (reflecting Highland Trust Company as trustee of the Cottonwood Ventures II Management Trust); Wyly Ex. V (The Cottonwood Ventures II Management Trust) § 1.5. Hennington, the CFO of the Wyly family office, signed documents on behalf of Highland Trust Company. *See e.g.,* Wyly Ex. U at 18 (showing Hennington signing as the "Authorized Officer" of Highland Trust Company).

1023 Wyly Ex. V at § 1.5(a).

1024 *Id.* § 1.3(a).

1025 Joint Stipulation ¶ 45; Memorandum Opinion Exhibit F. Although the evidence shows that at some point Orange, Pops, FloFlo, Bubba, Katy, and Balch were transferred at least some interest in Cottonwood II Limited (IOM) in 2001, these shares were returned to Bessie IOM Trust in 2006. In addition, the evidence in the record shows that such appointments to the Cayman LLCs were not "formal appointments out of the overall trust and will be revocable. They exist as a sub-fund via an informal understanding with the trustee whereby we account for these entities separately and liaise with particular family members regarding the underlying assets." IRS Ex. 90 at SEC100066424. In addition, Bessie IOM Trust wholly owned these Cayman LLCs. Memorandum Opinion Exhibit B.

1026 Wyly Ex. V §§ 1.5(a) ("Any Trustee may be removed ... by the following individual(s) and entity(s) ... [1] by SAM and/or KELLY if either is living and competent, and the Corporation"), 1.5(a) (defining Corporation as Cottonwood II Limited (IOM)).

1027 568 F.3d at 544.

1028 *Id.*

1029 *Id.*

1030 *Southgate Master Fund, L.L.C.*, 659 F.3d at 481.

1031 *Klamath,* 568 F.3d at 544; *Southgate Master Fund, L.L.C.,* 659 F.3d at 481–82.

1032 *See, e.g.,* Tr. Trans. 1549:5–1550:2 (Laurie) ("Well, the concept was that Dad's kids could build property on—building on that property in Colorado, and each was allowed a certain amount. And I reasoned, well, I'm not in Colorado year-round. I wonder if I could do the same concept in Dallas where I live."); IRS Ex. 87 at WYLYSEC01112940 ("Evan, Lisa, Laurie, and Kelly are planning to purchase a house for their mother using offshore funds. I think we would like to use the same Texas LLC, Texas Trust and off-shore corp. to get this done.").

1033 Joint Stipulations ¶¶ 43–47. The Court notes that the parties stipulated that, as of April 11, 2000, Rosemary's Circle R Ranch Limited (IOM) was owned by the Bessie IOM Trust and Orange. *Id.* ¶ 47. There is no explanation in the record, though, how Orange could hold an interest in Rosemary Circle R Ranch Limited (IOM) in April 2000, when it was not established until June 1, 2001. *Id.* ¶ 36. The Court assumes the earlier stipulation to be in error.

1034 *Id.* ¶ 36.

1035 *Id.* ¶ 46.

1036 *Id.* ¶ 44.

1037 *Id.* ¶ 45.

1038 *Id.* ¶ 47.

1039 The record shows that some percentage of Mi Casa Limited (IOM) was transferred from the Bessie IOM Trust to FloFlo in 2001; however, the record does not disclose when that transfer occurred or what percentage was transferred. *See* Tr. Trans. 2519:24–2520:13 (Hennington); IRS Ex. 90 (showing allocation of assets); Wyly Ex. G at HST_PSI230998 (financial statement showing FloFlo holding an interest in "Mi Casa Limited" as of December 31, 2001).

1040 As found by the SDNY Court in the SEC Action, to which we have applied collateral estoppel effect here. Collateral Estoppel No. 24.

1041 As reflected in the record: (i) the Cayman LLCs were established June 1, 2001 and were wholly-owned by the Bessie IOM Trust, Joint Stipulations ¶ 36, (ii) the Mi Casa, Spitting Lion, Cottonwood Ventures I and II, and Rosemary Circle R Ranch properties were purchased prior to June 1, 2001, Wyly Exs. BJ, BN, K, L, M, and S and Joint Stipulations ¶ 307, (iii) each IOM Real Estate Company was wholly-owned by the Bessie IOM Trust as of its formation, other than Rosemary Circle R Ranch Limited (IOM), which was owned by the Bessie IOM Trust and Orange as of April 11, 2000, Joint Stipulations ¶¶ 43–47, and (iv) as of June 1, 2001, the IOM Real Estate Companies were owned wholly or partially by the various Cayman LLCs, Joint Stipulations ¶¶ 44–47 (although ¶ 44 states "as of June 1, 2002," that date appears to be in error; the date, however, does affect this Court's ruling). Although the record shows that some percentage of Mi Casa Limited (IOM) was transferred from Bessie IOM Trust to FloFlo in 2001, the record does not disclose exactly when that transfer occurred or what percentage was transferred. *See* Tr. Trans. 2519:24–2520:13 (Hennington); IRS Ex. 90 (showing allocation of assets); Wyly Ex. G at HST_PSI230998 (financial statement showing FloFlo holding an interest in "Mi Casa Limited" as of December 31, 2001).

1042 The Bessie IOM Trust owned: (i) Spitting Lion Limited (IOM) indirectly (through its ownership of Orange, Pops, FloFlo, and Bubba), (ii) Cottonwood I Limited (IOM) directly in part and indirectly in part (through its ownership of Bubba), (iii) Cottonwood II Limited (IOM) directly in part and indirectly in part (through its ownership of the Cayman LLCs), (iv) Rosemary Circle R Ranch Limited (IOM) directly in part and indirectly in part (through its ownership of the Cayman LLCs), and (v) Mi Casa Limited (IOM) directly in part and/or indirectly in part (as the record is unclear).

1043 IRS Pre–Trial Brief [ECF No. 1018] at 78 ("Additionally, each child had full control of the entities that directly owned the property. The 'debts' were also transferred to the Cayman LLCs which were created for the benefit of children, showing the donative nature of the transactions involving Cottonwood I and II and the Cayman LLCs. * * * The listing of these obligations in the family financials records was not a sign of an actual debt, but rather to show to whom the property was assigned. This is reflected in the transfer of these 'loans' to the Cayman LLCs, which were created for the benefit of the children. Each Cayman LLC would receive the "loans" associated with the assets that they were using *i.e.* Cottonwood I to Bubba, LLC and Mi Casa to FloFlo, LLC.")

1044 As clearly shown in the record, the interests in the IOM Real Estate Companies transferred to the Cayman LLCs were returned to the Bessie IOM Trust when the Cayman LLCs were liquidated, which is directly contrary to the IRS' allegation that the interests were gifted by Sam to his children.

1045 Joint Stipulations ¶¶ 292–304; Computation Stipulations ¶ 6.

1046 Computation Stipulations ¶ 6. The Court is unsure whether the parties' stipulated figure is inclusive or exclusive of the ownership interests in the IOM Real Estate Companies. That determination is irrelevant, however, since the Court finds that no gift occurred in either instance.

1047 IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] ¶ 97.

1048 71 T.C.M. (CCH) 1674, 1996 WL 10259 (1996).

1049 IRS' Amended Proposed Findings of Fact and Conclusions of Law [ECF No. 1103] ¶ 97.

1050 *Id.*

1051 Computation Stipulations ¶ 15.

1052 Joint Stipulations ¶ 378.

1053 IRS Ex. 1281 at CWG–000340 (section titled "Sport Horses"). *See also* Memorandum Opinion Exhibit I.

1054 *See* Wyly Ex. KZ at SWYLY013139 (illustrating the ownership structure); Tr. Trans. 2553:14–2555:23 (Pulman discussing the ownership structure and related tax implications).

1055 Joint Stipulations ¶ 87.

1056 *Id.* ¶ 387.

1057 *Id.* ¶¶ 380, 384. The agreed demonstrative chart provided to the Court, however, shows that Stargate Sport Horses, LP (Texas) was owned 91.21% by Stargate Horse Properties, Inc. (Nevada) and 8.79% by Stargate Sport Horse

Management LLC (Texas), which are the same percentages reflected in the Agreement of Limited Partnership of Stargate Sport Horses, L.P. (Wyly Ex. X at 39). Although the Court notes this discrepancy, it is not material to its decision.

1058 Wyly Ex. Y (General Warranty Deed).

1059 Joint Stipulations ¶ 379.

1060 *Id.* ¶ 390.

1061 *Id.* ¶¶ 391–409.

1062 Computation Stipulations ¶ 16 (transfers by tax year).

1063 Tr. Trans. 2184:13–19 (Hennington); Wyly Ex. X (Agreement of Limited Partnership of Stargate Sport Horses, L.P.) at Article IV (Capital Contributions).

1064 Tr. Trans. 2184:20–2185:9 (Hennington).

1065 *Id.* at 2185:14–19, 2186:4–2187:20 (Hennington). *See also* Wyly Ex. X (Agreement of Limited Partnership of Stargate Sport Horses, L.P.) at § 11.02 (Method of Liquidation).

1066 Tr. Trans. 2187:16–20 (Hennington).

1067 *Id.* at 3982:4–8 (Messersmith) ("The gift occurred when the money hit the LP, but—because that's when Emily got control, but the gift is to Emily, but the gift did not occur until the money hit the LP.").

1068 Joint Stipulations ¶ 434.

1069 *Id.* ¶ 437; Wyly Ex. BC at SWYLY053239 (Articles of Organization file stamped October 22, 1999); *but see* Wyly Ex. BC at SWYLY053271(Operating Agreement of Little Woody, LLC (Colorado) dated as of November 30, 1999).

1070 Joint Stipulations ¶ 437. Although the Joint Stipulations state that Little Woody, LLC was formed in Texas and refers to the entity as "Little Woody, LLC (Texas)," the entity was formed in Colorado. Wyly Ex. BC (Articles of Organization and Operating Agreement of Little Woody LLC). Thus, it appears to the Court that the Joint Stipulations' references to Texas in paragraphs 437, 438, 440, 442–445, and 448–455 are in error.

1071 *Id.* ¶ 439.

1072 *Id.* ¶ 440.

1073 *Id.* ¶ 442. *See also* Exhibit J attached hereto.

1074 Tr. Trans. 2187:21–2188:7 (Hennington).

1075 Joint Stipulations ¶ 447.

1076 *Id.* ¶¶ 449–455 (detailing transfers by date).

1077 Tr. Trans. 3987:1–6 (Messersmith) ("The gift is actually made, though, at the point the funds hit Little Woody, LLC, because that's when they had control of it."). The Court notes, however, that Emily and Jennifer have no direct ownership of Little Woody LLC (Colorado). Instead, they are each 1% co-grantors of the Little Woody Management Trust (US), the direct parent of Little Woody LLC (Colorado).

1078 Computation Stipulations ¶ 17 (transfers by year); Joint Stipulations ¶¶ 448–455 (detailing specific transfers).

1079 Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 32 (citing *Guest v. C.I.R.,* 77 T.C. 9, 15–16 (1981) (quoting *Weil v. C.I.R.,* 31 B.T.A. 899, 906 (1934), *aff'd,* 82 F.2d 561 (5th Cir.1936); 26 U.S.C. § 2512(b); 26 C.F.R. § 25.2511–1(g)(1)).

1080 *See, e.g.,* Collateral Estoppel Nos. 52, 53.

1081 In short, (i) Charles had total control over Stargate Farms Limited (IOM) through his control over the trustee of the Tyler IOM Trust (*see* Collateral Estoppel Nos. 52, 53; Joint Stipulations ¶ 87), which (ii) had total control over the appointment of the officers and directors of Stargate Horse Properties Inc. (Nevada) (see Wyly Ex. AC (Bylaws of Stargate Horse Properties, Inc. (Nevada) at §§ 5.01 & 5.02 (stating chairman of the board or, if no chairman, president has operational control over the business), 3.2 & 5.02 (the shareholder has the ability to appoint and remove officers and reconstitute the board of directors); Joint Stipulations ¶ 387 (Stargate Horse Properties, Inc. (Nevada)'s sole shareholder is Stargate Farms Limited (IOM)), which (iii) in turn, had total control over the management of Stargate Sport Horses LP (Texas) (see Wyly Ex. X (Agreement of Limited Partnership of Stargate Sport Horses, L.P.) at §§ 6.01 (placing management of the business, including the right to sell assets, with the Managing General Partner), 10.02–10.03 & 1.01 (the Managing General Partner may be removed with the written consent of limited partners holding at least 50% of sharing ratio, as judged by investment capital), Ex. A (showing Stargate Horse Properties, Inc. as holding an Initial Sharing Ratio of 91.21%); which (iv) in turn had control over the management of Stargate Horse Farm (*see* Joint Stipulations ¶ 378).

1082 Tr. Trans. 2187:16–20 (Hennington).

1083 A copy of the Little Woody Management Trust (US) agreement may be found at Wyly Ex. BD.

1084 Tr. Trans. 2187:16–20 (Hennington).

1085 *See* p. 540 n. 1081, *supra.*

1086 Joint Stipulations ¶ 447–555.

[1087] *Id.* ¶¶ 439–442; Memorandum Opinion Exhibit J. Although the Joint Stipulations state that Little Woody, LLC was formed in Texas and refers to the entity as “Little Woody, LLC (Texas),” the entity was formed in Colorado. Wyly Ex. BC (Articles of Organization and Operating Agreement of Little Woody LLC). Thus, it appears to the Court that the Joint Stipulations' references to Little Woody LLC (Texas) are in error and should be references to Little Woody LLC (Colorado) (Little Woody, Ltd. is the Texas entity).

[1088] Wyly Ex. BC (Articles of Organization of Little Woody LLC) at SWYLY053239 (showing Charles as the sole manager), SWYLY053271 (Operating Agreement of Little Woody, LLC showing Charles signing as Manager). As reflected in the agreed chart submitted by the parties, Donnie Miller now serves as manager. Memorandum Opinion Exhibit J.

[1089] Joint Stipulations ¶ 442.

[1090] Wyly Ex. BD (The Little Woody Management Trust) at § 1.5.

[1091] Joint Stipulations ¶ 11 (“Mr. French served as primary counsel for Sam Wyly and Charles Wyly until early 2001 when the relationship was severed.”).

[1092] 26 C.F.R. § 25.2511–2(b).

[1093] *Holmes v. C.I.R.,* 62 T.C.M. (CCH) 839, 1991 WL 188869 (1991) (quoting *Hite v. C.I.R.,* 49 T.C. 580, 594 (1968)).

[1094] Wyly Ex. OJ (Amendment to Partnership Agreement of Stargate, Ltd) at 2. Documents referencing the formation of SGL vary between using December 14, 1992 and December 15, 1992 as the formation date. The actual date, however, is not material to the Court's analysis and decision.

[1095] *Id.* § 3.

[1096] *Id.*

[1097] The ownership percentages are those reflected in an agreed demonstrative chart submitted by the parties. The Court notes, however, that the percentages vary from those set forth in the Amendment to Partnership Agreement of Stargate, Ltd (Wyly Ex. OJ) at § 2.2. The discrepancy is minor and does not affect this Court's decision.

[1098] Tr. Trans. 2146:10–13 (Hennington) (stating the loans were between 1992 and 1999); Wyly Ex. PD (tracking balance of Unsecured Loan from 1993 through 2011, and showing borrowing as late as October 2007).

[1099] Schedule F [Case No. 14–35043, ECF No. 351] at 30; Statement of Financial Affairs [Case No. 14–35043, ECF No. 352] at Ex. 3.c.

[1100] Tr. Trans. 2147:9–14 (Hennington). A spreadsheet tracking the Unsecured Loan between March 1993 and December 2011 may be found at Wyly Ex. PD.

[1101] Wyly Ex. OK (Marital Agreement).

[1102] Tr. Tran. 2147:15–21 (Hennington); Wyly Ex. OL (The Caroline D. Wyly Irrevocable Trust). The beneficiaries of the CDW Irrevocable Trust are the children resulting from Dee and Charles' marriage and all of their respective descendants, whether then living or later born or adopted. *Id.* at § 1.6. Although the trust document states that the initial *res* may be found at Exhibit B to the document, Wyly Ex. OL has no Exhibit B attached.

[1103] Wyly Ex. ON. The CDW Irrevocable Note required quarterly interest payments. Quarterly principal payments of $651,350 commenced on December 31, 2009, with any unpaid interest and principal due on September 30, 2019. *Id.* at 1.

[1104] Wyly Ex. OO.

[1105] Wyly Ex. OP at 1.

[1106] *See* Tr. Trans. 2147:25–2148:11 (Hennington); Wyly Ex. OQ (The Charles J. Wyly, Jr. Irrevocable Trust), OR (Memorandum of Sale and Assignment of Partnership Interest), OS (Secured and Partially Guaranteed Promissory Note), OT (Specific Guaranty Agreement), OU (Pledge Agreement).

[1107] The ownership percentages are as reflected on an agreed demonstrative exhibit submitted by the parties. Although the Court was unable to trace these percentages through the documents (Wyly Exs. OJ–OV), the discrepancy was minor and not material to this Court's decision.

[1108] Wyly Ex. OW (Partnership Agreement for Stargate Investments, Ltd.) § 10.13.

[1109] *Id.* § 2.2; Joint Stipulations ¶ 162.

[1110] Wyly Ex. OW at Ex A (Initial Capital Contributions).

[1111] In 1992 and 1996, Charles entered into multiple transactions whereby he transferred securities that he had earned from Sterling Software, Sterling Commerce, and Michael Stores in exchange for private annuities payable to Dee and him. *See* Joint Stipulations ¶¶ 145–160. The private annuities entitled them to contractual payments commencing at various future dates. *See* pp. 394–408, *supra,* for a detailed explanation of the annuity transactions.

[1112] Tr. Tran. 2150:1–2151:4 (Hennington); Wyly Ex. OW (Partnership Agreement for Stargate Investments, Ltd.) at Exhibit A; Joint Stipulations ¶ 161.

[1113] Tr. Trans. 2154:1–4 (Hennington).

[1114] *Id.* at 2154:8–24 (Hennington).

[1115] *Id.* at 2154:25–2155:10 (Hennington).

[1116] *See id.* 2154:25–2155:15 (Hennington); Wyly Ex. PC (showing distributions from Stargate Investments (Texas) being paid to "Charles Wyly Community Property"). Because the Revocable Trusts were settled by Dee and Charles, the distributions from Stargate Investments (Texas) flowed through the Revocable Trusts to Dee and Charles and were reported on their tax returns. 26 U.S.C. § 671; Joint Stipulations ¶ 174.

[1117] Wyly Exs. ON (Dee), OS (Charles); Tr. Tran. 2158:3–2159:6 (Hennington).

[1118] Tr. Trans. 2163:3–13; 2169:8–12, 2171:6–23 (Hennington).

[1119] *Id.* 2163:18–2173:12 (Hennington).

[1120] *See id.* 3939:9–11 (Messersmith) ("So the gift is to the irrevocable trust, of which the kids are the sole beneficiaries, but the gift is to the irrevocable trust."); Computation Stipulations ¶ 18.

[1121] *Southgate Master Fund, L.L.C.*, 659 F.3d at 481.

[1122] Wyly Ex. PA at 11 (bank statement).

[1123] *Id.* at 7 (page titled "Stargate Investments, Ltd. Note Payable 12/31/99 payment").

[1124] *Id.*

[1125] *Id.* at 7, 9, 11.

[1126] *Id.* at 7, 11, 13.

[1127] *Id.* at 7, 9, 10.

[1128] Wyly Ex. PC at 1 (showing transferee as "Charles Wyly Community Property"). Although the record reflects that the Revocable Trusts are the sole owners of Stargate Investments (Texas), the distributions from Stargate Investments (Texas) were made directly into Charles and Dee's community property account because the CDW Revocable Trust is a grantor trust as to Dee and the CJW Revocable Trust is a grantor trust as to Charles, so the distributions would pass through the Revocable Trusts to Dee and Charles, respectively.

[1129] *See* Wyly Exs. PA, PC, PD. There are instances where the payments are difficult to track, however. For example, Wyly Ex. PA, on pp. 56–57, indicates that a $2.45 million payment was made on the Unsecured Loan on May 5, 2009; however, a review of the attached bank statement does not reflect this payment from Dee and Charles' account. Nonetheless, according to p. 57, of this $2.45 million, $2.284 million was deposited by Stargate Investments (Texas) back into Dee and Charles' community bank account on May 7, 2008.

[1130] This calculation is based upon the pre-Estate Planning Transactions percentages shown on Exhibit K hereto.

[1131] Wyly Ex. PD at 17–19 (showing Dee and Charles' last payment on the Unsecured Note in October 2010, leaving a loan balance of $25,400,128).

[1132] Statement of Financial Affairs [Case No. 14–35043, ECF No. 352] at Ex. 3.c (showing a $20,000 payment on September 4, 2014). Schedule F, Case No. 14–35043, ECF No. 351 at 30.

[1133] *See Klamath,* 568 F.3d at 543.

[1134] Although failure to satisfy this factor alone is sufficient to disregard the transaction for income tax purposes, the Court will nonetheless consider the remaining two *Klamath* factors, which the Debtor has also failed to satisfy.

[1135] *Klamath,* 568 F.3d at 544; *Southgate Master Fund, LLC,* 659 F.3d at 481–82.

[1136] Wyly Ex. OM (Memorandum of Sale and Assignment of Partnership Interest).

[1137] *See* Computation Stipulations ¶ 18. Respective counsel for the parties stated on the record that they believed a more precise stipulated amount could be presented to the Court after entry of this Memorandum Opinion resolving various issues. Thus, a final amount (whether stipulated or as determined by the Court) will be included in the Final Order that will follow the issuance of this Memorandum Opinion.

[1138] *See* Computation Stipulations ¶ 18.

[1139] The Court notes that the IRS' Proof of Claim filed against Dee's estate only references fraud penalties under § 6663 (related to filed returns), not § 6651 (failure to file). At closing argument, however, Dee's counsel stated that she would not argue that the IRS had waived its right to allege liability under § 6651. Tr. Trans. 4067:11–16 (Ross) ("we've decided, based upon the argument today, to just allow [the IRS] to argue whatever gift tax theories they have and not to brief the issue").

[1140] *See* Debtors' Amended Proposed Findings of Fact and Conclusions of Law [ECF No. 1102] ¶ 86 ("Charles and Dee did not file gift tax returns in the years the IRS alleges that they made gifts."); IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] ¶ 567 ("Charles and Dee Wyly did not file gift tax returns for gifts made in tax years ... 2010.").

[1141] *See Enayat v. C.I.R.,* 98 T.C.M. (CCH) 436, 2009 WL 3763085, *24 (2009) ("To determine whether Woodbury fraudulently failed to file its tax return for taxable year 1999, we examine the same badges of fraud we used when considering the imposition of the fraud penalty ... under section 6663(a).... "). Thus, the Court will not repeat the relevant standards previously detailed on pp. 385–86, 389–94 *supra.*

[1142] IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] ¶ 239.

[1143] *Id.*

[1144] Computation Stipulations ¶ 18.

[1145] 26 U.S.C. § 6038.

[1146] *Id.* § 6038(a).

[1147] *Id.* §§ 6038, 6048; 26 C.F.R. § 1.6038–2(a).

[1148] 26 U.S.C. § 6038(b).

[1149] *Id.* § 6048.

[1150] *Id.* § 6048(a)(1), (a)(3)(A)(i).

[1151] *Id.* § 6048(a)(1), (a)(3)(A)(ii).

[1152] *Id.* § 6048(c)(1).

[1153] *Id.*; 26 C.F.R. §§ 16.3–1, 404.6048–1.

[1154] 26 U.S.C. § 6677(a). The Court notes that the $10,000 alternative minimum penalty is only effective for notices and returns required to be filed after December 31, 2009. Hiring Incentives to Restore Employment Act, Pub.L. No. 111–147, § 535, 124 Stat. 71 (2010). However, since the $10,000 alternative minimum penalty is not applicable to any of the failures to file forms at issue in these Cases, this fact does not affect the Court's analysis.

[1155] *Id.* § 6048(b).

[1156] *Id.* § 6048(b)(1).

[1157] *Id.* § 6048(b); 26 C.F.R. §§ 16.3–1, 404.6048–1.

[1158] 26 U.S.C. § 6677(b). Again, the Court notes that the $10,000 alternative minimum penalty is only effective for notices and returns required to be filed after December 31, 2009 and that this fact does not affect the Court's analysis.

[1159] *Id.*

[1160] Collateral Estoppel Nos. 53, 54.

[1161] When the Court references the Foreign Corporations as to Dee, it is only referring to those of the Foreign Corporations owned by the Charles and Dee International Penalty Trusts. Similarly, when the Court references the Foreign Corporations as to Sam, it is only referring to those of the Foreign Corporations owned by the Sam International Penalty Trusts.

[1162] 26 U.S.C. § 6038(a).

[1163] *See* Computation Stipulations ¶¶ 9.A–9.E and 22.A–22.E.

[1164] 26 U.S.C. § 6038(e)(2). 26 C.F.R. § 1.6038–2(b) in turn defines "control" for the purposes of 26 U.S.C. § 6038 and Form 5471 in the following way:

> A person shall be deemed to be in control of a foreign corporation if at any time during that person's taxable year it owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock of the foreign corporation. A person in control of a corporation which, in turn, owns more than 50 percent of the combined voting power, or of the value, of all classes of stock of another corporation is also treated as being in control of such other corporation. The provisions of this paragraph may be illustrated by the following example:
>
> Example. Corporation A owns 51 percent of the voting stock in Corporation B. Corporation B owns 51 percent of the voting stock in Corporation C. Corporation C in turn owns 51 percent of the voting stock in Corporation D. Corporation D is controlled by Corporation A.

[1165] 26 U.S.C. § 318(a)(2)(B)(ii).

[1166] *See id.* §§ 671–679; Collateral Estoppel Nos. 53, 54.

[1167] 26 U.S.C. § 318(a)(1)(A)(i).

[1168] *Id.* § 318(a)(2)(A).

[1169] *Id.* § 318(a)(2)(B)(i).

[1170] *Id.* § 318(a)(2)(B)(ii).

[1171] TEX. FAM. CODE ANN. § 3.003 (providing that, under Texas law, "[p]roperty possessed by either spouse during or on dissolution of marriage is presumed to be community property" and that "[t]he degree of proof necessary to establish that property is separate property is clear and convincing evidence").

[1172] Tr. Trans. 3484:19–3485:9, 3489:15–17. During these transcript excerpts, the Court and the parties are discussing a list of joint questions that the Court provided to the Debtors and the IRS in writing in advance of closing arguments in hopes of getting detailed answers to the Court's questions during closing arguments.

[1173] This question was also from the list that the Court provided to the parties in advance of closing arguments. It reads as follows:

> 15. The parties' briefing on Contested Issue of Law D is thin, why wouldn't the grantor trust determination of the SDNY Court continue to apply after 2004 unless there were material factual or legal changes relating to the IOM Trusts?
>
> a. Debtors need to help me understand their argument here. No cases cited by either party, but IRS argument makes sense to me.
>
> b. If I'm overlooking briefing, where is it more fully briefed?

[1174] Joint Pre–Trial Order [ECF No. 1014] at 36.

[1175] Tr. Trans. 3485:2–9.

[1176] This question was also from the list that the Court provided to the parties in advance of closing arguments.

[1177] Joint Pre–Trial Order [ECF No. 1014] at 39.

[1178] Tr. Trans. at 3489:15–17.

[1179] *Ergo Science, Inc. v. Martin,* 73 F.3d 595, 599–600 (5th Cir.1996).

[1180] *See* 26 U.S.C. § 6038(b):

> **(b) Dollar penalty for failure to furnish information.—**
>
> **(1) In general.**—If any person fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any foreign business entity required under paragraph
>
> (1)of subsection (a), such person shall pay a penalty of $10,000 for each annual accounting period with respect to which such failure exists.
>
> **(2) Increase in penalty where failure continues after notification.**—If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the United States person, such person shall pay a penalty (in addition to the amount required under paragraph (1)) of $10,000 for each 30–day (or fraction thereof) during which such failure continues with respect to any annual accounting period after the expiration of such 90–day period. The increase in any penalty under this paragraph shall not exceed $50,000.

The Computation Stipulations break down the exact amount of penalties for which Sam and Dee respectively will be liable if this Court does not grant relief due to reasonable cause or under the Eighth Amendment. Computation Stipulations ¶¶ 10 and 23.

[1181] 26 U.S.C. § 6048(b).

[1182] *See* Computation Stipulations ¶¶ 7.A–8 and 20.A–21 (breaking down the trusts for which Forms 3520–A should have been filed and the total amount of applicable penalties).

[1183] *See* 26 U.S.C. §§ 6038(b), 6677.

[1184] *See* Computation Stipulations ¶¶ 8 and 21 (indicating amounts much greater than $10,000 for each year at issue).

[1185] 26 U.S.C. § 6048(c)(1).

[1186] DISTRIBUTION, Black's Law Dictionary (10th ed.2014).

[1187] IRS Notice 97–34, Information Reporting on Transactions with Foreign Trusts and on Large Foreign Gifts, 1997 WL 337826, at *14 ("**IRS Notice 97–34** "). IRS Notice 97–34 is the only regulatory authority that purports to directly interpret 26 U.S.C. § 6048, and the IRS draws on it heavily for the purposes of its analysis. This notice is not entitled to deference under *Chevron USA, Inc. v. Natural Res. Def. Council, Inc.,* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). *BMC Software, Inc. v. C.I.R.,* 780 F.3d 669, 675 (5th Cir.2015). This is because the IRS Notice has not gone through the notice and comment rulemaking process. However, this notice has persuasive weight under *Skidmore v. Swift & Co.,* 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944).

[1188] IRS Post–Trial Brief [ECF No. 1118] at 30. Note that because of the operation of community property laws, any distributions received by either Charles or Dee are treated as received by both Charles and Dee. *See* TEX. CONST. art. 16, § 15; TEX. FAM. CODE ANN. §§ 3.001–3.003.

[1189] *See* Computation Stipulations ¶¶ 12.B and 25.B (listing annuity income for which the IRS believes that Forms 3520 should have been filed).

[1190] *See* 26 U.S.C. § 6048(c); *see also* IRS Notice 97–34 at *14 (distinguishing gratuitous distributions from compensation or certain transfers otherwise taxable).

[1191] As was the case in their gift analysis, the IRS merges and melds these doctrines in their post-trial briefing. *See* IRS Post–Trial Brief [ECF No. 1118] at 38–42. Although the heading of the portion of the IRS' post-trial brief covering these issues discusses only what "the substance of the transactions, rather than their form" demands, the brief also discusses the economic substance doctrine and the step transaction doctrine.

[1192] Debtors' Post–Trial Brief [ECF No. 1117] at 58.

[1193] 26 U.S.C. § 6048(c).

[1194] *See id.* § 6048(c)(1) (emphasis added).

[1195] *U.S. v. Kaluza,* 780 F.3d 647, 658–59 (5th Cir.2015) (footnotes and internal citations omitted).

[1196] *Carrieri v. Jobs.com Inc.,* 393 F.3d 508, 518–19 (5th Cir.2004) (citing *U.S. v. Kay,* 359 F.3d 738, 743 (5th Cir.2004)).

[1197] *Lamie v. U.S. Trustee,* 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004).

[1198] *U.S. v. Transocean Deepwater Drilling, Inc.,* 767 F.3d 485, 494 (5th Cir.2014) (internal citations and quotation marks omitted).

[1199] *Id.*

[1200] *Elgin Nursing and Rehab. Center v. U.S. Dept. of Health and Human Services*, 718 F.3d 488, 494 (5th Cir.2013) (quoting *U.S. Nat'l Bank of Or. v. Indep. Ins. Agents of Am., Inc.*, 508 U.S. 439, 455, 113 S.Ct. 2173, 124 L.Ed.2d 402 (1993)).

[1201] *Flora v. U.S.,* 362 U.S. 145, 150, 80 S.Ct. 630, 4 L.Ed.2d 623 (1960).

[1202] 26 U.S.C. § 6048(c).

[1203] *Id.* at § 6048(c) (emphasis added).

[1204] *Carrieri,* 393 F.3d at 518–19 (citing *Kay,* 359 F.3d at 743).

[1205] 2A Sutherland Statutory Construction § 47:33 (7th ed.) (internal marks omitted).

[1206] *Barnhart v. Thomas,* 540 U.S. 20, 26, 124 S.Ct. 376, 157 L.Ed.2d 333 (2003) (quoting *Nobelman v. American Sav. Bank,* 508 U.S. 324, 330, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993)).

[1207] *Id.* at 28, 124 S.Ct. 376.

[1208] *D.G. ex rel. LaNisha T. v. New Caney Indep. School Dist.*, 806 F.3d 310, 317 (5th Cir.2015).

[1209] *U.S. v. Campbell,* 49 F.3d 1079, 1086 (5th Cir.1995) (quoting *Quindlen v. Prudential Ins. Co.,* 482 F.2d 876, 878 (5th Cir.1973) (internal quotation marks omitted)).

[1210] *Gould v. Gould,* 245 U.S. 151, 153, 38 S.Ct. 53, 62 L.Ed. 211 (1917).

[1211] *C.I.R. v. Acker,* 361 U.S. 87, 91, 80 S.Ct. 144, 4 L.Ed.2d 127 (U.S.1959) (quoting *Keppel v. Tiffin Savings Bank,* 197 U.S. 356, 362, 25 S.Ct. 443, 49 L.Ed. 790 (1905)); *see also Ivan Allen Co. v. U.S.,* 422 U.S. 617, 627, 95 S.Ct. 2501, 45 L.Ed.2d 435 (U.S.1975) (tax penalties are strictly construed); *Rand v. C.I.R.,* 141 T.C. 376, 393 (T.C.2013) (stating that "[t]he law is settled that 'penal statutes are to be construed strictly,' and that one 'is not to be subjected to a penalty unless the words of the statute plainly impose it' " and refusing to apply a penalty under § 6662.); *Mohamed v. C.I.R.,* 106 T.C.M. (CCH) 537, 2013 WL 5988943, at *10 (T.C.2013) (strictly construing a tax penalty statute in favor of the taxpayer while noting that "[t]he application of that strict-construction canon to tax law no longer enjoys universal approval.").

[1212] *Stephan v. C.I.R.,* 197 F.2d 712, 714 (5th Cir.1952).

[1213] *U.S. v. Marshall,* 798 F.3d 296, 318 (5th Cir.2015) ("We also heed the longstanding canon of construction that if the words of a tax statute are doubtful, the doubt must be resolved against the government and in favor of the taxpayer." (internal quotation marks omitted)); *see Allen v. Atlanta Metallic Casket Co.,* 197 F.2d 460, 461 (5th Cir.1952).

[1214] *Rand,* 141 T.C. at 393 (stating that "[t]he law is settled that 'penal statutes are to be construed strictly,' and that one 'is not to be subjected to a penalty unless the words of the statute plainly impose it' " and refusing to reply a penalty under § 6662.); *Mohamed,* 2013 WL 5988943 at *10 (strictly construing a tax penalty statute in favor of the taxpayer).

[1215] Debtors' Post–Trial Brief [ECF No. 1117] at 59.

[1216] 26 C.F.R. § 1.679–4(c) (discussing when certain obligations can be ignored for the purposes of § 679).

[1217] Although, as explained in at pp. 566–67 n. 1237, *infra,* the Court finds that the IRS is estopped from arguing that the annuity payments were gratuitous transfers based upon its agreements in the Computation Stipulations, the Court will nonetheless consider this argument.

[1218] *Id.* at § 1.679–4(c).

[1219] 26 U.S.C.§ 679(a)(1); 26 C.F.R. §§ 1.679–1, 1.679–4.

[1220] 26 C.F.R. § 1.679–4(b); *see* 26 U.S.C. § 679(a)(2).

[1221] 26 C.F.R. § 1.679–4(c); *see* 26 U.S.C. § 679(a)(3).

[1222] In support of its argument that the private annuity payments should be treated as gratuitous transfers rather than fair market value exchanges for the purpose of § 6048(c), the IRS also points to language in IRS Notice 97–34 that defines a distribution as "any gratuitous transfer of money or property from a foreign trust." However, the IRS cites no statutory or regulatory authority that indicates that annuity payments can be construed as gratuitous transfers. *See* IRS Post–Trial Brief [ECF No. 1118] at 37.

1223 Computations Stipulations ¶¶ 1–2 (Sam income tax and penalty liability), 3–6 (Sam gift tax and penalty liability), 7.A–12.B (Sam International Penalties liability), 13–14 (Dee income tax and penalty liability), 15–19 (Dee gift tax and penalty liability), 20.A–25.B (Dee International Penalties liability). The Computation Stipulations are subject to certain contingencies. *See id.* ¶¶ 26–32.

1224 *See id.* ¶ 32.

1225 *See id.* ¶¶ 1, 13.

1226 *Id.* ¶¶ 1, 13; Proof of Claim (Sam) at note 1(b); Proof of Claim (Dee) at note 1(b).

1227 *See* 26 U.S.C. § 952(a) ("For purposes of this subpart, the term 'subpart F income' means, in the case of any controlled foreign corporation, the sum of... ").

1228 Proof of Claim (Sam) at note 1(b); Proof of Claim (Dee) at note 1(b).

1229 Debtors' Reply to IRS' Post–Trial Brief [ECF No. 1121] at 67–68.

1230 *Id.* at 70 ("[T]he Debtors are not certain of the IRS' current position as to that agreement given its request that this Court find for it on both its gift tax argument and its Form 3520 reporting argument without disclosing the contradictory nature of those positions.").

1231 *Markow v. Alcock,* 356 F.2d 194, 198 (5th Cir.1966).

1232 73 F.3d 595, 598 (5th Cir.1996).

1233 *Id.* at 599–600.

1234 *See* Computation Stipulations ¶ 40 (noting a date of January 26, 2016).

1235 *Id.* ¶ 32.

1236 Tr. Trans. 3461:1–6 (Adams).

1237 For the same reasons, the Court also concludes that the IRS is estopped from arguing that the annuity payments were gratuitous transfers. During closing arguments, the Court asked Debtors' counsel what the consequences would be if the Court found that the annuity transactions were flawed, and specifically whether this would allow the annuity payments to be treated as distributions and what the tax consequences of treating the annuities as flawed would be. Tr. Trans. 3462:17–3466:15 (closing question no. 9). After responding that this question "was a doozy," Debtors' counsel stated that the status of the annuities was not an issue in the case anymore because of the Computation Stipulations. *Id.* 3462:17–3466:15. When Debtors' counsel asked the IRS' counsel whether he agreed, IRS counsel replied that "... I—to use Your Honor's words, listening check, I—that sounds right based on the comp stip that Mr. Cole and Mr. Lan and I worked on for quite a while. That sounds right, Your Honor." *Id.* at 3466:12–15. Debtors' counsel then replied "I'm very happy with that answer. I don't have to brief that." *Id.* at 3466:20–21.

1238 *Klamath,* 568 F.3d at 543 (citing *Coltec Indus., Inc. v. U.S.,* 454 F.3d 1340, 1353–54 (Fed.Cir.2006)).

1239 *Security Indus. Ins. Co.*, 702 F.2d at 1244.

1240 *Southgate Master Fund, L.L.C.*, 659 F.3d at 479.

1241 *Chemtech Royalty Assoc., L.P. v. U.S.*, 766 F.3d 453, 460 (5th Cir.2014) (quoting *Southgate Master Fund, L.L.C.*, 659 F.3d at 479).

1242 *Gregory v. Helvering,* 293 U.S. 465, 469, 55 S.Ct. 266, 79 L.Ed. 596 (U.S.1935).

1243 *Acker,* 361 U.S. at 91, 80 S.Ct. 144 (quoting *Keppel,* 197 U.S. at 362, 25 S.Ct. 443); *see also Ivan Allen Co. v. U.S.,* 422 U.S. 617, 627, 95 S.Ct. 2501, 45 L.Ed.2d 435 (1975) (tax penalties are strictly construed); *Rand,* 141 T.C. at 393 (stating that "[t]he law is settled that 'penal statutes are to be construed strictly,' and that one 'is not to be subjected to a penalty unless the words of the statute plainly impose it' " and refusing to reply a penalty under § 6662.); *Mohamed,* 2013 WL 5988943 at *10 (strictly construing a tax penalty statute in favor of the taxpayer).

1244 *See* Debtors' Post–Trial Brief [ECF No. 1117] at 60.

1245 *See, e.g.,* Tr. Trans. 1592:22–1593:4 (IRS Agent Herrick testifying that the Wylys' manner of reporting annuity income was "unusual").

1246 *See, e.g., id.* 1914:4–1915:14 (Hennington testifying that there was no way in their tax program to make sure that additional self-employment tax was added in without reporting the income on Schedule C, and that Pulman and French advised the Wylys that the annuity payments were subject to self-employment tax), 2210:5–19 (Hennington, however, later testified that she could override the system, but only does so "if it is absolutely necessary.").

1247 IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF 1103] ¶ 118. The IRS has also stated that "[b]ecause the maximum amount of taxable earnings subject to the self-employment tax went from a maximum of $87,000 in 2003 to a maximum of $113,700 in 2013, none of the annuity income reported on the Schedules C to their income tax returns increased the amount of the Wylys' self-employment tax since they earned more than the maximum subject to the tax from other sources of income properly listed on the Schedules C. All annuity income reported on the Schedule C, however, would have been subject to the 2.9% hospital insurance (HI) tax." *Id.* ¶ 119.

1248 *See, e.g.,* Joint Ex. 111 (Sam 2007 tax return) at SWYLY 023031; Tr. Trans. 1596:10–1598:23 (Herrick describing how the reporting of the annuity payments simply as "ANNUITIES" was how they were reported on Wyly 1040s).

1249 IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] ¶¶ 418–21; IRS Post–Trial Brief [ECF No. 1118] at 68–79.

1250 IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] ¶¶ 430–33; IRS Post–Trial Brief [ECF No. 1118] at 61–68.

1251 Debtors' Post–Trial Brief [ECF No. 1117] at 61.

1252 IRS Post–Trial Brief [ECF No. 1118] at 59–61; *see also* Computation Stipulations ¶¶ 12.B; 25.B.

1253 *See* IRS Post–Trial Brief [ECF No. 1118] at 59; Joint Stipulations ¶¶ 297, 299.

1254 Joint Stipulations ¶¶ 87, 297.

1255 Collateral Estoppel Nos. 21–24.

1256 *See* IRS Post–Trial Brief [ECF No. 1118] at 60; Joint Stipulations ¶ 301.

1257 Joint Stipulations ¶ 301.

1258 *Id.* ¶ 36.

1259 Collateral Estoppel Nos. 21–24.

1260 Joint Stipulations ¶¶ 293, 294; Debtors' Ex. B.

1261 Joint Stipulations ¶ 27.

1262 Collateral Estoppel Nos. 17, 47–54.

1263 *See* IRS Post–Trial Brief [ECF No. 1118] at 60; Joint Stipulations ¶¶ 287, 288.

1264 Joint Stipulations ¶¶ 287, 288.

1265 *Id.* ¶ 21.

1266 *See* IRS Post–Trial Brief [ECF No. 1118] at 60; Joint Stipulations $ 289.

1267 Joint Stipulations ¶¶ 21, 289.

1268 *See* IRS Post–Trial Brief [ECF No. 1118] at 60; Joint Stipulations $ 290.

1269 Joint Stipulations ¶¶ 21, 289.

1270 *See* IRS Post–Trial Brief [ECF No. 1118] at 61; Joint Stipulations ¶ 292 ("In June 2001, East Baton Rouge Limited (IOM), East Carroll Limited (IOM), Moberly Limited (IOM), and Yurta Faf Limited (IOM), transferred a number of financial assets to Greenbriar Limited (IOM), which in turn, loaned the assets it received, together with additional financial assets of its own to Security Capital in return for a promissory note from Security Capital to pay Greenbriar Limited (IOM) $55,815,672.03."). Security Capital then loaned the financial assets to the various Cayman LLCs. *Id.* ¶ 303.

1271 Joint Stipulations ¶ 21.

1272 *Id.* ¶ 36.

1273 *See* IRS Post–Trial Brief [ECF No. 1118] at 60; Joint Stipulations $ 295.

1274 Joint Stipulations ¶¶ 21, 295.

1275 *See* IRS Post–Trial Brief [ECF No. 1118] at 59–60; Joint Stipulations $ 21; Collateral Estoppel No. 54.

1276 *See* 26 U.S.C. § 6048(c).

1277 *See* IRS Notice 97–34, at *14–15.

1278 26 C.F.R. § 1.641(a)–0.

1279 *See* Federal Tax Coordinator 2d (RIA), ¶ C–1002, Taxation of Grantor Trusts, 19xx WL 218101 (2016) ("To the extent that the grantor trust rules apply, the regular rules for taxing trusts and their beneficiaries ... do not apply.").

1280 26 U.S.C. § 643(i).

1281 Reprising an argument that it made in the context of the annuity payments, the IRS also argues that the loans should be treated as gratuitous transfers rather than loans under the principles of 26 U.S.C. § 679 and 26 C.F.R. § 1.679–4. This argument was addressed in the context of the annuity transactions, and the analysis is the same here. The statutes and regulations cited by the IRS are not applicable to this situation. *See* pp. 563–64, *supra.*

1282 *See* Wyly Exs. B(Sam), D (Charles), E (Charles), (F) Sam).

1283 Sam's January 2002 loan from Security Capital is factually different from his other loans from Security Capital in one potentially material respect—*i.e,* Sam was unable to repay the loan at maturity and Security Capital and he agreed to restructure the loan on favorable terms. However, Sam reduced the principal amount outstanding on this loan by $1,500,000 and paid an overdue annual interest payment to Security Capital in order to obtain an extension of the original maturity date to July 14, 2018. From this Court's perspective, this difference does not make the loan a gratuitous transfer.

1284 Wyly Ex. D.

1285 *Id.* at SWYLY053519.

1286 Tr. Trans. 2089:1–6 (Hennington).

1287 Wyly Ex. E.

1288 *Id.* at SWYLY053511.

1289 *Id.*

1290 Tr. Trans. 2089:1–6 (Hennington).

1291 *See* Case No. 14–35074, Claim Nos. 6–1, 7–1. Security Capital seeks to collect $6,000,000 in principal and $598,610.96 in pre-petition interest related to Charles' October 2002 loan, along with additional interest, attorney fees, and costs. Security Capital also seeks to collect $25,000,000 in principal and $5,503,561.64 in pre-petition interest related to Charles' March 2003 loan, along with additional interest, attorney fees, and costs.

1292 Wyly Ex. F.

1293 *Id.* at SWYLY053503.

1294 Tr. Trans. 2088:13–25 (Hennington).

1295 *See* Case No. 14–35043, Claim No. 12–1. The Security Capital Proof of Claim seeks $10,089,149.33 plus costs, attorney fees, and additional interest related to this loan. $10,000,000 of the Proof of Claim represents the unpaid principal of the $10,000,000 July 2003 loan, and $89,149.33 represents pre-petition interest.

1296 Wyly Ex. B.

1297 *Id.*

1298 *Id.*

1299 *Id.* at 17–18.

1300 *See* Wyly Exs. D, E, and F (promissory notes); Joint Stipulations ¶¶ 285–302.

1301 *See* pp. 570–71, *supra.*

1302 *See* Wyly Post–Trial Brief at 63; Joint Stipulations ¶¶ 27, 36, 87, 297, 292, 293, 297, 299, and 301 (charting the paths of the loans at issue that were received by the Wylys).

1303 26 U.S.C. § 6048(a).

1304 Joint Stipulations ¶¶ 168 and 169.

1305 *Id.* at ¶¶ 19, 21, 25 27, 78, 80, 88, and 94; Collateral Estoppel Nos. 21–24.

1306 IRS Post–Trial Brief [ECF No. 1118] at 79–80.

1307 Joint Stipulations ¶¶ 168 and 169.

1308 *See* pp. 559–61, *supra.*

1309 26 U.S.C. § 6038(a)(2) (Secretary determines when Form 5471 is due); 26 C.F.R. § 1.6038–2(i) ("Returns on Form 5471 required under paragraph (a) of this section shall be filed with the United States person's income tax return on or before the date required by law for the filing of that person's income tax return. Directors of Field Operations and Field Directors are authorized to grant reasonable extensions of time for filing returns on Form 5471 in accordance with the applicable provisions of § 1.6081–1 of this chapter. An application for an extension of time for filing a return of income shall also be considered as an application for an extension of time for filing returns on Form 5471.").

1310 *See* Computation Stipulations ¶¶ 9.A–10, 22.A–23.

1311 26 U.S.C. § 6038(c)(4)(B). This reasonable cause provision operates to relieve taxpayers from liability under § 6038(b) as well as under § 6038(c)(1), which penalizes taxpayers for violations of § 6038(a) by reducing their foreign tax credits; however, § 6038(c)(1) is not at issue here. In addition, § 6038(c)(4)(B) also operates to extend the 90–day period relevant for post-notification penalties under § 6038(b)(2).

1312 *See id.* § 6048(b)(1).

1313 2015 Instructions for Form 3520–A.

1314 26 U.S.C. § 6677.

1315 *See* Computation Stipulations ¶¶ 7.A–8, 20.A–21.

1316 26 U.S.C. § 6677(d). The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause. 26 U.S.C. § 6677(d).

1317 *Brinkley,* 808 F.3d at 668 (internal quotation marks omitted) (quoting 26 C.F.R. § 1.6664–4(b)(1)); *Whitehouse Hotel Ltd. P'ship,* 755 F.3d at 249.

1318 *Klamath,* 568 F.3d at 548 (citing *Montgomery,* 127 T.C. at 66).

1319 *Brinkley,* 808 F.3d at 669 (quoting *Klamath,* 568 F.3d at 548); *Streber,* 138 F.3d at 223.

1320 *Streber,* 138 F.3d at 223 (quoting *Heasley v. C.I.R.,* 902 F.2d 380, 385 (5th Cir.1990) (overruled on other grounds)).

1321 26 C.F.R. § 1.6664–4(b).

1322 469 U.S. at 246, 105 S.Ct. 687 (citing 26 C.F.R. § 301.6651–1(c)(1)); *see Ferguson v. C.I.R.,* 568 F.3d 498, 501 (5th Cir.2009); *see also Staff IT, Inc. v. U.S.,* 482 F.3d 792, 798–99 (5th Cir.2007) ("For failure-to-file situations under § 6651(a), the Treasury Regulations explain: If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to reasonable cause." (internal formatting omitted)).

1323 *Staff IT, Inc.,* 482 F.3d at 798–99 (failure to file under § 6651); *Neonatology Associates,* 115 T.C. at 98 (penalties under § 6662).

1324 *Boyle,* 469 U.S. at 245, 105 S.Ct. 687.

1325 *Staff IT, Inc.,* 482 F.3d at 798–99 (adopting *Boyle* definition of willful neglect in a case involving failure to file under § 6651); *Nance v. U.S.,* 2013 WL 1500987, at *5 (W.D.Tenn.2013) (adopting *Boyle* definition of willful neglect in case involving penalties under § 6677).

1326 *James v. U.S.,* 2012 WL 3522610, at *3 (M.D.Fla.2012) (interpreting reasonable cause under § 6048); *Congdon v. U.S.,* 2011 WL 3880524, at *2 (E.D.Tex., 2011) (interpreting reasonable cause under § 6038).

1327 *See* pp. 475–513, *supra.*

1328 *See Boyle,* 469 U.S. at 251, 105 S.Ct. 687; *Whitehouse Hotel Ltd. P'ship,* 755 F.3d at 249; *Stanford,* 152 F.3d at 461–62. The Court notes that most of the Fifth Circuit cases that it cites in its discussion of the legal standards related to establishing a reasonable cause defense based on reliance on the advice of counsel are decided in the context of § 6664, which requires a taxpayer to establish both "reasonable cause" and "good faith" in order to escape liability. Here, only "reasonable cause" and lack of "willful neglect" (under § 6677 only) are the relevant standards. The Court notes that these Fifth Circuit cases draw their analysis from *U.S. v. Boyle,* a Supreme Court case where "reasonable cause" and lack of "willful neglect" were the relevant standards. Thus, the Court views the reasoning of these Fifth Circuit cases as applicable in the context of the reasonable cause defenses that the Debtors are raising to the International Penalties.

1329 *Whitehouse Hotel Ltd. P'ship,* 755 F.3d at 249 (quoting *Boyle,* 469 U.S. at 251–52, 105 S.Ct. 687).

1330 *Brinkley,* 808 F.3d at 669 (internal marks omitted) (quoting *Klamath,* 568 F.3d at 548); *see Whitehouse Hotel Ltd. P'ship,* 755 F.3d at 249; *Southgate Master Fund, L.L.C.,* 659 F.3d at 493.

1331 *Brinkley*, 808 F.3d at 669; *Southgate Master Fund, L.L.C.*, 659 F.3d at 493.

1332 *Southgate Master Fund, L.L.C.,* 659 F.3d at 493 (quoting 26 C.F.R. § 1.6664–4).

1333 *Id.*

1334 *Thomas,* 2013 WL 690599, at *3.

1335 *See* Debtors' Pre–Trial Brief [ECF No. 1015] at 62–74, 106–07.

1336 *See id.* at 62–74.

1337 1995 WL 322722, at *4 (M.D.Fla.1995).

1338 *Rice v. C.I.R.,* 14 T.C. 503, 508 (1950); Debtors' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1102] at 191. *Rice* involved a taxpayer who held a common misconception about a certain deduction that—despite having a common sense appeal—was nevertheless erroneous. *Id.* This misconception was insufficient to prove fraud. *Id.*

1339 36 T.C.M. (CCH) 1295, 1977 WL 3048 (1977).

1340 Debtors' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1102] at 206–07.

1341 The evidence shows that Dee relied entirely on Charles regarding all business, tax, and legal matters throughout their marriage. Tr. Trans. 159:20–160:15 (Dee testified that she relied entirely on husband throughout marriage), 159:13–19(Dee) ("Q. Have you ever prepared a tax return? A. Oh, heavens no."), 172:17–19 (Dee never discussed tax matters with husband), 1073:14–1075:2 (Sam testifying that he has not read a legal opinion), 387:10–388:11 (Sam testifying how he came to rely on tax professionals and that he did not understand the tax laws and regulations). Tr. Trans. 1074:18–1075:2 (Sam testifying that he did not personally read the opinion letter at IRS Ex. 177 addressed to him).

1342 Tr. Trans. 159:13–160:15, 293:2–294:23 (Dee testifying that she relied entirely on Charles to handle all tax and legal matters throughout their marriage, and it was her practice to simply sign whatever tax return was put in front of her without reviewing it), 389:25–390:17 (Sam testifying that he has not prepared his own tax returns or the underlying figures for his tax returns since the 1960s), 400:16–401:18 (Sam testifying that he relied on accountants and tax lawyers to prepare his tax returns because "Well, they had experience in doing it. They knew how to do it. They had dealt with it, and it's not something I had personally done ... And—and I had a lot of other things to do."), 414:9–25, 703:4–25 (in describing his management style, Sam testified that "I did what I learned. I—I needed to get real good people who knew how to do whatever it is that they did in all kinds of areas, whether they were technology or accounting or law or what have you. And I needed to let these people do what they do, because everybody knew more about anything than I would personally know"), 709:1–20 (Sam testified that he delegated the specifics of the offshore system to French and that "I didn't confer with Michael French on every specific of how he and other lawyers were setting up trusts and doing the legal things that they did."), 722:13–725:2 (Sam, describing the process that went into preparing his tax returns from 1992 through 2013, and testifying that he did not carefully read his 1992 tax return because "I can't say I was competent to read it" and that he signed it because "it was prepared by people that knew what they were doing. They were professional people, accountants, and they were lawyers.").

[1343] *Yelencsics v. C.I.R.,* 74 T.C. 1513, 1533 (1980) (leading case on this issue invoking "honest difference of opinion" where taxpayer did not consult any advisors); *But see Lemery v. C.I.R.,* 54 T.C. 480, 485 (1970) (Taxpayer's accountant apparently advised taxpayer—a Canadian—that he could establish Canadian residency for the year in question and would thus not need to report certain income. The tax court, without relying on the fact that the taxpayer received advice from his accountant, concluded that "while the issue is not free from doubt, we feel that O.D. 468 [(1920)], supra, [referring to Office Decisions, a type of Revenue Ruling issued before 1954] created such confusion and uncertainty on the question of this petitioner's residence that we cannot say his actions were due to 'negligence or intentional disregard of rules and regulations.' ").

[1344] *See, e.g, Barter Systems, Inc. of Wichita v. C.I. R.,* 59 T.C.M. (CCH) 72, 1990 WL 25024 (1990); *Lemery,* 54 T.C. at 490; *Marcello v. C.I.R.,* 43 T.C. 168, 182 (1964), *aff'd in part and remanded in part,* 380 F.2d 499 (5th Cir.1967); *see also Foster v. C.I.R.,* 756 F.2d 1430, 1439 (9th Cir.1985) (refusing to apply the negligence penalty in a "case of first impression with no clear authority to guide the decision makers as to the major and complex issues"); *Bergersen v. C.I.R.,* 70 T.C.M. (CCH) 568, 1995 WL 510012, at *26 (1995); *Rosen v. C.I.R.,* 67 T.C.M. (CCH) 2082, 1994 WL 26314, at *9 (1994) ("Imposition of the addition to tax for negligence is inappropriate if the deficiency turns on relatively complex legal issues with respect to which there can be an honest difference of opinion"); *Little v. C.I.R.,* 65 T.C.M. (CCH) 3025, 1993 WL 231723, at *12 (1993); *Howard v. C.I.R.,* 109 T.C.M. (CCH) 1193, 2015 WL 1060434 (2015) (taxpayer read relevant law but misinterpreted it, reasonable cause established because of taxpayer's attempt to comply by reading the law).

[1345] *Carlins v. C.I.R.,* 55 T.C.M. (CCH) 228, 1988 WL 13212 (1988) (refusing to allow taxpayer to escape negligence penalties by asserting honest difference of opinion where there was reliance on counsel and taxpayers were knowledgeable tax lawyers); *Gerdau Macsteel, Inc. v. C.I.R.,* 139 T.C. 67, 188 (2012) (same result in a case involving "well-educated tax professionals with extensive tax experience").

[1346] *See, e.g., Bruce v. C.I.R.,* 108 T.C.M. (CCH) 230, 2014 WL 4336234 (2014).

[1347] *See* Debtors' Pre–Trial Brief [ECF No. 1015] 151–54, 165 (emphasis added).

[1348] *See id.* ¶ 157 (citing *Boyle,* 469 U.S. at 251, 105 S.Ct. 687).

[1349] *See id.* ¶ 159.

[1350] *See id.* ¶ 151.

[1351] *See id.* ¶ 167.

[1352] According to the IRS, neither Sam nor Evan could state a single fact that Meadows Owens relied on in giving the advice. IRS Post–Trial Brief at 17 (citing Tr. Trans. 1703:15–23(Sam); 1851–1853(Evan)).

[1353] IRS Post–Trial Reply Brief [ECF No. 1120] at 10–11 (footnotes omitted).

[1354] *See* Computation Stipulations ¶¶ 9.A–10, 22.A–23.

[1355] Chatzky said that he believed such an opinion was issued, but no such opinion was admitted into evidence. Tr. Trans. 1170:1–11 (Chatzky). In fact, while Debtors' counsel attempted to refresh Chatzky's recollection using a draft opinion letter dated February 2, 1992, that draft is unsigned and was not offered into evidence. Accordingly, there is no evidence in the record as to whether an opinion regarding the Bulldog IOM Trust was ever finalized, signed and issued to Sam. It goes without saying, therefore, that we have no idea on this record what such an opinion, if ever finalized, signed and issued would have said.

[1356] SEC Tr. Trans. 3738:11–3738:14 (French).

[1357] Chatzky testified that he worked with Tedder's firm from time to time on particular clients, but that at some point in time they became partners in the same firm. While Chatzky could not be precise as to the timing, it was sometime between the April 1992 opinion letters just discussed and the May 19, 1993 opinion letters. Tr. Trans. 1134:121136:24 (Chatzky). Moreover, by February 22, 1996, Tedder and Chatzky were no longer law partners because Tedder "had a penchant for making statements to people that were either questionable or flatly untrue...." *Id.* at 1137:15–17. According to Chatzky, this made him uncomfortable, so the firm dissolved and Chatzky returned to practicing through his own firm, Chatzky & Associates. *Id.* at 1138:18–1139:9. After the dissolution of their firm, Chatzky testified that he no longer worked on common clients with Tedder, *id.* at 1139:16–20, and has never seen him, *id.* at 11411–5.

[1358] *See* pp. 500–01, *supra.*

[1359] *See* pp. 371–74, 413–16, *supra.*

[1360] *See id.*

[1361] *See* pp. 413–16, *supra.*

[1362] *See id.*

[1363] *See* pp. 415–23, 494–98, *supra.*

[1364] *See* pp. 494–98, *supra.*

[1365] *See* pp. 415–23, *supra.*

[1366] *See* pp. 475–513, *supra.*

[1367] *See* pp. 491–93, *supra.*

[1368] *See* pp. 371–74, 491–93, *supra.*

[1369] *See id.* In fact, Meadows Owens did not opine on the proper legal characterization of the Sam International Penalty Trusts at that time either. Rather, they simply concluded that the Wylys had a “reportable position” for tax purposes.

[1370] *See* Debtors' Pre–Trial Brief [ECF No. 1015] ¶¶ 151–54, 165.

[1371] That this was in fact the nature of the implicit advice given is supported by the fact that Sam's advisors did have him file Forms 3520 and 3520–A for foreign trusts that they did believe Sam was the grantor of. *See* Joint Exs. 142–175.

[1372] *See Nance v. U.S.,* 2013 WL 1500987 (W.D.Tenn.2013) (attorney did not indicate that Forms 3520–A needed to be filed to report offshore transactions).

[1373] *See* Debtors' Pre–Trial Brief [ECF No. 1015] ¶¶ 151–54, 165; Joint Exs. 142–175.

[1374] Wyly Ex. LN. This memorandum is addressing the Red Mountain IOM Trust, a trust settled by Cairns in 1995. But this trust is identical to the La Fourche IOM Trust settled by Cairns in 1995 on Sam's behalf. *See* IRS Exs. 17 (Deed of Settlement, La Fourche IOM Trust) and 42 (Deed of Settlement, Red Mountain IOM Trust).

[1375] Wyly Ex. OC at WYLYSEC01105085.

[1376] IRS Ex. 85.

[1377] *Id.* at SECI00150285.

[1378] *Boyle,* 469 U.S. at 245, 105 S.Ct. 687.

[1379] *See, e.g.,* IRS Ex. 85 at SECI00150263 (Robertson's 1991 notes on a Tedder seminar describing an annuity transaction involving a foreign corporation, “Problems: $1,000,000,000 funds is going into annuities annually. The IRS will address soon, if you wish tax advantage of this loophole do now. Tedder considers this the best estate planning tool. This is an aggressive tax mode to take—be sure to file every tax form available and any support schedule that seems pertinent.”); Tr. Trans. 1038:19–1044:4 (On cross examination, Sam admitted that he received these notes in 1991 and was on notice that the structures Tedder proposed were aggressive).

[1380] *See, e.g.,* IRS Ex. 85 at SECI00150263 (Robertson's 1991 notes on a Tedder seminar stating “Always over disclose what you've done to the IRS ... Always show your chart to the creditor, rely on law not secrecy.”), SECI00150266 (Robertson's notes on a 1991 Tedder seminar examining a real estate transaction and private annuity structure similar to that used by the Wylys and stating “Tedder says under the tax code this seems to work, but is aggressive. Be sure to file lots of forms.”), SECI00150285–SECI00150286 (Robertson's 1991 notes on a Tedder seminar describing numerous tax forms —including Forms 3520, 3520–A, and 5471—and stating “When in doubt file a form even if you have to make up the form.”).

[1381] *See* pp. 371–73, 413–16, *supra.*

[1382] *See* pp. 415–23, *supra.*

[1383] Tr. Trans. 387:10–388:11 (Sam testifying how he came to rely on tax professionals and that he did not understand the tax laws and regulations), 389:25–390:17 (Sam testifying that he has not prepared his own tax returns or the underlying figures for his tax returns since the 1960s), 400:16–401:18 (Sam testifying that he relied on accountants and tax lawyers to prepare his tax returns because “Well, they had experience in doing it. They knew how to do it. They had dealt with it, and it's not something I had personally done ... And—and I had a lot of other things to do.”), 414:9–25, 703:4–25 (in describing his management style, Sam testified that “I did what I learned. I—I needed to get real good people who knew how to do whatever it is that they did in all kinds of areas, whether they were technology or accounting or law or what have you. And I needed to let these people do what they do, because everybody knew more about anything than I would personally know”), 709:1–20 (Sam testified that he delegated the specifics of the offshore system to French and that “I didn't confer with Michael French on every specific of how he and other lawyers were setting up trusts and doing the legal things that they did.”), 722:13–725:2 (Sam, describing the process that went into preparing his tax returns from 1992 through 2013, and testifying that he did not carefully read his 1992 tax return because “I can't say I was competent to read it" and that he signed it because "it was prepared by people that knew what they were doing. They were professional people, accountants, and they were lawyers.").

1384 Based on the testimony provided at trial, the Court has questions about characterizing Tedder as a tax expert, but the Court is satisfied that Chatzky is a knowledgeable tax lawyer and that Lubar is an exceptionally well credentialed and knowledgeable tax lawyer.

1385 IRS Ex. 96 (memorandum dated June 30, 2003 from Hennington and Boucher to, among others, Sam and Charles discussing concerns); Tr. Trans. 1924:24–1925:16 (Hennington testified that she learned about Lubar and his connection with the Wyly family when she "received a—a call from Michelle Boucher relating to me that she had run into Mr. Lubar at a conference in the Cayman Islands, and that Mr. Lubar had made a comment to her that he thought there were issues with the '92 trusts and that he had told Mike that back years ago, and basically that she needed to look into it.")

1386 Tr. Trans. 1924:24–1951:24 (Hennington described the investigations that were done in response to Lubar's concerns); IRS Ex. 96 (a memo reporting to Sam, Charles, Evan, and Donnie what Hennington and Boucher had learned from investigating Lubar's concerns regarding the offshore system).

1387 IRS Ex. 96.

1388 *See* Wyly Exs. OC at WYLYSEC01105084–85 (outline of meeting of Hennington, Pulman, and other Meadows Owens lawyers that, among other things, explained that "Todd Welty went through the penalties associated with not filing a 3520 and 5471. He went on to say that the disclosure would alleviate some of the accuracy-related penalties under § 6662, but if the transaction was a tax shelter, the disclosure would not alleviate potential penalties. Todd Welty stated the biggest penalty risk is under § 6677, which provides a for a penalty of 5% of the gross asset of the trust at the end of the year."), OD (similar outline of a meeting that Cousins held with Sam and Evan on October 15, 2003 outlining potential penalties for failures to file Forms 3520–A and 5471); Tr. Trans. 1787:9–18 (Cousins) (identifying Wyly Ex. OD as his meeting outline for a meeting he held with Sam and Evan).

1389 Wyly Ex. OB.

1390 *Id.* at WYLYSEC01112419–2420. The meeting notes refer to Form "3528," which the Court believes is actually a reference to Form 3520–A.

1391 *See* pp. 458–60, *supra.*

1392 26 U.S.C. §§ 6038, 6048.

1393 *See* Joint Exs. 110 (Sam 2006), 111 (Sam 2007), 112 (Sam 2008), 130 (Dee and Charles 2003), 133 (Dee and Charles 2006), 134 (Dee and Charles 2007), 135 (Dee and Charles 2008), IRS Exs. 40 (Dee and Charles 2004), 42 (Dee and Charles 2005), 50 (Dee and Charles 2009), 52 (Dee and Charles 2010), 54 (Dee and Charles 2011), 71 (Sam 2002) 74 (Sam 2004), 75 (Sam 2005), 155 (Sam 2003), 159 (Sam 2009), 160 (Sam 2010), 161 (Sam 2011), 162 (Sam 2012), 163 (Sam 2013).

1394 26 U.S.C. §§ 6038, 6048.

1395 Tr. Trans. 2072:17–2074:13 (Hennington) ("[The IRS] made clear that [the foreign trusts and annuities] was the focus of their audit when they started in '04." Hennington also testified that the IRS' audit of Sam and Charles began sometime in "Early 2004," after Sam filed his first Form 8275 disclosure).

1396 As we know, Sam had been audited before and had been the subject of prior tax court decisions. *See* Joint Exs. 188 (tax court decision related to Sam for 1998), 189 (tax court decision related to Sam for 1999); Tr. Trans. 2448:6–2462:16 (Hennington describing previous audits involving Sam and Wyly-related entities Computer Associates and Green Funding Corporation).

1397 *See* Debtors' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1102] ¶ 371. The IRS is more blunt in its characterization: "Caroline Wyly did not raise a reasonable cause defense; rather; [sic] her only defense to the penalties in this case is that she didn't know about, and relied on her husband with respect to, transactions that were part of the Offshore System." IRS Post–Trial Brief [ECF No. 1118] at 5.

1398 26 C.F.R. § 1.6664–4(c)(2).

1399 1995 WL 700551, at *1, *aff'd in part, reversed in part,* 112 F.3d 1258 (5th Cir.1997).

1400 *Reser,* 1995 WL 700551, at *1.

1401 *Id.* at *1.

1402 *Id.*

1403 *Id.*

1404 *Id.* at *3.

1405 *Id.* at *4.

1406 *Id.*

1407 *Id.*

1408 *Id.* at *6.

1409 *Id.* at *8.

1410 *Id.*

1411 *Id.*

1412 *Id.* at *9.

1413 *Id.* at *10 (internal citations omitted).

1414 *Reser,* 112 F.3d at 1260.

1415 *Id.*

1416 *Id.*

1417 *Id.* at 1262.

1418 *Id.* at 1268.

1419 *Id.*

1420 *Id.*

1421 *Id.*

1422 *Id.*

1423 *Id.* at 1270.

1424 *Id.* at 1271.

1425 *Id.* at 1271–72.

1426 *Id.* at 1272.

1427 *Id.*

1428 *See* pp. 464–76, *supra.*

1429 Tr. Trans. 159:20–160:15(Dee) (relied entirely on husband throughout marriage).

1430 *Id.* at 159:13–19(Dee) ("Q. Have you ever prepared a tax return? A. Oh, heavens no."); 172:17–19 (Dee never discussed tax matters with husband).

1431 *Id.* at 159:13–160:9, 293:2–294:23(Dee).

1432 *Id.* at 1336:17–1338:12 (Donnie Miller) ("Q. And did you ever discuss the offshore trust system with Dee Wyly? A. No, I didn't. Q. Did you ever hear Charles Wyly talk business with Dee? A. No. Q. Did you ever hear anyone talk about business with Dee Wyly? A. No. Q. In the 34 years, thereabouts, that you've known Dee Wyly, have you ever talked business with her? A. No. Q. To your knowledge, did anyone inform Dee Wyly about the intricacies of the offshore trust system? A. Not to my knowledge, no."), 164:5–165:3(Dee) (first heard the name Soulieana at her deposition in July 2015, never discussed IOM structure with anyone before bankruptcy case filed), 165:22–166:23; 174:16–24(Dee) (didn't ever see Eiseman or Marguerite Green invoices at the time purchases were made), 182:10–183:3; 183:18–20(Dee) (never heard of Tyler IOM Trust or Keith King), 184:20–185:11, 186:12–15(Dee) (never heard of Red Mountain IOM Trust or Shaun Cairns), 322:6–14(Dee) (does not know what a limited partner, general partner, limited partnership, or annuity is), 188:22–189:9(Dee) (never heard of Lincoln Creek IOM Trust), 192:8–11(Dee) (never heard of Maroon Limited (IOM)).

1433 *Id.* at 164:5–165:3(Dee); 322:13–14(Dee).

1434 *Id.* at 151:8–24(Dee).

1435 *Reser,* 112 F.3d at 1268.

1436 *See* p. 446 n. 573, *supra.*

1437 *Reser*, 112 F.3d at 1269.

1438 Tr. Trans. 3027:14–16 (Dubinsky).

1439 *Reser,* 112 F.3d at 1262 n. 11.

1440 *See* 26 U.S.C. § 6013.

1441 *See id.* §§ 6013, 6038, 6048, 6677.

1442 Tr. Trans. 160:10–161:14(Dee).

1443 *Belk v. C.I.R.,* 93 T.C. 434 (1989); *see also Sanders v. C.I.R.,* 21 T.C. 1012, 1040 (1954) ("A wife required to file a return because of income of her husband in a community property state or who joins in a joint return cannot shed the responsibility for delinquency by saying that she relied entirely on her husband, not a specially qualified tax authority."). *But see Fleming v. C.I.R.,* 47 T.C.M. (CCH) 1281, 1984 WL 15452 (1984) ("Petitioner recognized the need to file tax returns, and occasionally asked her husband and his counsel about filing returns. In response to her inquiries, she was told that filing returns was not her concern."); *Connor v. C.I.R.,* 44 T.C.M. (CCH) 6, 1982 WL 10600 (1982) (husband was travelling musician who concealed finances from wife. Wife was honestly ignorant of husband's large income and had all inquiries about financial matters angrily rebuffed); *Crane v. C.I.R.,* 44 T.C.M. (CCH) 213, 1982 WL 10648 (1982) (husband was a tax protestor who refused to tell wife how much he earned and who actively dissuaded her from trying to file her own tax return).

1444 64 T.C.M. (CCH) 1662, 1992 WL 385385, at *2 (1992).

1445 *Id.* at *5.

1446 *See, e.g., id.*

1447 *Boyle,* 469 U.S. at 251, 105 S.Ct. 687.

1448 U.S. CONST. amend. VIII.

1449 *U.S. v. Bajakajian,* 524 U.S. 321, 327, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998) (labeling the relevant portion of the Eighth Amendment as the "Excessive Fines Clause").

1450 These four cases are *U.S. v. Halper,* 490 U.S. 435, 109 S.Ct. 1892, 104 L.Ed.2d 487 (1989); *Browning–Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc.,* 492 U.S. 257, 109 S.Ct. 2909, 106 L.Ed.2d 219 (1989); *Austin v. U.S.,* 509 U.S. 602, 113 S.Ct. 2801, 125 L.Ed.2d 488 (1993); and *U.S. v. Bajakajian,* 524 U.S. 321, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998). The Court notes that the Debtors do not ask the Court to find that the International Penalties are unconstitutional on their face, but only as applied to them here. This approach is consistent with the Supreme Court's Excessive Fines Clause jurisprudence, which has exclusively considered whether a fine is excessive as to a particular person as opposed to in all instances. *See, e.g., U.S. v. Bajakajian,* 524 U.S. 321, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998).

1451 IRS Post–Trial Brief [ECF No. 1118] at 95.

1452 *U.S. v. Halper,* 490 U.S. 435, 109 S.Ct. 1892, 104 L.Ed.2d 487 (1989).

1453 *See Bajakajian,* 524 U.S. at 327, 118 S.Ct. 2028 ("We have, however, explained that at the time the Constitution was adopted, the word fine was understood to mean a payment to a sovereign as punishment for some offense. The Excessive Fines Clause thus limits the government's power to extract payments, whether in cash or in kind, as punishment for some offense." (internal cites and quotation marks deleted) (quoting *Austin,* 509 U.S. at 609–610, 113 S.Ct. 2801; *Browning–Ferris Indus.,* 492 U.S. at 265, 109 S.Ct. 2909.

1454 *Halper,* 490 U.S. at 437, 109 S.Ct. 1892.

1455 *Id.*

1456 *Id.*

1457 *Id.*

1458 U.S. CONST. amend. V.

1459 *Halper,* 490 U.S. at 443, 109 S.Ct. 1892.

1460 *Id.* at 448–49, 109 S.Ct. 1892.

1461 *Id.*

1462 *Id.* at 448, 109 S.Ct. 1892.

1463 *Hudson v. U.S.,* 522 U.S. 93, 96, 101, 102, 118 S.Ct. 488, 139 L.Ed.2d 450 (1997). The Debtors fail to mention *Hudson* in their briefing. However, the *Hudson* Court also notes that some of the concerns addressed in *Halper* are addressed more appropriately by the Excessive Fines Clause than the Double Jeopardy Clause. *Id.* at 102–03, 118 S.Ct. 488.

1464 *Halper,* 490 U.S. at 449, 109 S.Ct. 1892.

1465 *Id.* at 451, 109 S.Ct. 1892.

1466 *Id.* at 446, 109 S.Ct. 1892.

1467 *Id.* at 449, 109 S.Ct. 1892 ("We acknowledge that this inquiry will not be an exact pursuit. In our decided cases we have noted that the precise amount of the Government's damages and costs may prove to be difficult, if not impossible, to ascertain. *See, e.g., Rex Trailer* [*Co. v. U.S.*], 350 U.S. [148] at 153, 76 S.Ct. [219], at 222 [100 L.Ed. 149 (1956)]. Similarly, it would be difficult if not impossible in many cases for a court to determine the precise dollar figure at which a civil sanction has accomplished its remedial purpose of making the Government whole, but beyond which the sanction takes on the quality of punishment. In other words, as we have observed above, the process of affixing a sanction that compensates the Government for all its costs inevitably involves an element of rough justice. Our upholding reasonable liquidated damages clauses reflects this unavoidable imprecision. Similarly, we have recognized that in the ordinary case fixed-penalty-plus-double-damages provisions can be said to do no more than make the Government whole.")

1468 492 U.S. at 263–64, 109 S.Ct. 2909.

1469 *Id.* at 280, 109 S.Ct. 2909.

1470 *Id.* at 265, 109 S.Ct. 2909.

1471 509 U.S. at 604, 113 S.Ct. 2801.

[1472] *Id.* at 609–10, 622, 113 S.Ct. 2801 (quoting *Browning–Ferris Indus.,* 492 U.S. at 265, 109 S.Ct. 2909 (internal quotation marks omitted)).

[1473] *Id.* at 609–10, 113 S.Ct. 2801.

[1474] *Id.* at 620 n. 12, 113 S.Ct. 2801.

[1475] *Id.* at 621, 113 S.Ct. 2801 (alterations in original omitted) (quoting *U.S. v. Ward,* 448 U.S. 242, 254, 100 S.Ct. 2636, 65 L.Ed.2d 742 (1980)).

[1476] *Id.* at 621–22, 113 S.Ct. 2801.

[1477] *Id.* at 622 n. 14, 113 S.Ct. 2801.

[1478] *Id.* at 610–11, 622, 113 S.Ct. 2801.

[1479] 524 U.S. 321, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998).

[1480] *Id.* at 327, 118 S.Ct. 2028 ("This Court has had little occasion to interpret, and has never actually applied, the Excessive Fines Clause.").

[1481] *Id.* at 325, 118 S.Ct. 2028.

[1482] *Id.*

[1483] *Id.* at 325, 339, 118 S.Ct. 2028.

[1484] *Id.* at 326, 118 S.Ct. 2028.

[1485] *Id.* at 328, 118 S.Ct. 2028.

[1486] *Id.* at 329 n. 4, 118 S.Ct. 2028 ("We do not suggest that merely because the forfeiture of respondent's currency in this case would not serve a remedial purpose, other forfeitures may be classified as nonpunitive (and thus not 'fines') if they serve some remedial purpose as well as being punishment for an offense. Even if the Government were correct in claiming that the forfeiture of respondent's currency is remedial in some way, the forfeiture would still be punitive in part. (The Government concedes as much.) This is sufficient to bring the forfeiture within the purview of the Excessive Fines Clause. *See Austin,* 509 U.S. at 621–622, 113 S.Ct. 2801, 2811–2812, 125 L.Ed.2d 488 (1993)").

[1487] *Id.* at 333, 118 S.Ct. 2028.

[1488] *Id.* at 334, 118 S.Ct. 2028.

[1489] *Id.* at 336, 118 S.Ct. 2028 (citing *Solem v. Helm,* 463 U.S. 277, 290, 103 S.Ct. 3001, 77 L.Ed.2d 637 (1983) ("Reviewing courts ... should grant substantial deference to the broad authority that legislatures necessarily possess in determining the types and limits of punishments for crimes"); *Gore v. U.S.,* 357 U.S. 386, 393, 78 S.Ct. 1280, 1285, 2 L.Ed.2d 1405 (1958) ("Whatever views may be entertained regarding severity of punishment, ... these are peculiarly questions of legislative policy")).

[1490] *Id.*

[1491] *Id.*

[1492] *Id.* at 337, 118 S.Ct. 2028.

[1493] *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028.

[1494] *Id.* at 334, 118 S.Ct. 2028.

[1495] *Austin,* 509 U.S. at 622, 113 S.Ct. 2801 (quoting *Browning–Ferris,* 492 U.S. at 265, 109 S.Ct. 2909).

[1496] *Id.* at 621, 113 S.Ct. 2801 (citing *Halper,* 490 U.S. at 448, 109 S.Ct. 1892).

[1497] *Bajakajian,* 524 U.S. at 337, 118 S.Ct. 2028.

[1498] *Id.* at 337–40, 118 S.Ct. 2028; *U.S. v. Varrone,* 554 F.3d 327, 331 (2d Cir.2009).

[1499] The Debtors cite two district court cases—*Callister Nebeker & McCullough v. U.S.* and *Crawford v. U.S. Dept. of the Treasury* —that do not decide whether tax penalties under 26 U.S.C. § 6708 and 31 U.S.C. § 5314 are excessive due to lack of a sufficient factual record and neglect to discuss whether they are fines. *Callister Nebeker & McCullough v. U.S.,* 2015 WL 5918494 (D.Utah Oct. 9, 2015); *Crawford v. U.S. Dept. of the Treasury,* 2015 WL 5697552, at *4 (S.D.Ohio Sept. 29, 2015). The Debtors also cite a case in which a district court judge lowered the criminal contempt fine imposed by a bankruptcy judge from $10,000 to $3,000. *In re Swaffar,* 253 B.R. 441, 451 (Bankr.E.D.Ark.2000). As the Eleventh Circuit has noted, the concerns at play when evaluating a judicially imposed fine are very different than those that are at play when evaluating a legislatively imposed fine.). *U.S. v. 817 N.E. 29th Drive, Wilton Manors, Fla.,* 175 F.3d 1304, 1309 (11th Cir.1999).

[1500] The Court does recognize that the Supreme Court has declared a unique and obviously punitive tax to be punishment for the purposes of a double jeopardy analysis. *See Dept. of Rev. of Mont. v. Kurth Ranch,* 511 U.S. 767, 114 S.Ct. 1937, 128 L.Ed.2d 767 (1994) (characterizing a tax as punishment for the purposes of a double jeopardy analysis but in discussing the Eighth Amendment specifically noting that "[a] civil forfeiture may violate the Eighth Amendment's proscription against excessive fines. *Austin v. U.S.,* 509 U.S. 602, 113 S.Ct. 2801, 125 L.Ed.2d 488 (1993).").

[1501] 13 F.3d 432 (1st Cir.1993).

[1502] *Id.* at 434.

[1503] *Id.*

[1504] *Id.* at 434–35.

[1505] *Id.* at 435.

[1506] 303 U.S. 391, 58 S.Ct. 630, 82 L.Ed. 917 (1938).

[1507] *Id.* at 401, 58 S.Ct. 630. In fairness, *Helvering v. Mitchell* and *McNichols* both involved fraud penalties, which are different in many respects from the International Penalties at issue here. In addition, *Helvering v. Mitchell* was decided before *Austin* recast the inquiry of what constitutes "punishment" under the Eighth Amendment.

[1508] *Id.*

[1509] *Bickham Lincoln–Mercury Inc. v. U.S.*, 168 F.3d 790, 795 (5th Cir.1999).

[1510] *John Corp. v. City of Houston,* 214 F.3d 573, 580 (5th Cir.2000) (quoting *Ingraham v. Wright,* 430 U.S. 651, 664, 97 S.Ct. 1401, 51 L.Ed.2d 711 (1977)).

[1511] *Austin,* 509 U.S. at 622, 113 S.Ct. 2801 (quoting *Browning–Ferris Indus.,* 492 U.S. at 265, 109 S.Ct. 2909).

[1512] *Id.* at 602, 113 S.Ct. 2801.

[1513] JCS–12–96 NO 9 (I.R.S.), 1996 WL 34405424, at *56 (Dec. 18, 1996) (emphasis added) (hereinafter "**General Explanation** "). The Debtors correctly point out that this report of the Joint Committee on Taxation is not true legislative history, as it was prepared *after* the passage of the Small Business Job Protection Act of 1996. *See Estate of Wallace v. C.I.R.,* 965 F.2d 1038, 1050 n. 15 (11th Cir.1992) ("We cite the General Explanation not as an expression of legislative intent, as it was prepared by committee staff after enactment of the statute, but as a valuable aid to understanding the statute. We accord it no weight as binding authority on legislative intent."). However, the Fifth Circuit has noted in a tax context that the views of such Joint Committee Reports "are entitled to great respect." *McDonald v. C.I.R.,* 764 F.2d 322, 336 (5th Cir.1985) ("The Joint Committee is a staff committee, and its 'Explanation' was issued after the fact. Hence it does not directly represent the views of the legislators or an explanation available to them when acting on the bill. The Joint Committee's views, however, are entitled to great respect."). The Court also notes that while the statutory penalty amounts under 26 U.S.C. § 6038 were not increased until 1997, the 1996 General Explanation explicitly names § 6038 as one of the subsections that is being changed because of concerns regarding noncompliance with laws related to foreign trusts. *See* Taxpayer Relief Act of 1997, Pub.L. No. 105–34, § 6038, 111 Stat. 788 (1997) (increasing penalties for violations of § 6038); General Explanation at *54–56 (listing § 6038 as one of the sections that the General Explanation is discussing).

[1514] General Explanation, 1996 WL 34405424, at *55.

[1515] 26 U.S.C. § 6038(b).

[1516] *Id.* at §§ 6048(b), 6677. Violations of § 6048(a) or (c)—for which this Court has held the Debtors are not liable—result in penalties of $10,000 or 35% of the value of the property involved in the unreported transfer or distribution, whichever is greater. 26 U.S.C. §§ 6048(a), (c), 6677.

[1517] *See* IRS' Amended Proposed Findings of Facts and Conclusions of Law [ECF No. 1103] ¶ 270.

[1518] General Explanation, 1996 WL 34405424, at *56 ("The Congress understood that some of the jurisdictions in which U.S. settlors established foreign trusts have strict secrecy laws. The Congress was concerned that the secrecy laws may effectively preclude the Treasury Department from obtaining information necessary to determine the tax liabilities of the U.S. grantors or U.S. beneficiaries with respect to items related to such foreign trusts.").

[1519] *Austin,* 509 U.S. at 622 n. 14, 113 S.Ct. 2801 (quoting *Halper,* 490 U.S. at 448, 109 S.Ct. 1892).

[1520] *U.S. v. Alt,* 83 F.3d 779, 782 (8th Cir.1996) (emphasis in the original).

[1521] *Bickham Lincoln–Mercury Inc.*, 168 F.3d at 795.

[1522] *Newell Recycling Co., Inc. v. U.S. E.P.A.*, 231 F.3d 204, 210 (5th Cir.2000).

[1523] *McNichols,* 13 F.3d at 434.

[1524] *Hudson,* 522 U.S. at 102, 118 S.Ct. 488.

[1525] *Austin,* 509 U.S. at 621, 113 S.Ct. 2801 (emphasis in original) (quoting *Halper,* 490 U.S. at 448, 109 S.Ct. 1892).

[1526] *Bajakajian,* 524 U.S. at 331, 118 S.Ct. 2028.

[1527] *Id.* at 336–37.

[1528] *Thomas v. C.I.R.,* 62 F.3d 97, 103 (4th Cir.1995).

[1529] 106 T.C.M. (CCH) 523, 2013 WL 5988939, at *26–27 (2013) (citing *Thomas,* 62 F.3d at 103, and holding that 26 U.S.C. § 6662(h) did not violate the Excessive Fines Clause).

[1530] *Halper,* 490 U.S. at 446, 109 S.Ct. 1892.

1531 *Id.* at 449, 109 S.Ct. 1892.

1532 389 F.3d 483 (5th Cir.2004).

1533 *Id.* at 486 (quoting *817 N.E. 29th Drive,* 175 F.3d at 1309.

1534 175 F.3d 1304 (11th Cir.1999).

1535 *Id.* at 1309. *See Browning–Ferris Indus.,* 492 U.S. at 290, 109 S.Ct. 2909 (O'Connor, J., concurring in part and dissenting in part) (stating that in seventeenth-century England, the imposition of fines was solely a judicial function).

1536 *Id.* at 487; *see also U.S. v. George,* 779 F.3d 113 (2d Cir.2015) (considering the ongoing nature of a violation in the context of an Excessive Fines Clause analysis).

1537 *U.S. v. Wallace,* 389 F.3d 483, 487 (5th Cir.2004).

1538 231 F.3d 204 (5th Cir.2000).

1539 *Id.* at 210. The Debtors argue in their post-trial reply that an interpretation of the Excessive Fines Clause where a statutory maximum is always constitutionally permissible is one where "the statute would swallow the Constitution." *See* Debtors' Post–Trial Reply Brief [ECF No. 1121] at 80. However, the Debtors' argument ignores the fact that *Austin* and *Bajakajian* were decided in the context of forfeitures, sanctions that are not just different in degree but different in kind from the International Penalties. The Debtors also fail to reconcile their approach with the Fifth Circuit's pronouncements in *Wallace* and *Newell Recycling.*

1540 *But see Vanderbilt Mortg. and Fin., Inc. v. Flores,* 692 F.3d 358, 374 (5th Cir.2012) ("Even assuming that the Clause has been incorporated against the states, the fine in question—$10,000 for filing a fraudulent lien—is not 'grossly disproportional to the gravity of a defendant's offense.' " (quoting *Bajakajian,* 524 U.S. at 334, 118 S.Ct. 2028)).

1541 Computation Stipulations ¶¶ 7.A through 9. Were the Court to include the Form 3520 penalties for which it has found that Sam is not liable in the first instance, this figure would climb to $590,428,940. *Id.*

1542 *Bajakajian,* 524 U.S. at 337, 118 S.Ct. 2028.

1543 *Id.* at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

1544 *U.S. v. Ahmad,* 213 F.3d 805 (4th Cir.2000).

1545 *Austin,* 509 U.S. at 621, 113 S.Ct. 2801 (quoting *U.S. v. Ward,* 448 U.S. 242, 254, 100 S.Ct. 2636, 65 L.Ed.2d 742 (1980)).

1546 *Bajakajian,* 524 U.S. at 339, 118 S.Ct. 2028.

1547 26 U.S.C. § 6677(b).

1548 This analysis is different for violations of § 6038. Although income from controlled foreign corporations is taxable to the controlled foreign corporation's owner under 26 U.S.C. § 951, violations of § 6038 result in a flat fine of $10,000 per violation. Although in certain cases this could make penalties under § 6038 more disproportional than penalties under § 6677, the Court notes that this is certainly not the case here. The minimum penalty under § 6677 is $10,000 per violation, and percentage-based penalties apply here because of the extent of the Wyly wealth that was placed offshore and that Debtors did not report on Form 3520–A. *See* 26 U.S.C. § 6677. Less than 5% of Sam's or Dee's liability for International Penalties is for violations of § 6038. *See* Computation Stipulations ¶¶ 9.A through, 10, 22.a through 23.

1549 *Thomas,* 62 F.3d at 103.

1550 *See, e.g., U.S. v. Wallace,* 389 F.3d 483 (5th Cir.2004) (quoting *U.S. v. 817 N.E. 29th Drive,* 175 F.3d 1304, 1309 (11th Cir.1999)).

1551 *See, e.g., Wallace,* 389 F.3d at 485–86 (quoting *817 N.E. 29th Drive,* 175 F.3d at 1309).

1552 *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

1553 *See* IRS Exs. 567 (Hennington writes to Alan Stroud, a lawyer at Meadows Owens "I am sure I read this at the time and overlooked or did not pay attention to the 3520 filing requirement. It seems that we would have preferred to not have anything reportable on the note if that was a possibility."), 570 (email between Hennington and Boucher where Hennington expresses a lot of concern that certain loans may be subject to reporting requirements); SEC Tr. Trans. 1720:14–1721:6 (French) (Tedder said to Sam that making SEC filing could jeopardize the tax status of the offshore system).

1554 *See* IRS Exs. 567, 570.

1555 *See* IRS Ex. 412 (French fax noting the need to avoid SEC reporting requirements); IRS Exs. 567 and 570; SEC Tr. Trans. 1720:14–1721:6 (French) (Tedder said to Sam that making SEC filing could jeopardize the tax status of the offshore system); Joint Exs. 142, 175 (Forms 3520 and 3520–A that the Wylys did file gave a false impression of the offshore system, as they did not include forms for the trusts through which most of the offshore transactions flowed, many of these forms were not dated or signed, and were filed on versions of IRS forms that indicated the forms had been filed late).

1556 General Explanation, 1996 WL 34405424, at *56. Of note is the fact that the IRS Agent in charge of the international side of the audit of Sam and Charles noted that, as of the time of trial, the IRS had still not received any documents directly from the Cayman Islands. Tr. Trans. 1581:21–1582:17 (Herrick).

[1557] *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

[1558] General Explanation, 1996 WL 34405424, at *56.

[1559] *See* IRS Exs. 85 (June 12, 1991 memorandum from Robertson to Sam, Charles, Evan, French, and Ethel Ketter, in-house CPA for the Wyly family office, discussing Tedder's seminar on asset protection and tax deferral) at SECI00150278 (discussing controlled foreign corporations and recommending multiple jurisdictions, including Cayman and IOM, followed by the statement that "Tedder says all tax haven governments are stable at this time"), 111 (Wyly Family Foreign Trust Planning Confidential Conference Outline dated September 7, 2000) at SWYLY009418, § II.C.2 (referring to the 1992 IOM trusts as having "tax haven status").

[1560] *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

[1561] *Bajakajian,* 524 U.S. at 338, 118 S.Ct. 2028.

[1562] Debtors' Post–Trial Reply Brief [ECF No. 1121] at 81. The Court notes an issue with this number. The IRS maintains, without providing its own figure, that the Debtors "conveniently ignore the substantial amounts of interest due on their unpaid income tax liabilities for all of the years during which they use of funds *[sic]* belonging to the United States." IRS Post–Trial Reply Brief [ECF No. 1120] at 71. The Debtors also note in their post-trial reply that their estimate could be revised to be even lower "when the stipulated income figures are worked through the 'tax return' software of the IRS for the appropriate years, after the Court renders its decision. Debtors' Post–Trial Reply Brief [ECF No. 1121] at 81 n.219. Based on its own calculations derived from the Computation Stipulations, the Court calculates Sam's tax liability for years 1996 through 2013 to exceed $300,000,000. *See* Computation Stipulations Attachment A. For the purposes of its Excessive Fines Clause analysis, the Court will assume that the Debtors' figure, which according to the IRS and the Court's own calculations is low, is correct.

[1563] Sam's counsel also argued at closing, without citation to evidence, that these penalties are 1.4 times greater than the stipulated-to income amounts. Tr. Trans. 3630:5–15 (Cole) ("[M]ost of the money at issue here is from these failure to file penalties. They exceed not only the income tax, but the total income that the parties have stipulated to").

[1564] *See* pp. 414–15, 488–95, *supra.*

[1565] *See* pp. 421–23, 494–98, *supra.*

[1566] *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

[1567] 26 U.S.C. § 6677.

[1568] *Id.* § 6677(c)(2).

[1569] *Id.*

[1570] Computation Stipulations ¶¶ 20.A—21. If the Court included the Form 3520 penalties, for which it has found that Dee is not liable, this figure would climb to $341,348,276. *Id.*

[1571] 492 F.3d 175 (2d Cir.2007).

[1572] *Id.*

[1573] *Id.* at 179.

[1574] *Id.*

[1575] *Id.*

[1576] *Id.*

[1577] *Id.*

[1578] *Id.* at 180.

[1579] *Id.* at 188–189.

[1580] *Id.* at 179.

[1581] *Id.* at 189.

[1582] *Id.* at 191.

[1583] *Id.* at 188.

[1584] *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

[1585] Tr. Trans. 151:8–24 (Dee testifying that she "literally never" discussed business with Charles), 164:5–165:3(Dee), 322:13–14. (Dee testifying that she never discussed the offshore system with any other person).

[1586] *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

[1587] General Explanation, 1996 WL 34405424, at *56.

[1588] Tr. Trans. 159:20–160:15 (Dee testifying that she relied entirely on husband throughout marriage).

[1589] *Id.* at 159:13–19(Dee) ("Q. Have you ever prepared a tax return? A. Oh, heavens no."), 172:17–19 (Dee testifying that she never discussed tax matters with husband).

[1590] *Id.* at 159:13–160:9, 293:2–294:23(Dee).

1591 *von Hofe,* 492 F.3d at 189.

1592 *Bajakajian,* 524 U.S. at 337–40, 118 S.Ct. 2028; *Varrone,* 554 F.3d at 331.

1593 *See Petrella v. Metro–Goldwyn–Mayer, Inc.,* ––– U.S. ––––, 134 S.Ct. 1962, 1967, 188 L.Ed.2d 979 (2014) (characterizing laches as an equitable defense); FED. R. CIV. P. 8 (c) (listing laches as an affirmative defense).

1594 908 F.2d 18 (5th Cir.1990).

1595 *Id.* at 19.

1596 *Id.* at 25.

1597 26 U.S.C. § 6501. It is unclear whether § 6501 applies to the IRS' claims for penalties. Although § 6501 is a limitation on the time period for assessment of "taxes" and not "penalties," 26 U.S.C. § 6665(a)(2) states that "[a]ny reference in this title to 'tax' imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and the penalties provided by this chapter." 26 U.S.C. § 6663 is a part of the chapter to which § 6665 refers, and could thus be encompassed by the language of § 6501 referring to "taxes." Despite this reading, under *Sage,* it is arguable that there is no statute of limitations for collection of fraud penalties, as no statute of limitations appears on the face of § 6663 and the *Sage* court refused to apply language similar to § 6665 in order to expand the § 6501 statute of limitations. *Sage,* 908 F.2d at 25. However, it must be remembered that the *Sage* court reached this conclusion and allowed the IRS to assert penalties in part because of the Supreme Court's mandate that "[s]tatutes of limitations must receive a strict construction in favor of the government." *Id.* at 24 (citing *Badaracco v. C.I.R.,* 464 U.S. 386, 104 S.Ct. 756, 78 L.Ed.2d 549 (1984)). Another issue is that even if § 6501 does create a statute of limitations applicable to the assessment of fraud penalties, these penalties may be sought "at any time" under the terms of § 6501(c)(1). An effectively unlimited statute of limitations may be subject to the same analysis as a lack of a statute of limitations where laches is concerned. Finally, no statute of limitations appears on the face of those statutes that impose the International Penalties. *See* 26 U.S.C. §§ 6038, 6048, 6677. *But see* 26 U.S.C. § 6501(c)(8)("(A) In general.—In the case of any information which is required to be reported to the Secretary pursuant to an election under section 1295(b) or under section 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any tax return, event, or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section. (B) Application to failures due to reasonable cause.—If the failure to furnish the information referred to in subparagraph (A) is due to reasonable cause and not willful neglect, subparagraph (A) shall apply only to the item or items related to such failure."). Regardless of whether § 6501 does or does not apply to certain of the IRS' claims, the Court still concludes that laches does not bar any of the IRS' claims because laches may not be invoked in order to prevent the collection of taxes and because the elements of laches have not been satisfied.

1598 26 U.S.C. §§ 6501(c)(1), (c)(8).

1599 134 S.Ct. at 1974.

1600 22 F.3d 631, 634 (5th Cir.1994); *Lucia v. U.S.,* 474 F.2d 565, 570 (5th Cir.1973) (acknowledging in dicta that there are cases—including one from the Supreme Court—that hold that "in the enforcement of Government tax claims, the United States is not barred by a laches defense."); *see also U.S. v. Weintraub*, 613 F.2d 612, 618 (6th 1979) (holding that the government is exempt from the consequences of laches); *Jacksonville Paper Co. v. Tobin,* 206 F.2d 333, 334 (5th Cir.1953) (referring to the "well established rule that the United States is not bound by state statutes of limitations or by laches."); *Redstone v. C.I.R.,* 110 T.C.M. (CCH) 564, 2015 WL 8479063, at *8 (2015) (citing to *Fein* in refusing to apply laches).

1601 *See, e.g., U.S. v. Fernon,* 640 F.2d 609, 612 (5th Cir. Unit B 1981) ("it is well settled that the United States is not bound by state statutes of limitation or subject to the defense of laches in enforcing its rights" (internal citations and quotation marks omitted) (quoting *U.S. v. Summerlin,* 310 U.S. 414, 416, 60 S.Ct. 1019, 84 L.Ed. 1283 (1940)).

1602 310 U.S. 414, 416, 60 S.Ct. 1019, 84 L.Ed. 1283 (1940).

1603 46 F.3d 670, 673 (7th Cir.1995); *see also Dial v. C.I.R.,* 968 F.2d 898, 904 (9th Cir.1992) ("laches is not a defense to the United States' enforcement of tax claims.").

1604 *Tregre v. C.I.R.,* T.C. Memo. 1996–243, 1996 WL 272947, at *11 (1996), *aff'd,* 129 F.3d 609 (5th Cir.1997) (unpublished).

1605 *Johnson v. Crown Enter., Inc.,* 398 F.3d 339, 344 (5th Cir.2005) (internal quotation marks omitted) (quoting *Goodman v. Lee,* 78 F.3d 1007, 1014 (5th Cir.1996) (quoting *Geyen v. Marsh,* 775 F.2d 1303, 1310 (5th Cir.1985)).

1606 Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 188.

1607 *See, e.g., Niedringhaus,* 99 T.C. at 209 (six years elapsed between beginning of criminal investigation and tax court decision); *Paschal v. C.I.R.,* 68 T.C.M. (CCH) 366, 1994 WL 424015 (1994) (Over ten years elapsed between when taxpayer was notified that he was subject to a criminal investigation and the tax court decision).

[1608] *See* pp. 394–407, 446, *supra.*

[1609] *Michigan Exp., Inc. v. U.S.,* 374 F.3d 424, 427 (6th Cir.2004) (internal quotation marks omitted) (*quoting Fisher v. Peters,* 249 F.3d 433, 444 (6th Cir.2001)).

[1610] *Knapp v. U.S. Dept. of Agriculture,* 796 F.3d 445, 461 (5th Cir.2015). Since the party seeking to invoke estoppel must establish these things, the burden of proof is on the party asserting estoppel. *See id.*; *see also* FED. R. CIV. P. 8(c)(1) (identifying estoppel as an affirmative defense).

[1611] *Robertson–Dewar v. Holder,* 646 F.3d 226, 229 (5th Cir.2011) (internal quotation marks omitted) (quoting *Office of Pers. Mgmt. v. Richmond,* 496 U.S. 414, 110 S.Ct. 2465, 110 L.Ed.2d 387 (1990) (noting that the Supreme Court has "reserved every finding of estoppel that we have reviewed")).

[1612] *Knapp,* 796 F.3d at 461 ("Our court has not decided whether equitable estoppel may lie against the government, but even if it does, 'the burden that a petitioner must meet is very high.') (quoting *Robertson–Dewar,* 646 F.3d at 230); *see also Heckler v. Community Health Services of Crawford County, Inc.,* 467 U.S. 51, 60, 104 S.Ct. 2218, 81 L.Ed.2d 42 (U.S.,1984) ("We have left the issue open in the past, and do so again today."). *But see Simmons v. U.S.,* 308 F.2d 938, 945 (5th Cir.1962) ("it is well settled that the doctrine of equitable estoppel, in proper circumstances, and with appropriate caution, may be invoked against the United States in cases involving internal revenue taxation.").

[1613] *Id.* at 460; *Robertson–Dewar,* 646 F.3d at 230; *see also U.S. v. Marine Shale Processors,* 81 F.3d 1329, 1351 (5th Cir.1996). ("the burden on a party seeking to estop the United States is heavy indeed."); *Jones v. Dept. of Health & Human Services,* 843 F.2d 851, 853 (5th Cir.1988) ("A private individual asserting estoppel against the government has a very heavy burden to bear.").

[1614] *Heckler,* 467 U.S. at 60, 104 S.Ct. 2218; *see also Marine Shale Processors,* 81 F.3d at 1349 (noting that applying the doctrine of equitable estoppel against the government can raise a variety of potential separation of powers problems). The tax court made similar observations in a tax context. *Nadler v. C.I.R.,* 64 T.C.M. (CCH) 70, 1992 WL 156029 (1992) ("a person might sustain such a profound and unconscionable injury in reliance on the Commissioner's action as to require, in accordance with any sense of justice and fair play, that the Commissioner not be allowed to inflict the injury. It is to be emphasized that such situations must necessarily be rare, for the policy in favor of an efficient collection of the public revenue outweighs the policy of the estoppel doctrine in its usual and customary context." (quoting *Schuster v. C.I.R.,* 312 F.2d 311, 317 (9th Cir.1962)).

[1615] *Fano v. O'Neill,* 806 F.2d 1262, 1265 (5th Cir.1987) (citation and internal quotation marks omitted) (quoting *Heckler,* 467 U.S. at 60–61, 104 S.Ct. 2218). *See also Fredericks v. C.I.R.,* 126 F.3d 433, 443 (3d Cir.1997); *Walsonavich v. U.S.,* 335 F.2d 96, 101 (3d Cir.1964) ("While it is true estoppel is to be rarely invoked against the United States ... there are circumstances where the Government should be required by our law to stand behind the written agreements of a high public official like the Commissioner ... in order to prevent manifest injustice.") (internal citations omitted).

[1616] Debtors' Pre–Trial Brief [ECF No. 1015] at ¶ 194.

[1617] *Marine Shale Processors,* 81 F.3d at 1350; *Ingalls Shipbuilding, Inc. v. Director, Office of Workers' Comp. Programs, U.S. Dept. of Labor,* 976 F.2d 934, 938 (5th Cir.1992); *see Michigan Exp., Inc. v. U.S.,* 374 F.3d 424, 427 (6th Cir.2004) ("Finding the common approach of sister circuits prudential, we hold that "affirmative misconduct" is more than mere negligence. It is an act by the government that either intentionally or recklessly misleads the claimant. The party asserting estoppel against the government bears the burden of proving an intentional act by an agent of the government and the agent's requisite intent.").

[1618] *Fano,* 806 F.2d at 1265; *see also Peacock v. U.S.,* 597 F.3d 654, 661 (5th Cir.2010) (where the United States did not realize that a doctor who had allegedly performed an operation negligently was not its employee for over a year, and upon discovering this information filed a successful motion to dismiss plaintiff's claims against it, "[w]hile the length of time it took for this information to come to light was unreasonably long, this is not an indication of willful misconduct on the Government's part. Thus, the district court did not abuse its discretion in rejecting Peacock's argument that the Government should be judicially estopped from claiming that Dr. Warner was an independent contractor.").

[1619] *Robertson–Dewar,* 646 F.3d at 229 (internal marks omitted) (quoting *Linkous v. U.S.,* 142 F.3d 271, 278 (5th Cir.1998)); *Moosa v. I.N.S.,* 171 F.3d 994, 1004 (5th Cir.1999) (internal marks omitted) (quoting *Linkous,* 142 F.3d at 278)).

[1620] Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 188.

[1621] Wyly Ex. OB at WYLYSEC01112418 ("All here are with Counsel. We do not have settlement authority. Our Client is the operational side of IRS ... "), WYLYSEC01112421 ("Don't usually do this much on anonymous basis. At what point will you say who you are? ... Counsel can only do so much as to general resolution. We can give input into how to resolve these cases, more globally for all affected cases."), WYLYSEC01112422 ("Someone has to say it's okay to settle."), WYLYSEC01112423 ("Can't give you any promises"). An IRS Counsel attorney who was at the meeting testified that no

IRS client representative attended the meeting. Tr. Trans. 2864:8–10 (Grimm). Furthermore, Lubar testified regarding this meeting that "I think they were prepared to have one more meeting without identifying the clients, but they made it clear that after that, if we really wanted to try to settle this, obviously we had to reveal who the clients were, and that was a big step, of course." Lubar Depo. Trans. 79:18–80:4.

[1622] Wyly Ex. OB at WYLYSEC01112422. Furthermore, one of the IRS Office of the Chief Counsel attorneys to whom this statement is attributed—Grimm—said that "the Office of Chief Counsel never selects an issue champion. It's the IRS that does, and they don't always select an issue champion for issues." Tr. Trans. 2871:7–13 (Grimm). Grimm also specifically testified that "[n]o one in Chief Counsel has ever had the authority to select or appoint an issue champion" and that an issue champion does not have the authority to enter into a settlement agreement directly with a taxpayer. *Id.* at 2873:23–2874:3, 2876:11–14 (Grimm).

[1623] Tr. Trans. at 2876:15–18 (Grimm).

[1624] *See, e.g., Walsonavich,* 335 F.2d at 101; *Sanders v. C.I.R.,* 225 F.2d 629, 634 (10th Cir.1955); *Graff v. C.I.R.,* 74 T.C. 743, 762 (1980) (citing *Wilber Nat. Bank v. U.S.,* 294 U.S. 120, 123, 55 S.Ct. 362, 79 L.Ed. 798 (1935)); *Utah Power & Light Co. v. U.S.,* 243 U.S. 389, 409, 37 S.Ct. 387, 61 L.Ed. 791 (1917); *Goldstein v. U.S.,* 227 F.2d 1, 4 (8th Cir.1955); *Midwest Motor Express, Inc. v. C.I.R.,* 27 T.C. 167 (1956), *aff'd,* 251 F.2d 405 (8th Cir.1958), *cert. denied,* 358 U.S. 875, 79 S.Ct. 116, 3 L.Ed.2d 105 (1958)).

[1625] *Marine Shale Processors,* 81 F.3d at 1349 (citing *U.S. v. Walcott,* 972 F.2d 323, 325 (11th Cir.1992)); *see U.S. v. Thompson,* 749 F.2d 189, 193 (5th Cir.1984) ("the government cannot be bound by unauthorized or incorrect statements of its agents."); *Bay Sound Transp. Co. v. U.S.,* 410 F.2d 505, 510 (5th Cir.1969) ("the Government will not be estopped by the unauthorized statements of its agents."); *see also Wright v. Allstate Ins. Co.,* 415 F.3d 384, 388 (5th Cir.2005) ("Whatever the form in which the Government functions, anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority. The scope of this authority may be explicitly defined by Congress or be limited by delegated legislation, properly exercised through the rule-making power. And this is so even though, as here, the agent himself may have been unaware of the limitations upon his authority." (quoting *Fed. Crop Ins. Corp. v. Merrill,* 332 U.S. 380, 384, 68 S.Ct. 1, 92 L.Ed. 10 (1947)).

[1626] *Triplett v. Heckler,* 767 F.2d 210, 213 (5th Cir.1985) (internal quotation marks omitted) (quoting *Thompson,* 749 F.2d at 193; *Hicks v. Harris,* 606 F.2d 65, 69 (5th Cir.1979)).

[1627] Tr. Trans. 2871:7–13 (Grimm). Tr. Trans. 2873:23–2874:3, 2876:11–14 (Grimm). Wyly Ex. OB at WYLYSEC01112418 ("All here are with Counsel. We do not have settlement authority. Our Client is the operational side of IRS.... "), WYLYSEC01112421 ("Don't usually do this much on anonymous basis. At what point will you say who you are? ... Counsel can only do so much as to general resolution. We can give input into how to resolve these cases, more globally for all affected cases."), WYLYSEC01112422 ("Someone has to say it's okay to settle."), WYLYSEC01112423 ("Can't give you any promises"). An IRS Counsel attorney who was at the meeting testified that no IRS client representative attended the meeting. Tr. Trans. 2564:8–10 (Grimm). Furthermore, Lubar testified regarding this meeting that "I think they were prepared to have one more meeting without identifying the clients, but they made it clear that after that, if we really wanted to try to settle this, obviously we had to reveal who the clients were, and that was a big step, of course." Lubar Depo. Trans. 79:18–80:4.

[1628] *U.S. v. Marine Shale Processors,* 81 F.3d 1329, 1349 (5th Cir.1996) (citing *Walcott,* 972 F.2d at 325); *see Thompson,* 749 F.2d at 193 ("the government cannot be bound by unauthorized or incorrect statements of its agents."), *Bay Sound Transp. Co.,* 410 F.2d at 510 ("the Government will not be estopped by the unauthorized statements of its agents."); *see also Wright,* 415 F.3d at 388 ("Whatever the form in which the Government functions, anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority. The scope of this authority may be explicitly defined by Congress or be limited by delegated legislation, properly exercised through the rule-making power. And this is so even though, as here, the agent himself may have been unaware of the limitations upon his authority." (quoting *Merrill,* 332 U.S. at 384, 68 S.Ct. 1).

[1629] 126 F.3d 433 (3d Cir.1997).

[1630] *Id.* at 435.

[1631] *Id.*

[1632] *Id.*

[1633] *Id.*

[1634] *Id.* at 442.

[1635] *Id.* at 441 ("We reject the notion that IRS agents examining Fredericks' file sometime in 1984 could have discovered a Form 872–A that was signed in 1980 and not known that the taxpayer had been misled as to its existence given that the three subsequently executed Forms 872 were also in Fredericks' file. It is exactly this combination of written agreements entered into by the IRS and Fredericks that prompted the IRS to forego soliciting additional one-year extensions.").

[1636] *Id.* at 442 ("Fredericks argues that if he had known the IRS was in possession of the Form 872–A, he would have filed the necessary document (Form 872–T) to terminate the indefinite consent. Relying on the IRS' misrepresentation that the Form 872–A was not in his file, followed by the IRS' repeated requests for Form 872 agreements, Fredericks concluded that it was unnecessary to terminate a consent agreement which the IRS maintained that it never received. He concluded that the subsequent Forms 872 were the only agreements relevant to his 1977 return. On June 30, 1984, when the last one-year Form 872 extension expired, Fredericks believed that the statute of limitations prevented the IRS from assessing any deficiencies.").

[1637] In fact, Grimm testified that she did not discover the identity of the taxpayers being represented at the anonymous meeting until late 2015. Tr. Trans. 2869:9–2870:4 (Grimm).

[1638] *Id.* at 2878:13–17 (Grimm).

[1639] *Heckler,* 467 U.S. at 59, 104 S.Ct. 2218.

[1640] *See id.* at 61–62, 104 S.Ct. 2218 (1984); *Cf. Linkous,* 142 F.3d at 278 ("Although the Plaintiffs baldly assert that Linkous 'relied on the government's actions in holding Dr. Sims out as its employee to her detriment,' the Plaintiffs fail to indicate what Linkous would have done differently had she known that Dr. Sims was a government contractor.").

[1641] *Knapp,* 796 F.3d at 461.

[1642] *Fredericks,* 126 F.3d at 441.

[1643] Wyly Ex. OB.

[1644] Joint Pre–Trial Order [ECF No. 1014] at 5.Y.

[1645] *Valley Ice & Fuel Co., Inc. v. U.S.,* 30 F.3d 635, 640 (5th Cir.1994) (citing *U.S. v. Coastal Ref. & Mktg., Inc.,* 911 F.2d 1036, 1043 (5th Cir.1990)).

[1646] *Coastal Ref. and Mktg., Inc.*, 911 F.2d at 1043.

[1647] *Clark v. Barnard,* 108 U.S. 436, 457, 2 S.Ct. 878, 27 L.Ed. 780 (1883).

[1648] *See* Debtors' Pre–Trial Brief [ECF No. 1015] ¶ 179 (arguing suspension is mandated beginning with the 1998 tax year), 179 n.170 ("There is no suspension for the 2011 and later tax years because the IRS Proofs of claim were issued before the suspension period would begin.").

[1649] As explained by the Code of Federal Regulations, "[t]he suspension period ... begins the day after the close of the 18–month period (36–month period, in the case of notices provided after November 25, 2007 ...) beginning on the later of the date on which the return is filed or the due date of the return without regard to extensions. The suspension period ends 21 days after the earlier of the date on which the IRS mails the required notice to the taxpayer's last known address, the date on which the required notice is hand-delivered to the taxpayer, or the date on which the IRS receives an amended return or other signed written document showing an increased tax liability." 26 C.F.R. § 301.6404–4(a)(4).

[1650] Joint Stipulations ¶¶ 183–196(Sam) and 206–217(Dee).

[1651] Form 5471 is titled "Information Return of U.S. Persons with Respect to Certain Foreign Corporations."

[1652] 26 U.S.C. § 6404(g)(2)(D).

[1653] *Id.* § 6404(g)(2)(B). Mandatory suspension does not apply to gift taxes. *Id.* § 6404(g)(1)(A) (suspending interest for items relating to "a return of tax imposed by subtitle A"—*i.e.,* income taxes); Debtors' Pre–Trial Brief [ECF No. 1015] at ¶ 179 n.168.

[1654] 550 U.S. 501, 127 S.Ct. 2011, 167 L.Ed.2d 888 (2007).

[1655] 142 T.C. 46 (2014).

[1656] Rev. Proc. 2005–38, 2005 WL 1597834, at *3 (eff. July 11, 2005).

[1657] The tax court has refused to give deference to this provision of the Revenue Procedure. *See Corbalis,* 142 T.C. at 54 (holding that § 6404(h) gives the tax court authority to review the both the IRS' decisions not to abate interest under § 6404(e) and suspend interest under § 6404(g)).

[1658] 550 U.S. 501, 127 S.Ct. 2011, 167 L.Ed.2d 888 (2007). The Hincks filed a claim with the IRS contenting that, because of IRS errors and delays, the interest assessed against them for specified periods should be abated under § 6404(e)(1). *Id.* at 505, 127 S.Ct. 2011. The IRS denied the request, and the Hincks then filed suit in the U.S. Court of Federal Claims seeking judicial review of the refusal to abate. *Id.* at 505–06, 127 S.Ct. 2011. The Federal Claims court granted the government's motion to dismiss for lack of jurisdiction based upon § 6404(h), and the taxpayers appealed. *Id.* The U.S. Court of Appeals for the Federal Circuit affirmed, and Certiorari was granted. *Id.* at 506, 127 S.Ct. 2011. The Supreme

Court ruled that § 6404(h) granted the tax court exclusive jurisdiction to review the IRS' refusal to abate under § 6404(e)(1). *Id.* at 506, 127 S.Ct. 2011.

1659 "In the case of any assessment of interest on ... any deficiency attributable in whole or in part to any error or delay by an officer or employee of the Internal Revenue Service (acting in his official capacity) in performing a ministerial act ... the Secretary may abate the assessment of all or any part of such interest for any period." 26 U.S.C. § 6404(e)(1) (1994 ed.).

1660 142 T.C. 46 (2014).

1661 The parties have also cited to *In re Gurley,* 335 B.R. 389 (Bankr.W.D.Tenn.2005), where the bankruptcy court held it lacked jurisdiction under 11 U.S.C. § 505 to review the IRS' decision not to abate interest and penalties because exclusive jurisdiction rested with the tax court under 26 U.S.C. § 6404(h). *Gurley,* however, also involved judicial review of the IRS' decision not to abate interest. *Id.* at 394–95. Here, no request for final determination was ever made.

1662 259 F.3d at 329–30 (footnotes and internal citations omitted).

1663 26 C.F.R. § 301.6404–4(b)(2).

1664 *Sala v. U.S.,* 552 F.Supp.2d 1157, 1162 (D.Colo.2007); *see also Bolton v. U.S.,* 2014 WL 5786575, at *2 (W.D.Tenn. Oct. 20, 2014) ("In order to prove tax fraud, the Government must show by clear and convincing evidence that Plaintiffs intentionally evaded taxes they knew they owed.").

1665 *See* pp. 389–462, *supra.*

1666 *See id.*

1667 While most of the Court's summary of what happened here will only refer to Sam, it applies equally to Charles, whose transactions and activities offshore mirrored Sam's in every relevant detail. That the Court must determine whether Charles committed tax fraud is clear since the IRS is asserting fraud penalties against Dee from 1992 through 2013, and during most of those years Dee and Charles filed joint tax returns.

1668 Accordingly, when the Court cites to transcripts in this Memorandum Opinion, it is only referring to the designated portions of the testimony.

1669 IRS Ex. 806.

1670 *Id.* at WYLYSEC00010967 ¶ 1.

1671 Joint Ex. 4 (The Bessie Trust agreement).

1672 These annuities involved Yurta Faf Limited (IOM) and Audubon Asset Limited (IOM). Joint Stipulations ¶ 36 (showing both entities are wholly-owned by Bessie IOM Trust), 131, and 141 (describing annuity transactions).

1673 *See, e.g.,* Joint Stipulations ¶¶ 292 (financial assets transferred from Yurta Faf Limited (IOM) to Greenbriar Limited (IOM), which Greenbriar Limited (IOM) then loaned to Security Capital and that were ultimately used to fund the Cayman LLCs), 357–359, 364–366 (funds related to the Cottonwood Ventures II property).

1674 Joint Ex. 17 (La Fourche Trust agreement).

1675 Collateral Estoppel No. 22; Cairns Depo Tr. 46:22–47:4, 48:5–49:2.

1676 Collateral Estoppel No. 22; Cairns Depo. Tr. 43:1–14; 46:16–21.

1677 IRS Ex. 92.

1678 Ironically, Wychwood Trust Limited was Cairns' trust company, through which he then collected trust management fees from Sam related to the La Fourche IOM Trust he purportedly settled for Sam "as an entirely gratuitous act."

1679 Cairns Depo. Tr. 47:2–4.

1680 Tr. Trans. 2029:3–9(Sam); Joint Stipulations ¶¶ 66, 67, 102, 103, 114, 116 (showing Lorne House Trust as having served as trustee for various Wyly-related trusts, including the Bulldog IOM Trust, Bessie IOM Trust, Tallulah IOM Trust, Pitkin IOM Trust, Tyler IOM Trust, and Woody International IOM Trust).

1681 Joint Stipulations ¶ 66 (showing Lorne House Trust serving as trustee of the Bessie IOM Trust from 1994–1998).

1682 Collateral Estoppel No. 22; Joint Stipulations ¶¶ 66 (showing Cairns' trust company, Wychwood Trust Limited, serving as trustee for Delhi IOM Trust and La Fourche IOM Trust) and 102 (Red Mountain IOM Trust).

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2017 WL 4946433
United States District Court,
E.D. Pennsylvania.

Arthur BEDROSIAN
v.
The UNITED STATES of America,
DEPARTMENT OF the TREASURY,
INTERNAL REVENUE SERVICE

CIVIL ACTION NO. 15-5853
|
Filed 09/20/2017

Attorneys and Law Firms

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Katherine M. Reinhart, Kavitha Bondada, U.S. Dept. of Justice, Washington, DC, for the United States of America, Department of the Treasury, Internal Revenue Service.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Baylson, District Judge

***1** Plaintiff Arthur Bedrosian initiated this case in order to obtain a refund of the $9,757.89 that he has paid to Defendant, the United States, for his allegedly "willful" violation of an Internal Revenue Service ("IRS") reporting requirement. The government counterclaimed for the full amount of the penalty, arguing that it was owed $1,007,345.48. After denying summary judgment for both parties, the undersigned presided over a one day bench trial at which Bedrosian defended his actions and the government attempted to frame them as satisfying the requisite "willful" standard. Both parties then filed post-trial briefs in which they proposed findings of fact and conclusions of law, and responded to two questions posed by the Court: (1) does any precedent exist for finding willfulness based on conduct similar to that of Bedrosian, and (2) did the government sustain its burden of proof regarding the calculation of the penalty amount. (ECF 62, 63.) Having considered the trial record and the post-trial briefing, we outline here our findings of fact and conclusions of law.

I. Findings of Fact

Bedrosian is a successful businessman who has spent his career in the pharmaceutical industry, rising in the ranks to the position he now holds—Chief Executive Officer at Lannett Company, Inc., a manufacturer and distributor of generic medications. (ECF 60, Trial Tr. at 26, 79-80.) In the early 1970s, when he was just getting started in the industry, Bedrosian held a position with Zenith Labs that required a significant amount of international travel. (Id. at 27.) Rather than rely solely on traveler's checks to make purchases abroad, in or about 1973 he decided to open a savings account with Swiss Credit Corporation in Switzerland. (Id. at 28-31.) At some point, Union Bank of Switzerland ("UBS") acquired Swiss Credit Corporation and Bedrosian's account was switched to UBS. (Id. at 31.) Bedrosian initially used the account in order to have access to funds while traveling abroad but, as the years went on, he began to use it more as a savings account. (Id. at 30-31.) He did not take a particularly active role in managing the account, but was kept abreast of its activities via certain information UBS would mail him and through annual meetings he would have with a UBS representative. (Id. at 40-41.) In 2005, UBS approached Bedrosian with a loan proposal that he accepted whereby it would lend him 750,000 Swiss Francs and convert his savings account into an investment account. (Id. at 42-43; Pl.'s Ex. 6.) That transaction resulted in a second account being created for Bedrosian at UBS, although he claims that he always considered them one account. (Trial Tr. at 57-58.) In 2008, UBS informed him that he had sixty days within which to repay the loan, close his accounts, and transfer all assets therein to another bank. (Id. at 44-45.) Bedrosian moved the funds to a different Swiss bank called Hyposwiss. (Id. at 44.)

Throughout this thirty five year period, from 1972 until 2007, Bedrosian used the services of an accountant named Seymour Handelman to prepare his income tax returns. (Id. at 47.) Bedrosian did not tell Handelman about his Swiss account until some point in the mid-1990s, at which time Handelman advised him that he had been breaking the law every year that he did not report the account on his tax return. (Id. at 49-50.) Bedrosian asked Handleman what he recommended doing about it, and Handelman stated that he could not "unbreak the law," and should therefore take no action. (Id. at 50-51.)

Handelman assured Bedrosian that his estate could deal with it upon his death, when his money was repatriated. Heeding Handleman's advice, Bedrosian continued to not report either Swiss account on his tax returns.

***2** In 2007, Handelman died and Bedrosian began working with a new accountant, Sheldon Bransky. (Id. at 52-53.) The return that Bransky filed for Bedrosian in 2008, for tax year 2007, included, for the first time, an affirmative answer to the question asking whether "[a]t any time during 2007, [he had] an interest in or signature or other authority over a financial account in a foreign country." (Id. at 53-54; P9.) Switzerland is listed as the country in which the account was located. (Pl.'s Ex. 9.) Bedrosian also filed a Report of Foreign Bank and Financial Accounts ("FBAR") for the first time in which he reported the existence of one of his two UBS accounts. (Govt. Ex. L.) The FBAR only listed his UBS account ending in 5316, which had assets totaling approximately $240,000, and did not report the account ending in 6167, which had assets totaling approximately $2 million. (Trial Tr. at 19, 56-67.) The 2007 FBAR was signed on October 14, 2008. (Pl.'s Ex. 10.) Bedrosian testified that he has no recollection of discussing the Swiss accounts with Bransky and that he is not sure how Bransky knew to check the "yes" box or file the FBAR. (Trial Tr. at 54-55.) Rather, Bedrosian stated that he simply gave Bransky the same materials that he gave Handleman year after year—a compilation of all the tax-related documents he received over the course of the year—and then signed the return that Bransky prepared. (Id.)

Around this time, following Handelman's death, Bedrosian became more aware of the seriousness of reporting foreign bank accounts and less comfortable with continuing the non-reporting practice Handelman had condoned. (Id. at 60-61.) He went to his personal lawyer, Steven Davis, in late 2008 and told him the history of what had happened with the UBS account and Handelman's advice. (Id. at 61-63.) Notably, at the time Bedrosian took these steps to rectify the issue, the government had not begun its investigation of him and he did not know that UBS had turned his information over to the IRS. (Id. at 64-65.) Davis brought a tax attorney colleague, Paul Ambrose, into the discussion and Ambrose advised Bedrosian to engage an accounting firm to go back and amend his returns from 2004 to the present. (Id. at 62.) From that point forward, Bedrosian heeded the advice of counsel, amended his returns, and paid taxes on the gains from his Swiss accounts. (Id. at 67-68.) The IRS alerted him in April 2011 that it would be auditing his returns, and thus began the process that culminated in this lawsuit. (Id. at 73.) Bedrosian was cooperative and forthcoming in his dealings with the IRS agents charged with investigating him. (Id. at 73-76.)

Much of the testimony at trial concerned whether Bedrosian knew that he had two accounts at UBS or was under the impression that he just had one. It is undisputed that he elected to stop receiving written communication from UBS regarding his accounts in 1993 and again in 2004 and that he got most, if not all, information about the accounts from an annual meeting that he had with a UBS representative in New York. (Govt. Ex. F.) It is also clear that he closed each account via separate letter to UBS, one dated November 5, 2008 and the other dated December 2, 2008. (Govt. Exs. J, K.) Having established the factual record, we turn to the legal implications of Bedrosian's conduct.

II. Conclusions of Law

In our memoranda on summary judgment and on the government's motion in limine to exclude evidence from the IRS investigation, we summarized the legal framework governing the key question of whether Bedrosian's violation of Section 5314 was "willful". See Bedrosian v. United States, No. 15-5853, 2017 WL 1361535 (E.D. Pa. Apr. 13, 2017); Bedrosian v. United States, No. 15-5853, 2017 WL 3887520 (E.D. Pa. Sept. 5, 2017). We reiterate, and expand on, that discussion for the parties and future litigants on the issue.

A. Standard of Review

Although the Third Circuit has not yet ruled on what standard of review applies to a determination of the validity of an IRS penalty under 31 U.S.C. § 5321, those courts that have considered the question have found the correct standard to be *de novo*. See United States v. Williams, No. 09-437, 2010 WL 3473311, at *1 (E.D. Va. Sept. 1, 2010), rev'd on other grounds, United States v. Williams, 489 Fed.Appx. 655 (4th Cir. 2012) (looking to enforcement actions brought by the government in other contexts which require a *de novo* review, as well as the fact that Section 5321 provides for no adjudicatory hearing before an FBAR penalty is assessed, to conclude that *de* *novo* review is appropriate); United States v. McBride, 908 F. Supp. 2d 1186, 1201 (D. Utah 2012) (applying *de novo* standard to whether underlying penalty was valid).

B. Burden of Proof

***3** The government bears the burden of proving each element of its claim for a civil FBAR penalty by a preponderance of the evidence, including the key question here of whether an individual's failure to report was "willful." Williams, 2010 WL 3473311, at *1; McBride, 908 F. Supp. 2d at 1201-02 (explaining that "[a]s with [g]overnment penalty enforcement and collection cases generally, absent a statute that prescribes the burden of proof, imposition of a higher burden of proof is warranted only where 'particularly important individual interests or rights,' are at stake") (quoting Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983)); United States v. Bohanec, No. 15-4347, ––– F. Supp. 3d. ––––, 2016 WL 7167860, at *6 (C.D. Cal. Dec. 8, 2016) (holding that because "[t]he monetary sanctions at issue [in an FBAR civil penalty action] do not rise to the level of 'particularly important individual interest or rights,' ... the preponderance of the evidence standard applies").

C. Analysis

i. Willfulness

Congress passed the Bank Secrecy Act ("BSA" or "Act") in 1970 in order to target the problem of the "unavailability of foreign and domestic bank records of customers thought to be engaged in activities entailing criminal or civil liability." California Bankers Ass'n v. Schultz, 416 U.S. 21, 26 (1974). The Act was intended to "require the maintenance of records, and the making of certain reports, which 'have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.' " Id. (quoting 31 U.S.C. § 5311). To that end, it granted the Secretary of the Treasury authorization to promulgate regulations prescribing certain recordkeeping and reporting requirements for domestic banks as well as individuals. Id. One such reporting requirement is the FBAR, which arises out of the mandate of Section 5314(a) and its corresponding regulations that all United States citizens must report on an annual basis to the IRS any "financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country." 31 C.F.R. § 1010.350(a); 31 U.S.C. § 5314(a). Failure to timely file an FBAR for each foreign financial account in which a taxpayer has an interest of over $10,000 results in exposure to a civil money penalty that varies depending on the taxpayer's level of culpability. 31 C.F.R. § 1010.306(c); 31 U.S.C. § 5321(a)(5). Specifically, non-willful violations of the FBAR reporting requirement result in a penalty not to exceed $10,000, whereas willful violations can lead to a penalty that is the greater of $100,000 or fifty percent of the balance in the account at the time of the violation. 31 U.S.C. § 5321(a)(5)(B)(i), (a)(5)(C). A "reasonable cause" exception exists for non-willful violations, but not for willful ones. 31 U.S.C. § 5321(a)(5)(C)(ii).

The parties have never disputed that Bedrosian meets all requirements of the relevant reporting laws—he is a U.S. citizen with a financial interest in a bank account in a foreign country that contained more than $10,000 during 2007. Where they disagree, and the only issue explored at trial, is whether Bedrosian's failure to file his 2007 FBAR was done with the requisite "willful" mental state. We discussed in our summary judgment memorandum that the precise definition of that term as used in Section 5321, the civil penalty provision, has not been clearly established by statute or precedent. But, we also noted that every federal court to have considered the issue has found the correct standard to be the one used in other civil contexts— that is, a defendant has willfully violated Section 5314 when he either knowingly or recklessly fails to file an FBAR. See, e.g., Williams, 489 Fed.Appx. at 658; Bohanec, 2016 WL 7167860, at *5; McBride, 908 F. Supp. 2d at 1204. That definition contrasts with the one proposed by Bedrosian, which is that in order for the government to sustain a willful FBAR penalty, it must meet the standard used in the criminal context and show that his actions amounted to a voluntary, intentional violation of a known legal duty. See Cheek v. United States, 498 U.S. 192, 201 (1991). Although on summary judgment we declined to hold what the appropriate standard of willfulness was, we indicated that the civil standard stood on far stronger precedential footing. Consistent with those dicta, we now hold that Section 5321's requisite willful intent is satisfied by a finding that the defendant knowingly or recklessly violated the statute. The government need not prove improper motive or bad purpose.

***4** To further elucidate the definition of “willfulness” in this context, we note that acting with “willful blindness” to the obvious or known consequences of one's actions will satisfy the standard. See McBride, 908 F. Supp. 2d at 1205 (citing Global-Tech Appliances, Inc. v. SEB S.A., ––– U.S. ––––, 131 S.Ct. 2060, 2068-69 (2011)). Willful blindness is established when an individual “takes deliberate actions to avoid confirming a high probability of wrongdoing and [when he] can almost be said to have actually known the critical facts.” Global-Tech Appliances, Inc., 131 S.Ct. at 2070-71. In the tax reporting context, the government can show willful blindness by evidence that the taxpayer made a “conscious effort to avoid learning about reporting requirements.” Williams, 489 Fed.Appx. at 659-60.

In order for an individual to act “willfully” in a situation “involving a requirement to report or disclose certain information to the IRS,” he must engage in “conduct which is voluntary, rather than accidental or unconscious.” McBride, 908 F. Supp. 2d at 1205; see Brounstein v. United States, 979 F.2d 952, 955-56 (3d Cir. 1992) (in case involving willful failure to pay taxes, holding that “willfulness is ‘a voluntary, conscious and intentional decision to prefer other creditors over the Government’ ”). Further, reckless disregard satisfies the willfulness standard. McBride, 908 F. Supp. 2d at 1204. “While ‘the term recklessness is not self-defining,’ the common law has generally understood it in the sphere of civil liability as conduct violating an objective standard: action entailing ‘an unjustifiably high risk of harm that is either known or so obvious that it should be known.’ ” Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 68 (2007) (quoting Farmer v. Brennan, 511 U.S. 825, 836 (1994)). Finally, in terms of the type of evidence capable of establishing willfulness, the government can meet its burden “through inference from conduct meant to conceal or mislead sources of income or other financial information,” and may use “circumstantial evidence and reasonable inferences drawn from the facts because direct proof of the taxpayer's intent is rarely available.” McBride, 908 F. Supp. 2d at 1205 (quoting United States v. Sturman, 951 F.2d 1466, 1476-77 (6th Cir. 1991)).

At trial and in his trial brief Bedrosian acknowledged that we were likely to conclude that the civil standard of willfulness applied, and he focused his advocacy on the argument that his actions were far less egregious than those of defendants found liable in other cases for willfully violating the FBAR requirement. He summarized the facts of three cases in which the willful penalty was imposed and compared them to his own conduct, contending that the record did not support a finding that he had acted with the requisite intent. The government countered with evidence intended to show that Bedrosian was well aware that his 2007 FBAR was inadequate, such as his business acumen, the fact that Handelman had told him in the mid-1990s that his failure to report his Swiss accounts was illegal, and various indicia that he knew that he had two accounts at UBS rather than just the one that he reported. The government additionally argued that even if it was true that Bedrosian did not know he had two accounts at the time he filed his 2007 FBAR, he easily could have gotten that information by reaching out to UBS.

We start from the premise that the question of “[w]hether a person has willfully failed to comply with a tax reporting requirement is a question of fact.” Williams, 489 Fed.Appx. at 658; see United States v. House, 524 F.2d 1035, 1045 (3d Cir. 1975) (“The question of willfulness is uniquely for the trier of fact.”). Indeed, the Third Circuit has held that determinations of willfulness depend on consideration of the defendant's “state of mind, knowledge, intent and belief regarding the propriety of their actions.” E.E.O.C. v. Westinghouse Elec. Corp., 725 F.2d 211, 218 (3d Cir. 1983). Therefore, it is not enough to simply read the black letter definition of the term—knowing or reckless violation of a statutory duty—in a vacuum; rather, disposition of this case requires a fact-and context-specific inquiry into Bedrosian's actions.

***5** Here, the narrative developed at trial, largely via the credible testimony of Bedrosian, is that of an educated and highly financially literate businessman who took a calculated risk for several years by not complying with his tax reporting obligations. He admitted as much—that Handelman told him he had been breaking the law every year he did not report his Swiss accounts, and that he nevertheless continued to fail to report them, relying on Handelman's questionable advice. Nevertheless, Bedrosian is not before this Court for any of those violations of the tax law; rather, he is here solely for the determination of whether his failure to file an accurate FBAR for tax year 2007 was willful. After a careful review of the record, the trial transcript, and the parties' post-trial briefing, we cannot conclude, based on a comparison of the facts of this case compared with those of cases in which a willful FBAR penalty was imposed, that the government has proved, by a preponderance of the evidence, that Bedrosian's violation of Section 5314 was willful.

As stated above, this inquiry requires a probing of the factual circumstances of this case to determine whether Bedrosian had the requisite mental state. Having done so, it is simply not sufficiently clear from the record developed that he was willful in submitting his inaccurate 2007 FBAR. Rather, his actions were at most negligent, which does not satisfy the willfulness standard. There is no question that Bedrosian could have easily discovered that what had previously been one UBS account was now two, via the statements he occasionally received from the bank and the meetings he had annually with a UBS representative. In addition, the fact that he signed his 2007 FBAR two weeks prior to sending two separate letters to UBS to close his accounts sways in favor of an inference that he was aware of the existence of the second account at the time he filed the FBAR. Nevertheless, as discussed below, even if he did know that he had a second account yet failed to disclose it on the FBAR, there is no indication that he did so with the requisite voluntary or intentional state of mind; rather, all evidence points to an unintentional oversight or a negligent act.

The government contends that we should not concern ourselves with "whether [Bedrosian's] conduct was as egregious as the few other cases that have been litigated involving the FBAR penalty," and that we should instead take a broader view including other civil cases where willfulness was at issue. (ECF 63, Govt. Post-Trial Brief at 6.) We agree that willfulness findings in the larger civil context may be useful comparators, but consider the other FBAR penalty cases as the most on point precedent. To that end, perhaps most important to this decision are the crucial differences between this case and those in which a civil FBAR penalty has been sustained. In Williams, for example, the defendant deposited over $7 million into two Swiss bank accounts and failed to report the income from those accounts to the IRS from 1993 to 2000. Williams, 489 Fed.Appx. at 656. In the fall of 2000, government authorities became aware of the accounts, the defendant retained counsel, and Swiss authorities froze both accounts. Even after facing significant government scrutiny regarding his compliance with federal reporting requirements, the defendant nevertheless filed an FBAR for tax year 2000 in which he did not disclose his interest in either Swiss account. The defendant also allocuted, in connection with a simultaneous criminal investigation, to having unlawfully failed to report the existence of the Swiss accounts on his 2000 FBAR. On these facts, the Fourth Circuit overturned the district court's finding that the defendant's violation of Section 5314 had not been willful, reasoning that the above-recited facts at least established reckless conduct. Id. at 660.

The defendant's actions in Williams stand in contrast to Bedrosian's in 2007 and 2008. Crucially, in Williams the defendant "acknowledged that he willfully failed to report the existence of the [Swiss] accounts to the IRS or Department of the Treasury as part of his larger scheme of tax evasion," via his guilty plea allocution. Id. Here, there obviously has been no such acknowledgement. In addition, where the defendant in Williams submitted the inaccurate FBAR at issue after he was already the target of a government investigation regarding his noncompliance with federal tax law, showing a continued interest in misleading the authorities, Bedrosian was fully cooperative and honest with the IRS from the moment it began investigating him.

***6** Another of the few cases to have considered this issue is McBride, in which the defendant, cognizant of an imminent sizable increase in his company's revenue, "sought a way to reduce or defer the income taxes that would normally be paid on [the] revenue," and hired a financial management firm to help him do so. McBride, 908 F. Supp. 2d at 1189. The firm proposed a plan, which the defendant accepted, to move profits of his company to offshore entities, thereby resulting in approximately $2.7 million in otherwise taxable profits of the company to be routed directly to the defendant. Importantly, when faced with the IRS' investigation, the defendant repeatedly lied and refused to produce requested documents. Id. at 1200. Again, the willful finding in McBride is hard to map onto the instant facts, which are significantly less egregious and show nothing close to the carefully planned and complex tax evasion scheme perpetrated by the defendant in that case.

United States v. Bussell, No. 15-2034, 2015 WL 9957826 (C.D. Cal. Dec. 8, 2015), a case not briefed by the parties but one in which the court granted summary judgment for the government on an individual's willful violation of the FBAR requirement, is similarly distinguishable from this case. In Bussell, the court found that the defendant had "clearly acted with reckless disregard [of the statutory duty]" because she had been convicted of bankruptcy fraud and tax fraud for failing to disclosing offshore accounts, was subjected to civil penalties for her failures to disclose the accounts, was aware of the duty to report them on her FBAR and nevertheless did not. Id. at *5. Again, here there is nothing close to that level of evidence showing Bedrosian's willful violation of the FBAR requirement.

The government urges us to consider other civil cases, outside of the FBAR context, in which there were findings of willfulness. It cites to Greenberg v. United States, 46 F.3d 239 (3d Cir. 1994), in which the court considered whether an individual had willfully failed to pay certain employer withholding taxes, which determination depended on the individual's knowledge that his company had not paid the taxes at the time he disbursed company funds to employees and other creditors. Id. at 244. The defendant was indisputably aware that the company was delinquent in remitting withholding taxes when he decided that he "must pay more urgent bills right away in order to keep the business going and would pay the taxes later." Id. at 241. In contrast, here, Bedrosian's knowledge that his 2007 FBAR was inaccurate is far less clear—he undoubtedly did not give the form the requisite attention, but it is not apparent that he submitted it knowing that it omitted the second UBS account. The government's evidence going to that point relies on inferential leaps on which we are unwilling to hang a finding that Bedrosian was willful. Furthermore, while the court's analysis of willfulness in the context of Section 6672 of the Internal Revenue Code is surely relevant to the instant determination, as it arises in the civil tax penalty context, we find the specific FBAR penalty cases more persuasive because they deal with the same unique reporting requirement at issue here.

In summary, the only evidence supporting a finding that Bedrosian willfully violated Section 5314 is: (1) the inaccurate form itself, lacking reference to the account ending in 6167, (2) the fact that he may have learned of the existence of the second account at one of his meetings with a UBS representative, which is supported by his having sent two separate letters closing the accounts, (3) Bedrosian's sophistication as a businessman, and (4) Handelman's having told Bedrosian in the mid-1990s that he was breaking the law by not reporting the UBS accounts. None of these indicate "conduct meant to conceal or mislead" or a "conscious effort to avoid learning about reporting requirements," even if they may show negligence. Williams, 489 Fed.Appx. at 658.

***7** It is obvious that Bedrosian should have handled the situation differently and, in 2007-2008, should have been more careful about reviewing the 2007 FBAR and in being aware of the fact that he had not one but two accounts at UBS. Nevertheless, the facts show that he did check the box indicating he had a foreign account on his 2007 tax return, he did identify Switzerland as the country in which the account as located, and he did file an FBAR for 2007 stating he had assets in a foreign account. His error was in failing to list the second account. Furthermore, he approached his personal lawyer and retained an accounting firm to file amended returns and rectify the issue prior to learning that the government was investigating him and prior to learning that UBS was turning his information over to the IRS. Although we apply the lower, civil standard of willfulness here, we nevertheless do not see Bedrosian's as the sort of conduct intended by Congress or the IRS to constitute a willful violation. This is especially so in light of the dearth of precedent finding a willful violation on comparable facts. Because we find that the government failed to meet its burden as to the willfulness requirement, we decline to engage in an analysis concerning the calculation of the penalty amount.

ii. Illegal Exaction

Having concluded that the government has not established that Bedrosian was "willful" in his violation of Section 5314, we must determine whether Bedrosian has made out a claim for illegal exaction. An illegal exaction claim "involves money that was 'improperly paid, exacted, or taken from the claimant in contravention of the Constitution, a statute, or a regulation.' " Norman v. United States, 429 F.3d 1081, 1095 (Fed. Cir. 2005) (quoting Eastport S.S. Corp. v. United States, 178 Ct. Cl. 599, 605 (1967)). Where a taxpayer is able to establish that he paid taxes that were improperly collected by the government, he succeeds on such a claim. Id. Here, we found that the government failed to meet its burden to show that Bedrosian willfully violated Section 5314; therefore, we conclude that any money penalty exacted from Bedrosian under Section 5321(a)(5)(C), which permits the Secretary of the Treasury to, "[i]n the case of any person willfully violating, or willfully causing any violation of, any provision of section 5314," impose a penalty in the amount of the greater of $100,000 or 50%

of the balance in the non-reported account, was illegally exacted. See 31 U.S.C. § 5321(a)(5)(C), (D); Kipple v. United States, 102 Fed. Cl. 773, 777 (2012) (holding that "a necessary implication of 31 U.S.C. § 3720(A) [pertaining to the amount by which a person's tax refund may be reduced where that person owes a debt to a federal agency] is that an illegal exaction would arise if there was no legally enforceable debt"). The remedy must be a return of the money Bedrosian has paid. See Kipple, 102 Fed. Cl. at 777.

III. Conclusion

For the reasons explained above, the government has not met its burden to establish that Bedrosian willfully violated Section 5314. Consequently, the amount that Bedrosian paid in partial satisfaction of his allegedly willful violation of that section—$9,757.89—was illegally exacted from him and the Government owes him that sum.

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This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 9th Cir. Rule 36-3.
United States Court of Appeals, Ninth Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
John C. HOM, Defendant–Appellant.

No. 14–16214
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Argued May 9, 2016
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Submitted July 21, 2016 San Francisco, California
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Filed July 26, 2016

Synopsis
Background: United States brought action against gambler to recover penalty imposed for failure to file foreign bank and financial accounts report (FBAR). The United States District Court for the Northern District of California, William Alsup, J., entered summary judgment in United States' favor, and gambler appealed.

Holdings: The Court of Appeals held that:

[1] money transmitter that acted as intermediary between gambler's bank account and online poker sites was “financial institution,” but

[2] gambler's accounts with online poker cardrooms did not fall within definition of “bank, securities, or other financial account.”

Affirmed in part, reversed in part, and remanded.

Appeal from the United States District Court for the Northern District of California William Alsup, District Judge, Presiding. D.C. No. 3:13–cv–03721–WHA

Attorneys and Law Firms

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Joseph A. DiRuzzo, III, Jeffrey J. Molinaro, Fuerst Ittleman David & Joseph, PL, Miami, FL, for Defendant–Appellant.

Before: McKEOWN, and FRIEDLAND, Circuit Judges, and BOULWARE, * District Judge.

MEMORANDUM **

Defendant–Appellant John C. Hom appeals the district court’s grant of summary judgment in favor of the Government in this tax case. It is undisputed that Hom failed to file a tax form known as the Foreign Bank and Financial Accounts Report (“FBAR”) (Treasury Form TD F 90–22.1) for three accounts he held in 2006, and one account he held in 2007. Hom was assessed a total penalty of $40,000 ($10,000 per violation). When Hom failed to pay, the Government filed this lawsuit against Hom. The district court granted summary judgment against Hom, and Hom appealed.

The issue before us is whether Hom’s accounts with FirePay, PokerStars, and PartyPoker required the filing of FBAR forms under 31 U.S.C § 5314, which provides that the Secretary of the Treasury “shall require” U.S. persons to “keep records and file reports ... [when those persons] make[ ] a transaction or maintain[ ] a relation for any person with a foreign financial agency.” Under the regulation in effect at the time, the key questions are whether Hom’s accounts were “bank, securities, or other financial account[s]” and whether those accounts were “in a foreign country.” *See* 31 C.F.R. § 103.24 (2006). If both questions are answered in the affirmative, the accounts required the filing of FBAR forms.

“[F]inancial agency” is defined in 31 U.S.C § 5312(a)(1) as “a person acting for a person ... as a financial institution.” “[F]inancial institution” is in turn defined ***654** to include a number of specific types of businesses, including “a commercial bank,” “a private banker,” and “a licensed sender of money or any other person who engages as a business in the transmission of funds." 31 U.S.C. § 5312(a)(2).

[1] Hom's FirePay account fits within the definition of a financial institution for purposes of FBAR filing requirements because FirePay is a money transmitter. *See* 31 U.S.C. § 5312(a)(2)(R); 31 C.F.R. § 103.11(uu)(5) (2006). FirePay acted as an intermediary between Hom's Wells Fargo account and the online poker sites. Hom could carry a balance in his FirePay account, and he could transfer his FirePay funds to either his Wells Fargo account or his online poker accounts. It also appears that FirePay charged fees to transfer funds. As such, FirePay acted as "a licensed sender of money or any other person who engages as a business in the transmission of funds" under 31 U.S.C. § 5312(a)(2)(R) and therefore qualifies as a "financial institution." *See* 31 C.F.R. § 103.11(uu)(5) (2006). Hom's FirePay account is also "in a foreign country" because FirePay is located in and regulated by the United Kingdom. *See* IRS, FBAR Reference Guide, https://www.irs.gov/pub/irs-utl/irsfbarreferenceguide.pdf (last visited July 19, 2016) ("Typically, a financial account that is maintained with a financial institution located outside of the United States is a foreign financial account.").

[2] In contrast, Hom's PokerStars and PartyPoker accounts do not fall within the definition of a "bank, securities, or other financial account." PartyPoker and PokerStars primarily facilitate online gambling. Hom could carry a balance on his PokerStars account, and indeed he needed a certain balance in order to "sit" down to a poker game. But the funds were used to play poker and there is no evidence that PokerStars served any other financial purpose for Hom. Hom's PartyPoker account functioned in essentially same manner.

The Government argues that these entities were functioning as banks,[1] but this argument lacks support. Neither the statute nor the regulations define banking. In discerning the plain meaning of the text, we interpret words in light of their "ordinary, contemporary, common meaning" unless they are otherwise defined. *Perrin v. United States*, 444 U.S. 37, 42, 100 S.Ct. 311, 62 L.Ed.2d 199 (1979). Merriam–Webster dictionary defines bank as, "an establishment for the custody, loan, exchange, or issue of money, for the extension of credit, and for facilitating the transmission of funds." Merriam–Webster Dictionary, Bank, http://www.merriamwebster.com/dictionary/bank (last visited July 19, 2016).[2] There is no evidence that PartyPoker ***655** and PokerStars were established *for* any of those purposes, rather than merely for the purpose of facilitating poker playing.[3]

For the foregoing reasons, we REVERSE in part, AFFIRM in part, and remand.

Each party shall bear its own costs on appeal.

All Citations

657 Fed.Appx. 652, 118 A.F.T.R.2d 2016-5222, 2016-2 USTC P 50,358

Footnotes

* The Honorable Richard F. Boulware, United States District Judge for the District of Nevada, sitting by designation.

** This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36–3.

[1] The Government's belated attempt to argue that PokerStars and PartyPoker are "casinos" and thus qualify as financial institutions, is too little, too late. Not only did the Government not raise this argument below, it explicitly disclaimed reliance on that theory. We decline to address this argument raised for the first time on appeal because "[o]ur discretion to affirm on grounds other than those relied on by the district court extends to issues raised in a manner providing the district court an opportunity to rule on it." *Mansourian v. Regents of Univ. of Cal.*, 602 F.3d 957, 974 (9th Cir. 2010).

[2] The next two definitions in Merriam-Webster for "bank" do relate specifically to gambling establishments. *See* Merriam–Webster, Bank ("2: a person conducting a gambling house or game; *specifically*: dealer [and] 3: a supply of something held in reserve: as [ ] the fund of supplies (as money, chips, or pieces) held by the banker or dealer for use in a game."). The Government, however, did not advance the argument that these latter definitions of "bank" were what Congress intended, nor would that argument have been particularly persuasive given that Congress separately lists banks and casinos in the definition of financial institution. *See* 31 U.S.C. § 5312(a)(2)(X).

[3] The Fourth Circuit's decision in *United States v. Clines*, 958 F.2d 578, 579 (4th Cir. 1992), is not to the contrary. There, the court, in upholding a defendant's conviction for failing to file FBARs, explained, "By holding funds for third parties and disbursing them at their direction, [the entity at issue] functioned as a bank." *Id.* at 582. The Government seizes upon that single sentence to argue that holding funds alone is sufficient to qualify an entity as a bank, but this reading fails to consider that the entity at issue in *Clines* engaged in many traditional banking functions beyond merely holding funds. *See id.* at 580 (explaining that the services the entity provided the defendant and his business partners included "bookkeeping, accounting, and financial management responsibilities ... [as well as] investment of funds and management of accounts").

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868 F.3d 438
United States Court of Appeals, Sixth Circuit.

Mark CRAWFORD; Rand Paul, in his official capacity as member of the United States Senate; Roger Johnson; Daniel Kuettel; Stephen J. Kish; Donna-Lane Nelson; L. Marc Zell, Plaintiffs-Appellants,
v.
UNITED STATES DEPARTMENT OF the TREASURY; United States Internal Revenue Service; United States Financial Crimes Enforcement Network, Defendants-Appellees.

No. 16-3539
|
Argued: January 24, 2017
|
Decided and Filed: August 18, 2017
|
Rehearing En Banc Denied September 26, 2017

Synopsis

Background: Senator and several individuals alleged to be subject to Foreign Account Tax Compliance Act (FATCA) and Bank Secrecy Act's foreign bank account reporting (FBAR) requirement brought action against Department of the Treasury, Internal Revenue Service (IRS), and Financial Crimes Enforcement Network, seeking to enjoin enforcement of FATCA, intergovernmental agreements (IGA) that facilitate foreign financial institutions' (FFI) disclosures of financial account information to the United States Government, and the FBAR. The United States District Court for the Southern District of Ohio at Dayton. No. 3:15-cv-00250, Thomas M. Rose, J., 2016 WL 1642968, dismissed action for lack of standing. Plaintiffs appealed.

Holdings: The Court of Appeals, Boggs, Circuit Judge, held that:

[1] plaintiffs lacked standing to challenge FATCA's individual-reporting requirements and passthru penalty;

[2] plaintiffs lacked standing to challenge penalty imposed upon FFIs for noncompliance with FATCA;

[3] plaintiffs lacked Article III standing to challenge the constitutionality of IGAs;

[4] plaintiffs lacked Article III standing to bring pre-enforcement challenge to FBAR; and

[5] district court properly denied leave to amend.

Affirmed.

***442** ***443** Appeal from the United States District Court for the Southern District of Ohio at Dayton. No. 3:15-cv-00250—Thomas M. Rose, District Judge.

Attorneys and Law Firms

ARGUED: James Bopp, Jr., THE BOPP LAW FIRM, PC, Terre Haute, Indiana, for Appellants. Richard Caldarone, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellees. ON BRIEF: James Bopp, Jr., Richard E. Coleson, Courtney Turner Milbank, THE BOPP LAW FIRM, PC, Terre Haute, Indiana, for Appellants. Richard Caldarone, Gilbert S. Rothenberg, Teresa E. McLaughlin, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellees.

Before: BOGGS, SILER, and MOORE, Circuit Judges.

OPINION

BOGGS, Circuit Judge.

In 2010, Congress passed the Foreign Account Tax Compliance Act (FATCA), a law aimed at reducing tax evasion by United States taxpayers holding funds in foreign accounts. FATCA imposes account-reporting requirements (and hefty penalties for noncompliance) on both individual taxpayers and foreign financial institutions (FFIs). FFIs are further required to deduct and withhold a "tax" equal to 30% of every payment made by the FFI to a noncompliant (or "recalcitrant") account holder. To implement FATCA worldwide, the United States Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) have concluded intergovernmental agreements (IGAs), which facilitate FFIs' disclosure of financial-account information to the United States government, with more than seventy countries. Separately from FATCA and the IGAs, the Bank Secrecy Act imposes a foreign bank account reporting (FBAR) requirement on Americans living abroad who have aggregate foreign-account balances over $10,000; willful failure to file an FBAR invites a penalty of 50% of the value of the reportable accounts or $100,000, whichever is *greater*.

Plaintiffs—who include Senator Rand Paul and several individuals who claim to be subject to FATCA and the FBAR—sought to enjoin the enforcement of FATCA, the IGAs, and the FBAR, and they now appeal the dismissal of their lawsuit for lack of standing. For the reasons that follow, we affirm the judgment of the district court.

I

A. The Parties

Plaintiffs' original verified complaint asserts claims against three defendants: Treasury, which administers FATCA and the FBAR; the IRS (an office of Treasury that also administers FATCA and the FBAR); and the United States Financial Crimes Enforcement Network (FinCEN), a Treasury Department bureau with administrative authority over the FBAR. Each of the seven plaintiffs alleges a unique set of harms:

Mark Crawford

Plaintiff Mark Crawford is an American citizen living in Albania with a residence in Dayton, Ohio. Crawford owns Aksioner, a brokerage firm in Albania that is a partner of Saxo Bank in Copenhagen. Crawford alleges injury because Saxo will not allow Aksioner to accept clients who are United States citizens "in part because the bank does not wish to assume the burdens that would be foisted on it by FATCA." Crawford also claims that Aksioner—*which he owns*—denied Crawford's own application for a brokerage account, and that Crawford ***444** has suffered financial harm because FATCA is "forcing him to turn away prospective American clients living in Albania."

Senator Rand Paul

Senator Rand Paul claims that he "has been denied the opportunity to exercise his constitutional right as a member of the U.S. Senate to vote against the FATCA IGAs." Senator Paul claims that he would vote against the IGAs if they were submitted to the Senate for advice and consent under Article II, Section 2, of the United States Constitution, or if they were submitted to the whole Congress for approval as "congressional-executive agreements." Senator Paul does not otherwise challenge FATCA, and he does not in any way challenge the FBAR.

Roger Johnson

Plaintiff Roger Johnson is an American citizen living in Brno, Czech Republic. Johnson is married to Katerina Johnson, a Czech citizen with whom Johnson previously shared joint financial accounts before they separated their accounts to avoid subjecting Katerina's account information to disclosure under FATCA.

Stephen J. Kish

Plaintiff Stephen J. Kish is a Canadian citizen living in Toronto. Kish was also an American citizen at the time Plaintiffs' complaint was filed, but he has since renounced his American citizenship. Kish and his wife, a Canadian citizen, share a joint bank account at a Canadian bank. Kish alleges that "FATCA has at times caused some discord between" Kish and his wife because Kish's wife "strongly opposes the disclosure of her personal financial information from [the] joint bank account to the U.S. government." Kish's wife, however, is neither a plaintiff nor a proposed plaintiff in this litigation.

Daniel Kuettel

Plaintiff Daniel Kuettel is a Swiss citizen and former American citizen living in Bremgarten, Switzerland. Kuettel and his wife—a citizen of Switzerland and the Philippines—have a daughter (a citizen of the United States, the Philippines, and Switzerland) and a son (a citizen of the Philippines and Switzerland), both minors. Kuettel alleges that he renounced his citizenship in

2012 “because of difficulties caused by FATCA.” For instance, Kuettel alleges that before renunciation, his efforts to refinance his mortgage with Swiss banks were unsuccessful but that he “was able to refinance his home with a Swiss bank shortly thereafter.” Kuettel also alleges that he has a college-savings account for his daughter in his own name at a Swiss bank and wishes to transfer it to his daughter, but that he has refrained from doing so for fear that if he does, either he or his daughter or the account will be subject to the FBAR penalty “if the IRS determines that his daughter has ‘wilfully’ failed to file an FBAR.” Kuettel alleges that his daughter is incapable of filing the FBAR or of renouncing her United States citizenship because “she is only ten years old and too young to shoulder such an obligation,” and Kuettel does not wish to file the FBAR on his daughter’s behalf as FinCEN would ordinarily require the parent of a minor child to do.

Donna-Lane Nelson

Plaintiff Donna-Lane Nelson is a Swiss citizen and former American citizen living in both Geneva, Switzerland, and Argèles-sur-Mer, France. Nelson claims that she renounced her citizenship when, after FATCA was enacted, her Swiss bank (UBS) “notified her that she would not be ***445** able to open a new account if she ever closed her existing one[,] because she was an American.” Nelson subsequently married an American citizen with whom she shares a joint bank account at BNP Paribas in France. Nelson alleges that she “has had her private financial account information disclosed to the IRS and the Treasury Department despite the fact that she is not a U.S. citizen,” although Plaintiffs’ pleadings provide no further insight as to the nature of this alleged disclosure, such as who made it, when it was made, or what it contained. Nelson has also had to prove or explain to UBS, BNP Paribas, and Raiffeisen (another European bank) that she is not a United States citizen.

L. Marc Zell

Plaintiff L. Marc Zell is an American and Israeli citizen living in Israel. Zell, an attorney, alleges that “[b]ecause of FATCA, [he] and his firm have been required by their Israeli banking institutions to complete IRS withholding forms ... as a precondition for opening trust accounts for both U.S. *and non-U.S.* persons and entities” (emphasis added). Zell alleges that the “Israeli banking officials have stated that they will require such submissions regardless of whether the beneficiary is a U.S. person ... because the trustee is or may be a U.S. person,” and that, as a result, “banks have required [him] and his firm to close the trust account in some cases, and in other instances the banks have refused to open the requested trust account.” Zell alleges that he holds in trust certain client securities that are required by Israeli financial regulations to be “held by a qualified Israeli financial institution,” but Zell’s Israeli financial institution has requested Zell to transfer the securities elsewhere “because both he and the beneficiary in this instance are U.S. citizens.” Finally, Zell alleges that his non-United States clients have been required by Israeli banks “to fill out the IRS forms even though they have no connection with the United States,” and that “banking officials have stated that the mere fact a U.S. person trustee or his law firm is acting as a fiduciary is reason enough to require non-U.S. person beneficiaries to” report their identities and assets to the United States. Zell alleges that in “a few such instances,” the client-beneficiary has terminated the attorney-client relationship, “resulting in palpable financial loss” to Zell and his firm.

Proposed Additional Plaintiffs

In addition to these seven plaintiffs, Plaintiffs’ Proposed Amended Complaint sought to add three new plaintiffs: Plaintiff Johnson’s wife Katerina Johnson, Plaintiff Kuettel’s daughter Lois Kuettel, and Plaintiff Nelson’s husband Richard Adams. The amended complaint also includes statements, absent from the original complaint, that some of Plaintiffs’ bank balances exceeded the threshold amounts at which FATCA or FBAR requirements might apply, but the amended complaint otherwise recites the same claims and substantially the same facts as the original complaint. Importantly, none of the original plaintiffs or proposed plaintiffs alleges that they have faced direct consequences such as the imposition or threatened imposition of a financial penalty for noncompliance with FATCA, the IGAs, or the FBAR.

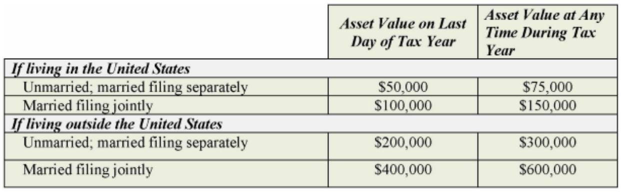
B. FATCA, the IGAs, and the FBAR

Plaintiffs assert challenges against five sets of laws: (1) FATCA’s individual-reporting requirements; (2)

FATCA's "FFI Penalty"; (3) FATCA's "Passthru Penalty"; (4) the IGAs; and (5) the FBAR Willfulness Penalty.

***446** *1. FATCA's Individual-Reporting Requirements*

FATCA requires United States taxpayers with "specified foreign financial assets" to file a special report with their annual tax returns that discloses the name and address of the financial institution that maintains each specified account; the name and address of any issuers of specified stocks or securities; information necessary to identify other specified instruments, contracts, or interests and their issuers; and the maximum value of each specified asset during the taxable year. 26 U.S.C. § 6038D(b)–(c). The reporting requirement applies to any United States taxpayer when the "aggregate value of all [specified] assets exceeds $50,000 (*or such higher dollar amount as the secretary may prescribe*)." § 6038D(a) (emphasis added). Notably, the Secretary of the Treasury has prescribed higher dollar amounts for many taxpayers depending on their marital status, maximum asset value during the tax year, and place of residence. The following individual-reporting thresholds have been in place since at least 2012:



	Asset Value on Last Day of Tax Year	*Asset Value at Any Time During Tax Year*
If living in the United States		
Unmarried; married filing separately	$50,000	$75,000
Married filing jointly	$100,000	$150,000
If living outside the United States		
Unmarried; married filing separately	$200,000	$300,000
Married filing jointly	$400,000	$600,000

See 26 C.F.R. § 1.6038D-2(a); *see also* Treasury Insp. Gen. for Tax Admin., U.S. Dept. of Treasury, "The Internal Revenue Service Has Made Progress in Implementing the Foreign Account Tax Compliance Act," Fig. 1., Ref. No. 2015-30-085 (Sept. 23, 2015).

Plaintiffs' pleadings below and principal brief on appeal acknowledge only the $50,000 and $75,000 values applicable to single filers residing in the United States. *See, e.g.*, Appellants' Br. 2. Plaintiffs' reply brief obliquely acknowledges the $200,000/$300,000 threshold values that would seem to apply to most of the Plaintiffs on account of their overseas residences, noting that "the secretary has recently increased the triggering amount for individuals living abroad," but Plaintiffs argue that "the threshold could be lowered to the statutory minimum at any time, thus triggering reporting for Plaintiffs." Reply Br. 7. Failure to report carries a penalty of up to $10,000 per violation plus 40% of the amount of any underpaid tax "attributable to" the assets for which disclosure was required. 26 U.S.C. §§ 6038D(d) ("[S]uch person *shall* pay a penalty of....") (emphasis added), 6662(j)(3). No penalty is due, however, if failure to report is "due to reasonable cause and not due to willful neglect." *Id.* § 6038D(g).

Plaintiffs seek to enjoin the statutory reporting requirement, 26 U.S.C. § 6038D; the regulation that implements the reporting requirement, 26 C.F.R. § 1.6038D-4(a)(5); a regulation that requires disclosing the opening or closing of a specified foreign account, 26 C.F.R. § 1.6038D-4(a)(6); and a regulation that requires disclosing "income, gain, loss, deduction, or credit recognized ... with respect to" specified assets, 26 C.F.R. § 1.6038D-4(a)(8).

***447** *2. FATCA's Institutional-Reporting Requirements, the FFI Penalty, and the Passthru Penalty*

FATCA also imposes an *institutional*-reporting requirement on FFIs,[1] which an FFI can satisfy in one of three ways as set forth in 26 U.S.C. § 1471(b)(1), (b)(2), and (b)(3). First, the FFI may enter into an agreement with Treasury whereby the FFI agrees, among other things, to take the following five actions:

(1) "to obtain such information regarding each holder of each account maintained by such institution as is necessary to determine which (if any) of such accounts are United States accounts";[2]

(2) to make annual reports to Treasury providing details on United States accounts, including the "name, address, and [Taxpayer Identification Number] of each account holder which is a specified United States person and, in the case of any account holder which is a United States owned foreign entity, the name, address, and [Taxpayer Identification Number] of each substantial United States owner of such entity"; the account number; the account balance or value; and "the gross receipts and gross withdrawals or payments from the account";

(3) "to deduct and withhold a tax equal to 30 percent of ... any passthru payment[3] which is made by such institution to a recalcitrant account holder[4]

or another foreign financial ***448** institution which does not meet the requirements of this subsection"—the so-called Passthru Penalty;

(4) to attempt to obtain a waiver from each account holder of any foreign law that would (but for such a waiver) prohibit the disclosure of the required information to the United States; and

(5) to close the accounts of any account holders from which such a waiver "is not obtained ... within a reasonable period of time." 26 U.S.C. § 1471(b)(1).

Second, the FFI "may be treated by the Secretary as meeting the requirements of" FATCA if the FFI either "complies with such procedures as the Secretary may prescribe to ensure that such institution does not maintain United States accounts" or "is a member of a class of institutions with respect to which the Secretary has determined that the application of [FATCA's reporting requirement] is not necessary." 26 U.S.C. § 1471(b)(2). As we discuss below, FFIs subject to the jurisdiction of countries that have signed IGAs with Treasury may be deemed compliant under 26 U.S.C. § 1471(b)(2) by virtue of their (and their country's) compliance with an IGA.

Third, the FFI may "elect" to withhold a tax from *payments sent to the FFI* from "accounts held by recalcitrant account holders or foreign financial institutions which do not meet the requirements of this subsection" rather than agreeing to withhold the 30% tax from *the FFI's payments* to recalcitrant account holders or noncompliant FFIs. 26 U.S.C. § 1471(b)(3).

If an FFI fails to meet FATCA's institutional-reporting requirement in one of these three ways, then the FFI is subject to having "a tax equal to 30 percent" deducted and withheld from *all* withholdable payments sent to the FFI. 26 U.S.C. § 1471(a). Plaintiffs assert and the government does not dispute that this tax—the so-called "FFI Penalty"—applies to United States-sourced income payable to the FFI as well as foreign-sourced income payable to the FFI from other FFIs. *See* 26 C.F.R. § 1.1471-2; Compl. 29; Appellees' Br. 4.

In short, if an FFI is not subject to the jurisdiction of a country that has concluded an IGA, the FFI must either comply with FATCA (and withhold the Passthru Penalty from payments it makes to recalcitrant account holders and noncompliant FFIs) or elect to have a 30% tax withheld from incoming payments from recalcitrant account holders or noncompliant FFIs; otherwise, the FFI becomes noncompliant itself and thus subject to the FFI Penalty of 30% of *all* withholdable payments[5] it receives from any source whatsoever.

Plaintiffs seek to enjoin the enforcement of the reporting requirement, the withholding provisions, the regulations implementing these provisions, and the IRS's use of Form 8966, "FATCA Report," on which FFIs make FATCA disclosures. Plaintiffs also seek to enjoin the enforcement of the Passthru Penalty, which is the 30% "tax"[6] that FFIs deduct and withhold from payments to recalcitrant account holders or noncompliant FFIs under 26 U.S.C. § 1471(b)(1)(D). *See also* 26 C.F.R. §§ 1.1471-4(a)(1), 1.1471-4T(b)(1).

***449** *3. The IGAs*

Treasury, on behalf of the United States, has reached agreements with dozens of foreign governments to "facilitate the implementation of FATCA." 26 C.F.R. § 1.1471-1(b)(79). These intergovernmental agreements (IGAs) take two forms: "Model 1" IGAs and "Model 2" IGAs.

Under a Model 1 IGA, the foreign government agrees to collect the financial information that FATCA would otherwise require FFIs to report, and the foreign government itself reports that information directly to the IRS. Notably, the Model 1 IGA makes clear that as long as the foreign government "complies with its obligations under" the IGA, any FFI within that government's jurisdiction that also complies with its own obligations under the IGA (such as sending accountholder information to the foreign government) "shall be treated as complying with" FATCA[7] and is exempt from FATCA reporting, penalties, and withholding. *See, e.g.*, U.S. Dept. of Treasury FATCA Resource Center, Model 1A IGA Reciprocal, Preexisting TIEA or DTC, Art. 4, § 1, (Nov. 30, 2014), http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-11-30-14.pdf.

Treasury has signed Model 1 IGAs with Canada (in force June 27, 2014), Czech Republic (in force December 18, 2014), Israel (in force August 29, 2016), France (in force October 14, 2014), and Denmark (in force September 30, 2015). Plaintiffs' original complaint, in which they sought to enjoin the Canadian, Czech, and Israeli IGAs, was filed July 14, 2015; Plaintiffs sought leave to file their proposed amended complaint, which would also enjoin the French and the Danish IGAs, on October 30, 2015. Neither complaint mentions that although all the above-mentioned Model 1 IGAs were *signed* on June 30, 2014, the Israeli IGA was not yet *in force* at the time of filing either complaint. U.S. Dept. of Treasury FATCA Resource Center, https://www.irs.gov/pub/irs-drop/a-16-27.pdf. Indeed, the Israeli Knesset did not approve regulations implementing FATCA until August 4, 2016. Nevertheless, Treasury has declared that any foreign jurisdiction that signed an IGA before November 30, 2014, would be treated "as if [it had] an IGA in effect" and would thus be exempt from FATCA reporting, penalties, and withholding—including penalties against recalcitrant account holders—"as long as the jurisdiction is taking the steps necessary to bring the IGA into force within a reasonable period of time." *See* IRS Announcement 2016-27, https://www.irs.gov/pub/irs-drop/a-16-27.pdf; IRS Announcement 2013-43, https://www.irs.gov/pub/irs-drop/n-13-43.pdf. One such announcement set December 31, 2016, as the date by which jurisdictions whose IGAs were not yet in force owed "a detailed explanation" to Treasury. *See* IRS Announcement 2016-27 at 2–3. The result of the Treasury notices and the pending IGA is that from the time Plaintiffs' complaint was filed until well after the district-court record closed, neither FATCA nor any IGA had any legal effect in Israel.

Under a Model 2 IGA, the foreign government agrees to modify its laws to the extent necessary to enable its FFIs to report their United States account information directly to the IRS. Treasury has signed a Model 2 IGA with Switzerland (in force June 2, 2014), in which the Swiss government has agreed to "direct all Reporting Swiss Financial Institutions" to "register with the IRS" and comply with ***450** applicable FATCA provisions. Swiss IGA Art. 3 § 1. One provision of the Swiss IGA, Article 5, is not yet in force because it requires that a separate "Protocol"—an amendment to a bilateral tax treaty that was signed by the United States and Switzerland in 2009—first come into force, but the United States Senate has not yet approved that Protocol, leaving Article 5 inoperative. Article 5 would authorize the United States to make "group requests" to the Swiss Federal Department of Finance or its designee for aggregated reportable-account information. Swiss IGA Art. 2 § 1; Art. 5. Despite the fact that Article 5 is inoperative, however, the Swiss Model 2 IGA, somewhat like the Model 1 IGAs, provides that Swiss FFIs that register with the IRS and comply with an "FFI Agreement" (essentially, an agreement between an individual Swiss FFI and the United States government to report United States account information) "shall be treated as complying with" FATCA and are thus exempt from any provisions of FATCA beyond those incorporated into the IGA or FFI Agreement. Swiss IGA Art. 6. Swiss FFIs' obligations are lighter under the IGA than under FATCA: for example, as long as a Swiss FFI complies with the registration and reporting requirements in Article 3 of the IGA, it is not required to withhold the passthru tax from recalcitrant account holders or to close any account holders' accounts. Swiss IGA Art. 7 § 1.

Plaintiffs seek to invalidate the Canadian, Czech, Israeli, French, Danish, and Swiss IGAs.

4. The FBAR Willfulness Penalty

The last set of laws at issue is the foreign-bank-account-reporting (FBAR) requirement of the Bank Secrecy Act, which requires any United States person with "a financial interest in or signature authority over at least one financial account located outside of the United States" to file FinCEN Form 114 (also referred to as the FBAR) with Treasury annually. Reporting is required for accounts held during the previous calendar year if "the aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year reported." *See* 31 U.S.C. § 5314; 31 C.F.R. §§ 1010.306(c), .350. The FBAR appears to have nothing to do with FATCA or the IGAs other than that presumably most if not all individuals subject to FATCA's reporting requirement are also required to file an FBAR, since the reporting threshold for the FBAR is lower than any reporting threshold for FATCA.

Nevertheless, Plaintiffs challenge the FBAR's willful-failure-to-report penalty ("Willfulness Penalty"), which provides that "[t]he Secretary of the Treasury *may* impose" a penalty equal to the *greater* of $100,000 or half the value in the reportable account(s) at the time of the violation. 31 U.S.C. § 5321(a)(5)(A), (C) (emphasis added). The ordinary penalty (absent a showing of willfulness), which Plaintiffs do not challenge, is $10,000 per violation. *Id.* § 5321(a)(5)(B)(i). Plaintiffs also seek to enjoin the FBAR account-balance-reporting requirement —that is, the requirement to complete FinCEN Form 114.

C. Counts Enumerated in the Complaint

In both the original complaint and the proposed amended complaint, Plaintiffs brought eight counts against Defendants. A brief summary of the counts is provided here as relevant background, although Plaintiffs need not demonstrate that they are likely to *prevail* as to any of these counts in order to have *standing* to bring them.

***451** *Counts 1 & 2: The IGAs Were Unconstitutionally Executed*

Plaintiffs claim in Count 1 that the IGAs are "unconstitutional sole executive agreements" that exceed the scope of the President's constitutional power because they are not authorized by Congress through the ordinary legislative process. Compl. 37. Plaintiffs claim that the only constitutionally permissible means by which the executive branch may make international agreements are by the Treaty Clause, an Act of Congress, a provision in an existing treaty, or the President's independent constitutional foreign-affairs power—which Plaintiffs claim does not include the power to impose a tax or to create a tax-collection mechanism like the IGAs.

Alternatively, in Count 2, Plaintiffs claim that the IGAs are impermissible because they are "inconsistent with legislation enacted by Congress in the exercise of its constitutional authority"—namely, FATCA—to the extent that they, among other things, allow FFIs to report to their national governments rather than to the IRS. Amended Compl. 49 (quoting State Department Foreign Affairs Manual). Plaintiffs thus claim that the IGAs "override" FATCA and "must be held unlawful and set aside" because "Treasury and the IRS have acted contrary to the President's constitutional power" in entering into the IGAs.

Count 3: The FATCA, IGA, and FBAR Reporting Requirements Violate the Equal Protection Clause

Plaintiffs claim that compared to the various data reported to the IRS about foreign accounts under FATCA, the IGAs, and the FBAR, "[t]he only financial information reported to the IRS about domestic accounts is the amount of interest paid to the accounts during a calendar year." Plaintiffs thus claim that United States citizens living abroad are treated differently than United States citizens living in the United States, in violation of the Fourteenth Amendment Equal Protection Clause (as incorporated against the federal government through the Fifth Amendment Due Process Clause). *See United States v. Ovalle*, 136 F.3d 1092, 1095 n.2 (6th Cir. 1998).

Counts 4–6: The FFI Penalty, Passthru Penalty, and FBAR Willfulness Penalty Impose Unconstitutionally Excessive Fines

In Count 4, Plaintiffs challenge the FFI Penalty, which is imposed directly upon FFIs for noncompliance with FATCA, as an unconstitutionally excessive fine, claiming that "[t]he penalty is used as a hammer to coerce compliance by [FFIs] everywhere in the world." Plaintiffs claim that the penalty is unconstitutional because it "is grossly disproportional to the gravity of the offense it seeks to punish." In Count 5, Plaintiffs lodge the same attack against the Passthru Penalty, which FFIs apply to recalcitrant account holders under FATCA. In Count 6, Plaintiffs lodge the same attack against the FBAR Willfulness Penalty.

Counts 7 & 8: The Institutional-Reporting Requirements of FATCA and the IGAs Violate Plaintiffs' Fourth Amendment Right to Privacy

In Count 7, Plaintiffs claim that FATCA's requirement that FFIs report account data to the United States constitutes a warrantless search in violation of Plaintiffs' Fourth Amendment protection against unreasonable searches and seizures. In Count 8, Plaintiffs claim that the IGAs' requirement that FFIs report account data either to their governments or ***452** to the United States likewise violates the Fourth Amendment.

D. Procedural History

Plaintiffs filed their original complaint in the United States District Court for the Southern District of Ohio on July 14, 2015. Plaintiffs moved for a preliminary injunction, which the district court denied, holding that Plaintiffs were not likely to succeed on the merits because they lacked standing and, alternatively, because they had brought allegations that failed as a matter of law. On October 30, 2015, Plaintiffs moved for leave to amend their complaint. The government filed both a motion to dismiss and an opposition to Plaintiffs' motion for leave to amend.

On April 26, 2016, the district court granted the government's motion to dismiss for lack of standing, declined to reach the government's motion to dismiss for failure to state a claim, and denied Plaintiffs' motion for leave to amend. The district court denied leave to amend only after considering the new plaintiffs and their new claims and after determining that even if leave to amend were granted, Plaintiffs still would not have standing to sue, rendering leave to amend futile. This timely appeal followed.

In the interest of simplicity, we will discuss whether Plaintiffs have standing in light of the facts pleaded in both the original complaint and the proposed amended complaint. For the reasons that follow, the district court rightly held that none of the plaintiffs had standing to sue, and that granting leave to amend would not cure the defect in standing.

II

A. Elements of Standing

[1] Federal courts have constitutional authority to decide only "cases" and "controversies." U.S. Const. art. III § 2; *see Muskrat v. United States*, 219 U.S. 346, 31 S.Ct. 250, 55 L.Ed. 246 (1911). The requirement of standing is "rooted in the traditional understanding of a case or controversy." *Spokeo, Inc. v. Robins*, ––– U.S. ––––, 136 S.Ct. 1540, 1547, 194 L.Ed.2d 635 (2016). To bring suit, Plaintiffs must have "alleged such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues" before the court. *Baker v. Carr*, 369 U.S. 186, 204, 82 S.Ct. 691, 7 L.Ed.2d 663 (1962).

[2] The "irreducible constitutional minimum" of standing is that for each claim, each plaintiff must allege an actual or imminent injury that is traceable to the defendant and redressable by the court. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560–62, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992) (holding wildlife-conservation organizations lacked standing to seek injunctive relief against the Secretary of the Interior's interpretation of the Endangered Species Act where organization members' harm was the endangering of wild animals in Sri Lanka but where the members had no current plans to go to Sri Lanka to observe the animals); *see Friends of the Earth, Inc. v. Laidlaw Envtl. Servs.*, 528 U.S. 167, 185, 120 S.Ct. 693, 145 L.Ed.2d 610 (2000) (agreeing that "a plaintiff must demonstrate standing separately for each form of relief sought").

1. Injury

[3] The injury must be an "injury in fact," meaning "an invasion of a *legally protected interest* which is (a) concrete and particularized, and (b) 'actual or imminent, not "conjectural" or "hypothetical." ' " *Lujan*, 504 U.S. at 560, 112 S.Ct. 2130 (emphasis added) (citations omitted) (first quoting *Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 82 L.Ed.2d 556 (1984); then ***453** quoting *Whitmore v. Arkansas*, 495 U.S. 149, 155, 110 S.Ct. 1717, 109 L.Ed.2d 135 (1990) (quoting *Los Angeles v. Lyons*, 461 U.S. 95, 102, 103 S.Ct. 1660, 75 L.Ed.2d 675 (1983))).

[4] There is no "legally protected interest" in maintaining the privacy of one's bank records from government access. *United States v. Miller*, 425 U.S. 435, 442, 96 S.Ct. 1619, 48 L.Ed.2d 71 (1976) (holding bank clients had no legitimate expectation of privacy in banking information revealed to a third party); *United States v. Warshak*, 631 F.3d 266, 288 (6th Cir. 2010) (noting that *Miller* involved "business records" as opposed to "confidential communications").

[5] The requirement that an injury be "concrete and particularized" has two discrete parts: concreteness, which is the requirement that the injury be "real," and not "abstract," *Spokeo*, 136 S.Ct. at 1548, and particularization, which is the requirement that the plaintiff "*personally* [have] suffered some actual or threatened injury" as opposed to bringing a generalized grievance. *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 472, 102 S.Ct. 752, 70 L.Ed.2d 700 (1982) (emphasis added).

[6] [7] Concreteness. "Abstract, intellectual problems," *FEC v. Akins*, 524 U.S. 11, 20, 118 S.Ct. 1777, 141 L.Ed.2d 10 (1998), "abstract concern," *Diamond v. Charles*, 476 U.S. 54, 67, 106 S.Ct. 1697, 90 L.Ed.2d 48 (1986), and "[a]bstract injury," *Lyons*, 461 U.S. at 101, 103 S.Ct. 1660, do not present concrete injuries. That said, concrete is not synonymous with tangible: intangible harms such as those produced by defamation or the denial of individual rights may certainly be concrete enough to constitute an injury in fact. *Spokeo*, 136 S.Ct. at 1549.

[8] Particularization. Additionally, "a plaintiff raising only a generally available grievance about government—claiming only harm to his *and every* citizen's interest in proper application of the Constitution and laws, and seeking relief that no more directly and tangibly benefits him than it does the public at large—does not state an Article III case or controversy." *Lujan*, 504 U.S. at 573–74, 112 S.Ct. 2130 (emphasis added); *see also Massachusetts v. Mellon*, 262 U.S. 447, 487, 43 S.Ct. 597, 67 L.Ed. 1078 (1923) (denying municipal taxpayer standing to challenge federal spending measure because the taxpayer's "interest in the moneys of the Treasury—partly realized from taxation and partly from other sources—is shared with millions of others; is comparatively minute and indeterminable"); *Hollingsworth v. Perry*, ––– U.S. ––––, 133 S.Ct. 2652, 2662, 186 L.Ed.2d 768 (2013) ("[A]n asserted right to have the Government act in accordance with law is not sufficient, standing alone[.]").

[9] [10] Legislative standing. The general rule that individual legislators lack standing to sue in their official capacity as congressman or senator follows from the requirement that an injury must be concrete and particularized. *See Raines v. Byrd*, 521 U.S. 811, 816, 821, 117 S.Ct. 2312, 138 L.Ed.2d 849 (1997) (in action by members of Congress to challenge the Line Item Veto Act, "loss of political power"—as opposed to loss of a private right—was not a concrete injury, and any institutional injury to Congress arising from the Act was not particularized to any individual plaintiff). An apparent exception to the general rule against legislative standing arises when the legislators are suing on a vote-nullification theory and allege that if their votes had been given effect, those votes would have been sufficient to defeat or enact a specific legislative ***454** action. *Coleman v. Miller*, 307 U.S. 433, 438, 59 S.Ct. 972, 83 L.Ed. 1385 (1939) (holding that where forty-member Kansas State Senate had deadlocked twenty-to-twenty in voting on a proposed constitutional amendment, the twenty senators who had voted against the amendment had standing to challenge the constitutionality of the lieutenant governor's tie-breaking vote in favor of the amendment, because the lieutenant governor's vote effectively nullified the plaintiffs' votes *and* the plaintiffs' votes would have been sufficient to prevent ratification of the amendment); *see also Baird v. Norton*, 266 F.3d 408, 410 (6th Cir. 2001) (holding that a Michigan House member and a Michigan state senator lacked standing to challenge gaming compacts that were approved by a concurrent-resolution procedure requiring only a majority of votes cast rather than by the ordinary legislative process that would have required a majority of the votes of all members in each house).

We held in *Baird* that to the extent that the legislators complained of the deprivation of procedural safeguards built into the ordinary legislative process, they had "at most, a generalized grievance shared by all Michigan residents alike," and thus lacked the sort of particularized injury in fact that standing requires. *Baird*, 266 F.3d at 411. And we held that the legislators could not show a *Coleman*-like vote-nullification injury because their votes "would not have been sufficient to defeat either the concurrent resolution ... or legislation to similar effect." *Id.* at 412. In such circumstances, legislators' remedy lies not with the courts but with the legislative process, for, as the Supreme Court noted in *Raines*, the legislature could simply "vote to repeal" offending legislation. 521 U.S. at 824, 117 S.Ct. 2312.

[11] Actual or imminent. Standing can derive from an imminent, rather than an actual, injury, but only when "the threatened injury is real, immediate, and direct." *Davis v. FEC*, 554 U.S. 724, 734, 128 S.Ct. 2759, 171 L.Ed.2d 737 (2008) (holding candidate for House of Representatives had standing to challenge election regulation exempting opponents of self-financing candidates from certain campaign-contribution limits where plaintiff candidate had declared his candidacy and was demonstrably a self-financing candidate whose opponents would imminently receive expanded access to campaign funding).

In a pre-enforcement challenge to a federal statute, the Supreme Court has held that a plaintiff satisfies the injury requirement of standing by alleging "an intention to engage in a course of conduct arguably affected with a constitutional interest, but proscribed by a statute, and [that] there exists a credible threat of prosecution thereunder." *Susan B. Anthony List v. Driehaus*, ––– U.S. ––––, 134 S.Ct. 2334, 2342, 189 L.Ed.2d 246 (2014) (quoting *Babbitt v. Farm Workers*, 442 U.S. 289, 298, 99 S.Ct. 2301, 60 L.Ed.2d 895 (1979)); *see also Warth v. Seldin*, 422 U.S. 490, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975); *Village of Arlington Heights v. Metro. Hous. Dev. Corp.*, 429 U.S. 252, 264, 97 S.Ct. 555, 50 L.Ed.2d 450 (1977) (holding that one of the plaintiffs had standing to challenge a discriminatory zoning law where an injunction against the law would have produced "at least a 'substantial probability,' *Warth*, 422 U.S. at 504, 95 S.Ct. 2197, that" the plaintiff's desired housing project would "materialize").

[12] **[13]** The mere *possibility* of prosecution, however—no matter how strong the plaintiff's intent to engage in forbidden conduct may be—does not amount to a "credible threat" of prosecution. Instead, the threat of prosecution "must be *certainly impending* to constitute injury in fact." ***455** *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 133 S.Ct. 1138, 1147, 185 L.Ed.2d 264 (2013) (quoting *Whitmore*, 495 U.S. at 158, 110 S.Ct. 1717). Putting the Supreme Court's language in *Warth*, *Driehaus*, and *Clapper* together: to have standing to bring a pre-enforcement challenge to a federal statute, there must be a *substantial probability* that the plaintiff actually will engage in conduct that is *arguably affected* with a constitutional interest, and there must be a *certain* threat of prosecution if the plaintiff does indeed engage in that conduct.

[14] Further, lawsuits that do not challenge "specifically identifiable Government violations of law," but instead challenge "particular programs agencies establish to carry out their legal obligations are ... rarely if ever appropriate for federal-court adjudication." *Lujan*, 504 U.S. at 568, 112 S.Ct. 2130 (citation omitted).

[15] Past injury is also inadequate to constitute an injury in fact when the plaintiff seeks injunctive relief but not does suffer "any continuing, present adverse effects." *Lyons*, 461 U.S. at 102, 103 S.Ct. 1660 (quoting *O'Shea v. Littleton*, 414 U.S. 488, 495–96, 94 S.Ct. 669, 38 L.Ed.2d 674 (1974)).

[16] **Third-party standing.** Generally, "a plaintiff must 'assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties.' " *Coyne ex rel. Ohio v. Am. Tobacco Co.*, 183 F.3d 488, 494 (6th Cir. 1999) (quoting *Warth*, 422 U.S. at 499, 95 S.Ct. 2197; *see also Ovalle*, 136 F.3d at 1100–01; *Powers v. Ohio*, 499 U.S. 400, 410, 111 S.Ct. 1364, 113 L.Ed.2d 411 (1991)). The rare "third-party standing" exception to this requirement allows federal courts to hear cases in which a plaintiff can "show that (1) it has suffered an injury in fact; (2) it has a close relationship to the third party; and (3) there is some hindrance to the third party's ability to protect his or her own interests." *Mount Elliott Cemetery Ass'n v. City of Troy*, 171 F.3d 398, 404 (6th Cir. 1999); *see also Connection Distrib. Co. v. Reno*, 154 F.3d 281, 295 (6th Cir. 1998). Plaintiffs have expressly stated that they "rely neither on third-party standing nor [on] the harms of others," Appellants' Br. 24, but the Government contends that without invoking third-party standing, Plaintiffs would have no way to attack the FFI Penalty, which is imposed only on financial institutions that are not parties to this litigation.

2. Causation

[17] Even if a plaintiff alleges an actual or imminent injury that is concrete and particularized, the plaintiff must also show that the injury is "fairly traceable to the defendant's allegedly unlawful conduct." *Allen*, 468 U.S. at 751, 104 S.Ct. 3315 (holding parents of schoolchildren lacked standing to sue IRS to challenge private schools' tax exemptions where the parents' alleged harm of increased school segregation was caused by the private schools' choice to racially discriminate and was not fairly traceable to the IRS). When a plaintiff's alleged injury is the result of "the independent action of some third party not before the court," the plaintiff generally lacks standing to seek its redress. *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 42, 96 S.Ct. 1917, 48 L.Ed.2d 450 (1976); *see also Lujan*, 504 U.S. at 560–61, 112 S.Ct. 2130; *Shearson v. Holder*, 725 F.3d 588, 592 (6th Cir. 2013); *Ammex, Inc. v. United States*, 367 F.3d 530, 533 (6th Cir. 2004) (holding that a retailer lacked standing to challenge a federal excise tax assessed against a third-party fuel supplier, even where the retailer was required by contract to pay the supplier an amount equal to the excise tax upfront at the time of purchase, since the "alleged injury ... ***456** in the form of increased fuel costs was not occasioned by the Government").

[18] Neither is injury caused by market conditions fairly traceable to a regulation that happens to regulate that market. *Warth*, 422 U.S. at 506, 95 S.Ct. 2197 (holding Rochester-area residents lacked standing to challenge suburb's zoning as unconstitutionally excluding low- and moderate-income residents where plaintiffs were unable to allege other than in conclusory terms that they had been injured; where none of the plaintiffs personally owned property in the suburb or had been denied a variance or permit by the suburb; and where the plaintiffs' "inability to reside in [the suburb was] the consequence of the economics of the area housing market, rather than respondents' assertedly illegal acts").

[19] Nor is an injury fairly traceable to the defendant's conduct if the plaintiffs have "inflict[ed] [the] harm on themselves based on their fears of hypothetical future harm." *Clapper*, 133 S.Ct. at 1151.

[20] As we noted above, Plaintiffs do not rely on third-party standing. Rather, Plaintiffs argue that they have suffered "indirect" harm. An indirect harm is an injury caused to a plaintiff when the defendant's unlawful conduct harms a third party who in turn causes the plaintiff's harm—unlike in third-party standing cases, a plaintiff claiming indirect harm is seeking to vindicate the plaintiff's *own* rights and not a third party's. Appellants' Br. 23 (citing *Roe v. Wade*, 410 U.S. 113, 124, 93 S.Ct. 705, 35 L.Ed.2d 147 (1973)). Plaintiffs rely heavily on *Roe*: they argue that the law challenged in *Roe directly* harmed abortionists, not women seeking abortions, but that the *indirect harm* to women seeking abortions was nevertheless fairly traceable to the law. Plaintiffs argue that in *Roe*, the doctors had only two options (provide abortions and thus break the law, or comply with the law by declining to provide abortions); Plaintiffs argue that in this case, similarly, FFIs have only two options: disregard FATCA and thus become subject to the 30% FFI Penalty, or comply with FATCA by refusing to do business with certain United States persons.

[21] But Plaintiffs' analogy overlooks a third option available here and not in *Roe*: FFIs may comply with FATCA *and* do business with United States persons —*without* imposing additional requirements on their clients beyond what FATCA and the IGAs themselves require.[8] As we will ***457** discuss, several of Plaintiffs' alleged harms arise not from FFIs' acting under the *command* of FATCA or an IGA, but rather from the FFIs' voluntary choice to go *above and beyond* FATCA and the IGAs. FFIs may do so, for example, by gathering FATCA-compliance-related information from non-United States persons, or by choosing not to do business with certain individuals, whether to protect their own interests in FATCA compliance or for some other reason. *See, e.g.*, Amended Compl. 12 ("[R]ather than reporting information about U.S. clients, Saxo Bank is turning away U.S. citizens like Mark."). And although an injury "produced by" a defendant's "determinative or coercive effect" upon a third party (such as the injury of inability to obtain an abortion, produced by the determinative effect of the challenged law in *Roe* upon abortionists) may suffice for standing, an injury that results from the third party's *voluntary and independent* actions or omissions does not. *Bennett v. Spear*, 520 U.S. 154, 169, 117 S.Ct. 1154, 137 L.Ed.2d 281 (1997).

3. Redressability

Finally, a plaintiff must also plead facts sufficient to establish that the court is capable of providing relief that would redress the alleged injury. *Lujan*, 504 U.S. at 561–62, 112 S.Ct. 2130.

B. Burden of Proof and Standard of Review

[22] **[23]** **[24]** Each plaintiff has the burden "clearly to allege facts demonstrating that he is a proper party to invoke judicial resolution of the dispute." *Warth*, 422 U.S. at 518, 95 S.Ct. 2197. "[W]e assess standing as of the time a suit is filed." *Clapper*, 133 S.Ct. at 1157. And standing must remain "extant at all stages of review." *Arizonans for Official English v. Arizona*, 520 U.S. 43, 67, 117 S.Ct. 1055, 137 L.Ed.2d 170 (1997) (quoting *Preiser v. Newkirk*, 422 U.S. 395, 401, 95 S.Ct. 2330, 45 L.Ed.2d 272 (1975)).

[25] **[26]** "Standing cannot be 'inferred argumentatively from averments in the pleadings,' " *FW/PBS, Inc. v. City* *of Dallas*, 493 U.S. 215, 231, 110 S.Ct. 596, 107 L.Ed.2d 603 (1990) (quoting *Grace v. American Central Ins. Co.*, 109 U.S. 278, 284, 3 S.Ct. 207, 27 L.Ed. 932 (1883)), or even from the government's concession of standing, "but rather 'must affirmatively appear in the record.' " *FW/PBS*, 493 U.S. at 231–36, 110 S.Ct. 596 (quoting *Mansfield C. & L.M.R. Co. v. Swan*, 111 U.S. 379, 392, 4 S.Ct. 510, 28 L.Ed. 462 (1884)) (holding certain plaintiffs did not have standing to attack ordinance governing sexually oriented businesses where the record did not reveal that any one of these plaintiffs was subject to the ordinance, even though the city attorney conceded at oral argument before the Supreme Court that "one or two" of them had had their licenses denied under the ordinance). The Supreme Court has "always insisted on strict compliance with this jurisdictional standing requirement," *Raines*, 521 U.S. at 819, 117 S.Ct. 2312. And the inquiry into whether plaintiffs have standing is "especially rigorous" where, as here, "reaching the merits of the dispute would force [a court] to decide whether an action taken by one of the other two branches of the Federal Government was unconstitutional." *Clapper*, 133 S.Ct. at 1147 (quoting *Raines*, 521 U.S. at 819–20, 117 S.Ct. 2312).

[27] We review de novo the district court's dismissal for lack of standing, we accept as true all the material allegations in the Plaintiffs' complaints, and we construe Plaintiffs' complaints in Plaintiffs' favor. *See Jenkins v. McKeithen*, 395 U.S. 411, 421–22, 89 S.Ct. 1843, 23 L.Ed.2d 404 (1969); ***458** *Haines v. Fed. Motor Carrier Safety Admin.*, 814 F.3d 417, 423 (6th Cir. 2016).

C. No Plaintiff Has Standing as to Any Claim

1. No Plaintiff Has Standing to Challenge FATCA

[28] No Plaintiff has standing to challenge FATCA's individual-reporting requirements or the Passthru Penalty because no Plaintiff (or proposed Plaintiff) has alleged either an *actual* injury that is fairly traceable to FATCA or an *imminent* threat of prosecution from noncompliance with FATCA.

First, no Plaintiff has alleged any actual enforcement of FATCA such as a demand for compliance with the individual-reporting requirement, the imposition of a penalty for noncompliance, or an FFI's deduction of the Passthru Penalty from a payment to or from a foreign account.

Second, no Plaintiff can satisfy the *Driehaus* test for standing to bring a pre-enforcement challenge to FATCA because no Plaintiff claims to hold enough foreign assets to be subject to the individual-reporting requirement, and, as a result, no Plaintiff can claim that there is a "credible threat" of either prosecution for failing to comply with FATCA or imposition of a Passthru Penalty by an FFI. All but two of the Plaintiffs either fail to state the value of their foreign assets altogether or allege only that they have foreign accounts with an aggregate value "greater than $10,000"—but FATCA's individual-reporting requirement applies only to individuals with *at least* $50,000 worth of assets held in foreign accounts, with significantly higher thresholds in some cases. *See, e.g.*, Amended Compl. 12, 19, 21, 28, 30, 34.

The two exceptions are Johnson and Zell. Johnson has alleged that "[t]he aggregate value of [his] foreign accounts has been greater than $75,000 in 2014 and 2015[,] which subjects him to both FATCA individual reporting and FBAR reporting." *Id.* at 16. But Johnson lives outside the United States and would thus have to hold foreign accounts with an aggregate value in excess of *$200,000* to be subject to the individual-reporting requirement. That Treasury might someday lower the threshold from $200,000 to $50,000 (the *statutory* minimum) or $75,000 or any other level does not change the fact that, now and at the time Plaintiffs filed suit, Johnson is not subject to FATCA. Nor is it of any consequence that Johnson's *foreign banks* may be subject to FATCA's *institutional*-reporting requirement on account of Johnson's ownership of accounts exceeding $75,000 in value. Johnson cannot challenge the individual-reporting requirement or the Passthru Penalty without showing that Johnson *himself* is subject to those provisions, and based on the facts as stated in Plaintiffs' pleadings, Johnson is not.

[29] Further, Johnson—like all Plaintiffs—lacks standing to challenge FATCA's FFI Penalty (the penalty imposed upon financial institutions for *their* noncompliance with FATCA) because such a challenge would require either that the foreign banks themselves bring suit or that Plaintiffs rely on third-party standing, and Plaintiffs have made clear that they do not.

As for Zell, he alleges that he "had *signatory authority* over accounts with an aggregate year-end balance of greater than $200,000 in 2014, which would subject him to FATCA individual reporting." *Id.* at 34 (emphasis added). But, although the Israeli IGA imposes a reporting requirement for trust accounts like Zell's, FATCA *itself* does not require reporting where, as here, the trust accounts are held entirely for the benefit of non-United States persons. And although the Israeli IGA appears as of August 2016 to be in force in ***459** Israel, it was not in force prior to then. Zell could not have been subject to FATCA's individual-reporting requirement, either at the time Plaintiffs' complaint was filed or at the time Plaintiffs sought leave to amend their complaint, based either on Zell's own accounts (for which he alleges only an aggregate value exceeding $10,000) or on Zell's "signatory authority" over his clients' trust accounts, because only the Israeli IGA, not FATCA itself, required (or requires) reporting of accounts based on signatory authority, and the Israeli IGA was not in effect when Plaintiffs filed or sought to amend their complaint.

Finally, some Plaintiffs allege other harms arising from FATCA apart from its individual-reporting requirement or its Passthru Penalty. But none of these alleged harms are injuries that are fairly traceable to FATCA. Crawford alleges that Saxo Bank's decision not to allow Crawford (or Aksioner, Crawford's brokerage firm) to accept United States clients, is an injury; even if it is, however, it is not fairly traceable to FATCA but rather, as in *Allen* and *Ammex*, to Saxo Bank's own independent actions. The Johnsons' decision to separate their own assets to avoid disclosing Katerina Johnson's financial affairs to the United States government when there is no allegation that FATCA has actually compelled any such disclosure, similarly, is traceable to the Johnsons' own independent actions, not to FATCA.

Nelson alleges that she has "had her private financial account information disclosed to the IRS and the Treasury Department despite the fact that she is not a U.S. citizen." Amended Compl. 28. But Nelson has stated no facts whatsoever indicating that her account information was disclosed *because of FATCA*—and thus any injury resulting from this disclosure cannot fairly be traced to FATCA.

In Plaintiffs' complaint, Adams and Zell have alleged that they have had difficulty obtaining banking services from foreign banks. Zell specifically alleges that he has been told to move securities out of an Israeli bank and that he has been informed that his non-United States clients are required to complete IRS forms at the request of Israeli banks. But, again, a foreign bank's choice either not to do business with Adams or Zell, or (as in Zell's case) to require Zell's non-United States clients to make financial or other disclosures even though these clients are not subject to FATCA, is a choice voluntarily made by the bank and is not fairly traceable to FATCA. And the resulting choice of any of Zell's clients not to do business with Zell is fairly traceable to the clients or perhaps to the Israeli banks, but is not fairly traceable to FATCA. Likewise with Kuettel, who alleges that he had difficulty refinancing his mortgage until after he renounced his American citizenship: such difficulty cannot serve as the basis for standing because it is, at best, past injury that is insufficient to warrant injunctive relief (it is past injury because Kuettel *has* renounced his American citizenship and no longer claims to have difficulty refinancing his mortgage), and, in any event, it is traceable only to the foreign banks and not to FATCA because nothing in FATCA prevented the foreign banks from refinancing Kuettel's mortgage.

Several plaintiffs allege injuries that are not concrete. Kish, for example, alleges that "FATCA has at times caused some discord between" him and his wife. *Id.* at 19. But marital discord, particularized though it may be, is not the sort of concrete injury that can give rise to standing. Neither is Crawford or Johnson's discomfort with FATCA's reporting requirements, or Nelson's "resent[ment]," *id.* at 28, at having to prove to European banks ***460** that she is no longer a United States citizen in order to obtain banking services.

[30] In sum, no Plaintiff has standing to challenge FATCA's individual-reporting requirements, the Passthru Penalty, or the FFI Penalty, because no Plaintiff has suffered direct harm that is fairly traceable to any of these challenged provisions, and because no Plaintiff has alleged sufficient facts to show a credible threat of prosecution for noncompliance with any of these challenged provisions. At best, Plaintiffs' claimed injuries are the second-order effects of government regulation on the market for international banking services. But "consequence[s] of the economics" of holding foreign assets are not, on their own, injuries in fact for the purpose of demonstrating Article III standing. *Warth*, 422 U.S.

at 506, 95 S.Ct. 2197. Because the burden of establishing standing falls squarely on the plaintiff, and because we are constrained to examine the district-court pleadings alone to determine whether standing existed at the time the complaint was filed, we hold that no Plaintiff has standing to challenge FATCA.

2. No Plaintiff Has Standing to Challenge the IGAs

[31] **[32]** Senator Paul challenges the constitutionality of the IGAs. Senator Paul alleges harm because he "has been denied the opportunity to exercise his constitutional right as a member of the U.S. Senate to vote against the FATCA IGAs." *Id.* at 444. But, as in *Raines*, any incursion upon Senator Paul's political power is not a concrete injury like the loss of a private right, and any diminution in the *Senate*'s lawmaking power is not particularized but is rather a generalized grievance. Unlike in *Coleman*, in which the plaintiff-legislators' votes would have been sufficient to defeat the contested legislation, Senator Paul has not pleaded that his vote on its own would have been sufficient to forestall the IGAs. Rather, Senator Paul has a remedy in the legislature, which is to seek repeal or amendment of FATCA itself, under the aegis of which Treasury is executing the IGAs.[9] Senator Paul therefore lacks legislative standing to challenge the IGAs. None of the other Plaintiffs have alleged injuries that are traceable to the IGAs. The other Plaintiffs thus also lack standing to challenge the IGAs.

3. No Plaintiff Has Standing to Challenge the FBAR

[33] Although most Plaintiffs have alleged foreign account balances over $10,000 so as to be subject to the FBAR requirement, no Plaintiff has alleged *both* an intent to violate the FBAR requirement *and* a credible threat of the imposition of a failure-to-file penalty, as *Driehaus* would require in order for there to be standing to bring a pre-enforcement challenge to the FBAR penalty. Other than Zell, no Plaintiff has alleged any intent to violate the FBAR requirement. Zell has alleged that he "is not currently complying with" the FBAR. Amended Compl. 34. But Zell has not alleged any facts that would show a credible threat of enforcement against him. Even if there were a credible threat of enforcement, the FBAR penalty is a discretionary penalty under 31 U.S.C. § 5321(a)(5)(A). Zell has not alleged any facts that show that the Willfulness Penalty, as opposed to the lower ordinary penalty (which Plaintiffs do not challenge, *see* Part I.B.4, *supra*), would be imposed for Zell's noncompliance with the FBAR.

***461** Further, no Plaintiff has alleged any *actual* injury arising from the FBAR other than Lois Kuettel. Lois has alleged that she would like to have a college-savings account placed in her name that her father is currently holding for her benefit in his own name, but that her father does not want to transfer the account to her for fear that it will trigger an FBAR requirement for Lois. This injury, however, is traceable to Daniel Kuettel's personal choice not to transfer the account, and not to the FBAR.

In sum, none of the plaintiffs have standing to sue, and the district court was correct to dismiss their suit.

III

The District Court Properly Denied Leave to Amend

[34] **[35]** We generally review a district court's decision to deny leave to file an amended complaint, other than amendments as a matter of course under Fed. R. Civ. P. 15(a)(1), for abuse of discretion. *United States ex rel. Bledsoe v. Cmty. Health Sys.*, 342 F.3d 634, 644 (6th Cir. 2003). When a district court bases its denial of a motion to amend "on the legal conclusion that the proposed amendment would not survive a motion to dismiss," however, we review the district court's decision de novo. *Greenberg v. Life Ins. Co. of Va.*, 177 F.3d 507, 522 (6th Cir. 1999). Here, even if Plaintiffs were granted leave to amend their complaint in order to bring claims by Katerina Johnson, Lois Kuettel, and Richard Adams, and in order to plead additional facts such as some of the Plaintiffs' account balances, no plaintiff would have standing to bring any of the claims in the proposed amended complaint for the reasons set forth above. The district court thoroughly reviewed all of the proposed new parties and proposed new claims in the amended complaint, and the district court properly held that leave to amend would be futile. Accordingly, we affirm the ruling of the district court denying Plaintiff's motion for leave to amend.

CONCLUSION

FATCA imposes far-reaching reporting obligations on individuals and financial institutions, which, like many government regulations, undoubtedly exact monetary and other costs of compliance. The IGAs, to be sure, are part of an unprecedented scheme of international tax enforcement. And the FBAR Willfulness Penalty, if it were to be imposed, is admittedly steep: it could theoretically bring a $100,000 fine for failure to report a foreign account with a balance of $10,000.01. None of these considerations, however, help these Plaintiffs at this time to clear the initial jurisdictional hurdle of standing.

Accordingly, we **AFFIRM** the judgment of the district court, and we **DENY** as moot Defendants' motion to strike.

All Citations

868 F.3d 438, 120 A.F.T.R.2d 2017-5544, 2017-2 USTC P 50,315

Footnotes

[1] A "foreign financial institution" (FFI) is "any financial institution which is a foreign entity." 26 U.S.C. § 1471(d)(4). Financial institutions include any entity that "accepts deposits in the ordinary course of a banking or similar business," "holds financial assets for the account of others" "as a substantial portion of its business," or "is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities ..., partnership interests, commodities ..., or any interest" in the same. 26 U.S.C. § 1471(d)(5). FATCA thus reaches across the globe, although its extraterritorial reach is not directly at issue in this litigation, nor is it at issue at all in the present appeal, which concerns only the Plaintiffs' standing to sue.

[2] A "United States account" is "any financial account which is held by one or more specified United States persons or United States owned foreign entities," subject to certain exceptions not applicable here. 26 U.S.C. § 1471(d)(1)(A). United States persons include citizens and residents of the United States, domestic partnerships and corporations, estates other than foreign estates, and trusts subject to primary administrative supervision by a court of the United States where a United States person has authority to control "all substantial decisions" of the trust. 26 U.S.C. § 7701.

[3] A "passthru payment" is defined as "any withholdable payment or other payment to the extent attributable to a withholdable payment." 26 U.S.C. § 1471(d)(7). Withholdable payments include "(i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States." *Id.* § 1473(1)(A). The "withholding agent" with respect to each withholdable payment is obligated to deduct and withhold the 30% tax. Withholding agents include "all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment." *Id.* § 1473(4).

[4] "Recalcitrant account holder" means any account holder that fails to comply with an FFI's "reasonable requests" for information necessary to determine which accounts are United States accounts; fails to provide name, address, Taxpayer Identification Number, and account-number information to an FFI for United States accounts; or fails, upon an FFI's request, to waive the applicability of a foreign law that would (but for a valid and effective waiver by the account holder) otherwise prohibit disclosure of such information. 26 U.S.C. § 1471(d)(6).

[5] *See* n.3, *supra*.

[6] We decline to address whether the 30% deduction is a tax or a penalty.

[7] The IGAs are the principal means by which an FFI may be treated as complying with FATCA under 26 U.S.C. § 1471(b)(2), discussed above.

[8] Plaintiffs' *Roe* analogy also fails when individual account holders are compared to the plaintiffs in *Roe*: the account holders' options are not "close your account or pay the penalty," but rather "close your account, pay the penalty, or keep your account open while filing the required paperwork to do so." This is unlike *Roe* where a woman seeking an abortion that was not otherwise permitted had no "third option": the only options were to seek an illicit abortion or to decline to have the abortion in the first place. A similar analogy could be drawn to highway-speed laws: a motorist wishing to travel quickly, perhaps to transport perishable goods or to visit an ill relative, has only the option to speed (and risk a traffic citation) or to comply with the law (and risk having spoiled goods or missing the death of a relative). In such a situation,

the motorist might well be able to argue that the injury of having spoiled goods or missing the death of the relative was fairly traceable to the speed-limit law. But this situation would *not* be like the Plaintiffs' situation here—rather, it would be analogous to the Plaintiffs' situation here if the motorist had a third option of speeding upon condition of filing paperwork with the state attesting to the reasons why speeding is necessary. Perhaps if that paperwork itself were difficult to file, an injury could arise from the time and trouble spent filing it—but, notably, Plaintiffs stated at oral argument that they do not assert that the time and trouble of filing FATCA paperwork is itself an injury for standing purposes.

[9] We note that Senator Paul introduced a bill to repeal FATCA in April 2017. S. 869, 115th Cong. (2017).

End of Document

2015 WL 9957826
United States District Court, C.D. California.

UNITED STATES
v.
BUSSELL

CASE NO.: CV 15-02034 SJO (VBKx)
|
Signed 12/08/2015

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PROCEEDINGS (in chambers): ORDER GRANTING IN PART AND DENYING IN PART THE GOVERNMENT'S MOTION FOR SUMMARY JUDGMENT REDUCING PENALTY ASSESSMENT TO JUDGMENT [Docket No. 23]; **ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION FOR JUDGMENT ON THE PLEADINGS** [Docket No. 27]

THE HONORABLE S. JAMES OTERO, UNITED STATES DISTRICT JUDGE

***1** These matters are before the Court on Plaintiff the United States of America's ("Plaintiff" or the "Government") Motion for Summary Judgment Reducing Penalty Assessments to Judgment ("Motion"), filed October 27, 2015, and Defendant Letantia Bussell's ("Defendant") Motion for Judgment on the Pleadings ("Defendant's Motion"), filed November 3, 2015. Defendant opposed the Motion ("Opposition")[1] on November 16, 2015, and the Government replied ("Reply") on November 18, 2015. The Government opposed Defendant's Motion ("Government's Opposition") on November 9, 2015, and Defendant did not Reply. The Court found these matters suitable for disposition without oral argument and vacated the hearings set for December 7, 2015. *See* Fed.R.Civ.P. 78(b). For the following reasons, the Motion is **GRANTED IN PART** and **DENIED IN PART**. Defendant's Motion is **GRANTED IN PART** and **DENIED IN PART.**

I. *FACTUAL AND PROCEDURAL BACKGROUND*

A. *Factual Background*

Defendant was married to John Bussell ("Mr.Bussell") from 1972 until his death in 2002. (Index of Exs. and Decls. in Supp. of Pl.'s Mot. ("Index"), ECF No. 24–1, Ex. 11 ¶ 3.) Defendant is a licensed physician who specializes in dermatology. *Bussell v. Comm'r,* 130 T.C. 222, 224 (2008). Defendant has maintained a dermatology practice in Beverly Hills, California since 1979. *Id.* From 1981 through approximately 1995, when Defendant filed for bankruptcy, Defendant conducted her medical practice through various corporations, including Letantia Bussell M.D. Inc. *Id.*

Before Mr. Bussell and Defendant (collectively, the "Bussells") filed for bankruptcy in 1995, the Bussells restructured Defendant's medical practice to conceal her interest in the practice. (Index, Ex. 21 at IOE_000104–105.)[2] The Bussells funneled Defendant's profits between 1993 and 1995, which totaled $1,149,048, into a non-interest bearing account with Sanwa Bank ("Sanwa Account"). The Bussells maintained control over the Sanwa Account, but the Sanwa Account was under the name of BBL Medical Management, Inc. ("BBL"). (Index, Ex. 21, at IOE_000105.) In January 1996, Defendant transferred the balance of the Sanwa Account to a personal bank account at Swiss Bank Corp. *Bussell v. Comm'r,* T.C. Memo.2005–77, 2005 WL 775755 at *4 (April 7, 2005). Swiss Bank Corp. later became known as UBS AG. (Index, Ex. 11 ¶ 2.) The Defendant failed to disclose the funds from the Sanwa Account and her interest in the Swiss account in her 1996 tax return. *Id.*

B. *The Subject Account and Defendant's Tax Filings*

***2** On January 29, 1997, the Bussells opened a second bank account with Swiss Bank Corp., account no. xxxx3235 (the "Subject Account"). (*See* Index, Ex. 4; Ex. 11 ¶ 2.) As part of the process of opening the Subject Account, the Bussells signed a Swiss Bank Corp. document naming themselves as the beneficial owners of the account. (*See* Index, Ex. 4. at IOE_000011.) The Bussells also signed a Swiss Bank Corp. document entitled "General power of attorney" granting Todd John Bussell, their son, signature authority over the Subject Account. (Index, Ex. 4 at IOE_000015.) Defendant also had signature authority over the Subject Account. (Index, Ex. 4 at IOE_000014.)

On October 15, 2007, Defendant filed her individual income tax return for the 2006 tax year. (*See* Index, Ex. 4.) In her 2006 tax return, Defendant did not report the interest income earned from the Subject Account. (Index, Ex. 11 ¶ 6.) Furthermore, Defendant did not file a Treasury Department Form 90–22.1, Report of Foreign Bank and Financial Accounts ("FBAR Form"), disclosing her financial interest in the Subject Account for the 2006 tax year. (Index, Ex. 11 ¶ 6.) During 2006, the Subject Account had a balance that exceeded $10,000. (Index, Ex. 11 ¶ 4.) On December 31, 2006, the Subject Account had a balance of $2,241,027. (Index, Ex. 11 ¶ 5.)

On October 23, 2007, Todd Bussell wrote to UBS AG and asked the bank to liquidate the Subject Account, as well as a second account, and requested that the balances be transferred to two accounts at Finter Bank Zurich. Todd Bussell requested that 50% of the balances be transferred to an account with Wakaduku Foundation as the beneficiary ("Wakaduku Account"), and the other 50% transferred to an account with Valmadera Foundation as the beneficiary ("Valmadera Account"). (Plaintiff's Proposed Statement of Uncontroverted Facts ("PSUF"), ECF No. 23–1, ¶ 16; *See also* Index, Ex. 5 at IOE 000018.)

Several transfers then occurred between the Subject Account and the other accounts. On November 1, 2007, the Subject Account had zero balance. (Index, Ex. 5 at IOE 000021.) On November 9, 2007, the Subject Account had a closing balance of $2,918,299.28. (Index Ex. 5 at IOE 000021.) Pursuant to Todd Bussell's request, on November 13, 2007, UBS AG made three separate payments to the Wakaduku Account and the Valmadera Account. (Index Ex. 5 at IOE 000022.) By November, 14, 2007, the Subject Account had zero balance again. (Index Ex. 5 at IOE 000022.)

C. *History of Legal Proceedings Against the Bussells*

On May 3, 2000, an Indictment was filed against the Bussells in the Central District of California. (Index, Ex. 18 at IOE_000074.) On January 31, 2002, a Redacted First Superseding Indictment (the "Indictment") was filed against the Bussells in which the Government brought various counts related to bankruptcy fraud and attempted tax evasion. (PSUF ¶ 3.)

On February 6, 2002, a jury convicted Defendant of the following: (1) one count of violating 18 U.S.C. § 371 (conspiracy to commit an offense against or defraud the United States); (2) two counts of violating 18 U.S.C. § 152(1) (concealment of assets in bankruptcy); (3) two counts of violating 18 U.S.C. § 152(3) (false declaration and statement as to avoid material matters); and (4) one count of violating 26 U.S.C. § 7201 and 18 U.S.C. § 2 (evading payment of income tax). (PSUF ¶ 3.)

After the conviction, on or about April 29, 2002, the Internal Revenue Service ("IRS") issued a jeopardy levy with regard to the Bussells' income tax liabilities for 1983, 1984, 1986, and 1987. (Index, Ex. 21, at IOE_000107.) The IRS also approved a jeopardy assessment against the Bussells for the 1996 tax year ("1996 Assessment"). The total amount of the jeopardy levy/assessment was $3.4 million, with $1,283,522 attributable to the 1996 tax year and the remaining $2,116,478 to the 1980s. (Index, Ex. 21, at IOE_000107.) The government explained that it levied a jeopardy assessment in part because:

> ***3** [I]n 1996 [Defendant] received $1,149,048 from financial accounts which were previously undisclosed and not reported on [Defendant's] Individual Income Tax Return Form 1040 for this period. These funds were concealed as part of the conspiracy to commit bankruptcy fraud.

(Index, Ex. 21, at IOE_000115.)

On August 23, 2002, Defendant filed a complaint in federal district court seeking review of the 1996 Assessment pursuant to 26 U.S.C. § 7429(b). (PSUF ¶ 4.) On December 11, 2002, the Court issued an order granting the Government's motion for summary judgment and denying Defendant's motion for summary judgment. (PSUF ¶ 5.) The Court held that the IRS's jeopardy determination was reasonable because Defendant's criminal history demonstrated that she had failed to report income and engaged in a scheme to hide assets from the IRS in an attempt to defeat the collection of unpaid taxes. (PSUF ¶ 5.)

While the jeopardy case was pending, Defendant filed a petition with the United States Tax Court (the "Tax Court") seeking a redetermination of deficiency in the

Bussells' 1996 taxes, as well as a redetermination of the civil tax fraud penalty imposed by the IRS pursuant to 26 U.S.C. § 6663(a). (PSUF ¶ 7.) The Tax Court concluded that the Bussells maintained, and failed to report, two foreign bank accounts in their 1996 tax return, a Swiss account and a "Syntex" bank account. *Bussell v. Commissioner of Internal Revenue,* T.C. Memo.2005–77, 2005 WL 775755 at *4 (April 7, 2005). The Tax Court held that Defendant was liable for the civil fraud penalty imposed pursuant to 26 U.S.C. § 6663(a), a decision that was affirmed by the Ninth Circuit Court of Appeals. (PSUF ¶ 8.)

D. *Procedural History of the Instant Case*

On June 5, 2013, the IRS assessed against the Defendant an FBAR penalty in the amount of $1,221,806 ("Assessment") for her alleged willful failure to disclose and report her interest in the Subject Account for the 2006 tax year. (Index, Ex. 1.) On March 19, 2015, the Government initiated the instant action to recover from the Defendant the Assessment and to reduce the Assessment to a judgment against Defendant. (*See generally* Compl., ECF No. 1; Mot., ECF No. 23.) The Government seeks a judgment ordering Defendant to pay $1,361,694.41, which includes the Assessment, the penalty for failure-to-pay the Assessment, and interest as of January 23, 2015, plus any accruing interest thereafter. (*See generally* Compl.; Index, Ex. 2.)

II. *DISCUSSION*

A. *Legal Standard for Judgment on the Pleadings*

"After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings." Fed.R.Civ.P. 12(c) ("Rule 12(c)"). "The principal difference between motions filed pursuant to [Federal Rule of Civil Procedure] 12(b) and Rule 12(c) is the time of filing. Because the motions are functionally identical, the same standard of review applicable to a Rule 12(b) motion applies to its Rule 12(c) analog." *Dworkin v. Hustler Magazine Inc.,* 867 F.2d 1188, 1192 (9th Cir.1989). In considering a motion for judgment on the pleadings, "[a]ll allegations of material fact are taken as true and construed in the light most favorable to the nonmoving party." *Buckey v. Cnty. of L.A.,* 968 F.2d 791, 794 (9th Cir.1992) (citation omitted). A complaint should not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Gibson v. United States,* 781 F.2d 1334, 1337 (9th Cir.1986) (citation omitted). Judgment on the pleadings is proper when "there is no issue of material fact in dispute, and the moving party is entitled to judgment as a matter of law." *Fleming v. Pickard,* 581 F.3d 922, 925 (9th Cir.2009).

B. *Legal Standard for Summary Judgment Motion*

***4** Federal Rule of Civil Procedure 56(a) mandates that "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(a). The moving party bears the initial burden of establishing the absence of a genuine issue of material fact. *See Celotex Corp. v. Catrett,* 477 U.S. 317, 323 (1986). "When the party moving for summary judgment would bear the burden of proof at trial, it must come forward with evidence which would entitle it to a directed verdict if the evidence went uncontroverted at trial. In such a case, the moving party has the initial burden of establishing the absence of a genuine issue of fact on each issue material to its case." *C.A.R. Transp. Brokerage Co. v. Darden Rests., Inc.,* 213 F.3d 474, 480 (9th Cir.2000) (citations omitted).

In contrast, when the nonmoving party bears the burden of proving the claim or defense, the moving party does not need to produce any evidence or prove the absence of a genuine issue of material fact. *See Celotex,* 477 U.S. at 325. Rather, the moving party's initial burden "may be discharged by 'showing'–that is, pointing out to the District Court–that there is an absence of evidence to support the nonmoving party's case." *Id.* "Summary judgment for a defendant is appropriate when the plaintiff 'fails to make a showing sufficient to establish the existence of an element essential to [his] case, and on which [he] will bear the burden of proof at trial.' " *Cleveland v. Policy Mgmt. Sys. Corp.,* 526 U.S. 795, 805–06 (1999) (quoting *Celotex,* 477 U.S. at 322).

Once the moving party meets its initial burden, the "party asserting that a fact cannot be or is genuinely disputed must support the assertion." Fed.R.Civ.P. 56(c)(1). "The mere existence of a scintilla of evidence in support of the [nonmoving party]'s position will be insufficient; there must be evidence on which the jury could reasonably find for the [nonmoving party]." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 252 (1986); *accord Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586 (1986) ("[O]pponent must do more than simply show that there is some metaphysical doubt as to the material facts."). Further, "[o]nly disputes over facts that might affect the outcome of the suit ... will properly preclude the entry of summary judgment [and f]actual disputes that are irrelevant or unnecessary will not be counted." *Anderson,* 477 U.S. at 248. At the summary judgment stage, a court does not make credibility determinations or weigh conflicting evidence. *See Id.* at 249. A court is required to draw all inferences in a light most favorable to the nonmoving party. *Matsushita,* 475 U.S. at 587.

In the instant case, the Government argues that it is entitled to summary judgment, ordering Defendant to pay an FBAR penalty of $1,361,694.41, because Defendant willfully violated the FBAR tax regulations by failing to report or otherwise disclose her interest in the Subject Account for 2006. (Mot.2.) Defendant responds by alleging a series of affirmative defenses. The Court begins by considering the Government's argument and then turns to the Defendant's affirmative defenses, as alleged in her briefing on the Government's Motion as well as Defendant's Motion for Judgment on the Pleadings.

C. *Section 5314 Violation*

Section 5314 of Title 31 of the United States Code authorizes the Secretary of the Treasury to require United States citizens to report certain transactions with foreign financial agencies. 31 U.S.C. § 5314. Under the implementing regulations of § 5314, "[e]ach United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship" to the IRS for each year in which such relationship exists, and shall provide such information on the FBAR Form. 31 C.F.R. § 1010.350(a). United States citizens who have an interest in a foreign bank, securities, or other financial account must report that interest to the IRS by June 30 of the year following any calendar year in which the aggregate balance of such account exceeded, at any time during the year, $10,000. 31 C.F.R. § 1010.306(c). If any person willfully fails to timely report interest in a foreign bank, securities, or other financial account to the IRS, then the maximum penalty shall be increased to the greater of either (1) $100,000, or (2) fifty percent of the balance in the account at the time of the violation. 31 U.S.C. § 5321(a)(5)(C)-(D).

1. *FBAR Violation*

***5** The Court grants summary judgment to the Government on the issue of whether Defendant violated the FBAR tax regulations. Defendant stipulates and agrees not to argue against the allegations that (1) Defendant is a United States citizen, (2) in 2006, Defendant had a financial interest in the Subject Account,[3] (3) in 2006, the Subject Account had a balance that exceeded $10,000, and (4) Defendant failed to report her interest in the Subject Account for the 2006 tax year. (*See generally* Index, Ex. 11.)

The Government's Motion is **GRANTED** to the extent that the Defendant violated § 5314 and its implementing regulations by failing to report her interest in the Subject Account for the 2006 tax year.

2. *Willfulness*

The Court further finds that the Government is entitled to summary judgment on the issue of Defendant's willfulness. Defendant stipulates and agrees not to argue against the allegations that (1) Defendant **willfully** failed to file an FBAR Form reporting her financial interest in the Subject Account for the 2006 tax year, and (2) Defendant **willfully** failed to report her financial interest in the Subject Account on her 2006 federal income tax return. (*See generally* Index, Ex. 11.)

Moreover, the record demonstrates that Defendant was willful in failing to report her financial interest in the Subject Account. Although § 5321(a)(5) does not define willfulness, courts adjudicating civil tax matters have held that an individual is willful where he/she exhibits a reckless disregard of a statutory duty. *See Safeco Ins. Co. of Am. v. Burr,* 551 U.S. 47, 57 (2007). Here, Defendant clearly acted with reckless disregard. Defendant has been convicted of bankruptcy fraud and tax fraud for her failure to disclose offshore accounts, and Defendant has been subjected to civil penalties for her failure to disclose offshore bank accounts. (*See generally, supra* Section I(C).) Defendant is aware of her statutory duty to report offshore accounts. Nevertheless, Defendant filed her 2006 tax return without reporting the Subject Account, and without filing an FBAR Form. Instead of reporting the Subject Account, Defendant liquidated the Subject Account shortly after filing her tax returns.

Accordingly, the Government's Motion is **GRANTED** to the extent that Defendant **willfully** failed to report her interest in the Subject Account for 2006. Pursuant to 31 U.S.C. § 5321(a)(5)(C)-(D), the IRS assessed an FBAR penalty against Defendant. [4]

3. *Affirmative Defenses*

Defendant spends the bulk of her Opposition and her Motion for Judgment on the Pleadings asserting the following affirmative defenses against the penalty Assessment: (1) because the Subject Account was the subject of prior legal proceedings against Defendant, the Assessment violates the constitutional protection against double jeopardy, (2) the Assessment is precluded by the applicable statute of limitations ("SOL"), (3) the Assessment is fundamentally unfair, as against Defendant's due process rights, (4) laches bar the Assessment, (5) the Assessment violates the Ex Post Facto Clause, (6) the Assessment violates the Excessive Fines Clause of the Eight Amendment, and (7) the Government's use of banking evidence in this case is not permitted by a United States treaty with Switzerland. (Def.'s Opp'n Pl.'s Mot. Summ. J. ("Opp'n"), EFC No. 29, 1.) The Court considers each of the defenses in turn and ultimately reduces the FBAR penalty judgment, based on Eighth Amendment concerns. [5]

a. *Double Jeopardy*

***6** Defendant begins by contending that the present Assessment action by the Government violates the Fifth Amendment's protection against double jeopardy. Defendant asserts that the funds from the Sanwa Account, which amounted to $1,149,048, were transferred to the Subject Account in 1997, and that she has already been punished for her failure to report these funds. (*See* Def.'s Mot. for J. on the Pleadings ("Def.'s Mot."), ECF No. 27, 1; Def.'s Opp'n Pl.'s Mot. Summ. J. ("Opp'n"), EFC No. 29, 3.)

The Court finds that no reasonable jury could find that the Subject Account was the subject of Defendant's prior legal proceedings, and therefore, **GRANTS** summary judgment to the Government and **DENIES** Defendant's Motion on this affirmative defense. The Bussells had at least two accounts in Switzerland, and the Defendant conflates these two accounts in her briefing. The Bussells transferred the full balance of the Sanwa Account to "a Swiss account" at Swiss Bank Corp, and the last transfer to this Swiss account was on or about June 11, 1996. *Bussell v. Commissioner,* T.C. Memo.2005–77, 2005 WL 775755 at *4–5 (April 7, 2005). The Bussells then opened the Subject Account, a second Swiss account, on January 29, 1997. (*See* Index, Ex. 4.) The funds from the Sanwa Account, which were the subject of prior penalties, could not have been transferred to the Subject Account because the Sanwa Account funds were transferred to the first account in 1996, six months before the Subject Account even existed.

b. *Statute of Limitations*

The Court next determines whether the IRS assessed the FBAR penalty outside the applicable SOL. The Secretary of the Treasury may assess a civil penalty for willfully failing to timely report financial interests in foreign accounts "at any time before the end of the 6–year period beginning on the date of the transaction with respect to which the penalty is assessed." 31 U.S.C. § 5321(b)(1). Pursuant to 31 C.F.R. § 1010.306(c), the deadline to report any interest in foreign accounts is "June 30 of the year following any calendar year in which the aggregate balance of such account exceeded, at any time during the year, $10,000."

The Defendant argues that the SOL began to run no later than June 30, 2002, because the Government has known about the Subject Account ever since it issued a jeopardy assessment on April 29, 2002 for funds Defendant deposited in the Subject Account. (Opp'n 3.) The Defendant also argues that, because the SOL began to run on June 30, 2002, the last day to assess an FBAR penalty would have been on June 30, 2008. (Opp'n 3.)

The Court disagrees with Defendant, **GRANTS** summary judgment to the Government, and **DENIES** Defendant's Motion on this affirmative defense. The SOL began to run on June 30, 2007, not June 30, 2002. The former date represents the Defendant's statutory deadline for reporting her financial interest in the Subject Account for the 2006 tax year. *See Moore v. United States,* No. 13–CV–02063–RAJ, 2015 WL 1510007 at* 2 (April 1, 2015) (holding that the six-year limitations period for assessing an FBAR civil penalty for 2005 would have run on July 1, 2012, six years after the June 30, 2006 deadline for submitting an FBAR for 2005). The IRS assessed Defendant's FBAR penalty on June 5, 2013, which is less than a month before June 30, 2013, the last day to assess an FBAR penalty against Defendant, based on a violation that took place on June 30, 2007.

c. *Due Process*

The Court next determines whether the Assessment violates Defendant's due process rights. Although procedural due process is a notoriously difficult right to define, this right generally expresses the principle that a litigant is entitled to fundamental fairness in court and administrative proceedings. *See Lassiter v. Dep't of Soc. Servs. of Durham Cnty.,* 452 U.S. 18, 25 (1981).

***7** Here, Defendant's due process argument is essentially a restatement of the SOL defense. According to Defendant, the Assessment is fundamentally unfair because the Government delayed the instant action. (Opp'n 6.) Defendant contends that the Government knew of the Subject Account in 2002, but the Government waited until 2013 to issue the Assessment. (Opp'n 6.) Defendant also argues that the IRS chose 2006 as the assessment year because in 2004 "Congress ... increased the maximum penalty from $100,000 to a theoretical number" allowing the IRS to maximize the penalty. (Opp'n 6.)

The Court **GRANTS** summary judgment to the Government and **DENIES** Defendant's Motion on the due process defense. Even if a jury could find that the Government had knowledge of the Subject Account in 2002, the Government's instant claim did not arise until June 30, 2007, when the Defendant failed to timely report the Subject Account in her 2006 tax return.

d. *Laches*

Defendant goes on to contend that the IRS unreasonably delayed the Assessment and that the Defendant is therefore, entitled to the affirmative defense of laches. (Opp'n 6.) Defendant's laches affirmative defense fails for the same reasons as the due process defense. The Government's claim here did not arise until 2007, and the Court **GRANTS** summary judgment to the Government and **DENIES** Defendant's Motion on the laches defense.

e. *Ex Post Facto*

The Court next considers Defendant's claim that the IRS Assessment violates the Ex Post Facto Clause of the Constitution. "The Constitution of the United States, Article 1, Section 9, prohibits the Legislature of the United States from passing any ex post facto law." *Calder v. Bull,* 3 U.S. 386, 389 (1798). An ex post facto law is one which imposes a punishment for an act which was not punishable when it was committed, or imposes additional punishment. *Id.* at 390.

Defendant argues that because Congress amended the applicable tax statute in 2004, the Assessment amounts to an ex post facto penalty, because the Government had knowledge of the Subject Account in 2002. In 2004, Congress increased the maximum penalty for willful FBAR violations from $100,000 to up to 50 percent of the highest aggregate balance in the account during the taxable year at the time of the violation. 31 U.S.C. § 5321(a)(5)(C)(i). The Government responds that the Ex Post Facto Clause does not apply because Defendant's willful violation of the law occurred more than two years after the law was amended in 2004.

The Court **GRANTS** summary judgment to the Government and **DENIES** Defendant's Motion on the ex post facto defense. The Government imposed the FBAR penalty based on Defendant's conduct related to her 2007 tax return, which was filed more than two years after the applicable law was amended in 2004.

f. *Excessive Fines*

Defendant next contends that the Assessment violates the Excessive Fines Clause of the Eighth Amendment to the Constitution. *See United States v. Bajakajian,* 524 U.S. 321, 328–29 (1998). Unlike the bulk of Defendant's affirmative defenses, this argument has some merit.

In *Bajakajian,* the Supreme Court held that "a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of a defendant's offense." *Id.* at 334. Although the *Bajakajian* court did not set a rigid set of factors to consider in conducting the proportionality inquiry, the Supreme Court did consider: (1) the nature and extent of the crime, (2) whether the violation was related to other illegal activities, (3) the other penalties that may be imposed for the violation, and (4) the extent of the harm caused. *See id.* at 337–340; *see also United States v. $100,348.00 in U.S. Currency,* 354 F.3d 1110, 1122 (9th Cir.2004); *Balice v. United States Dep't of Agric.,* 203 F.3d 684, 698–99 (9th Cir.2000).

***8** Although it is a somewhat close call, the Court holds that an FBAR penalty of $1,221,806 violates the Excessive

Fines Clause. For the reasons set out below, the Court reduces the Government's Assessment to $1,120,513, to comport with Eighth Amendment requirements.

i. *Nature of Offense and Relationship to Other Illegal Activities*

Defendant argues that the Assessment is excessive because Defendant's offense is solely a reporting offense, not a serious crime. Furthermore, Defendant argues that there is nothing to show that the funds themselves were involved in or derived from any kind of illegal activity. (Opp'n 16; Def's Mot. 11.)

The Court concludes that the nature of Defendant's alleged offense and the relationship of the offense to other illegal activities do not favor either the Defendant or the Government's position on the applicability of the Excessive Fines Clause. On the one hand, Defendant's offense, tax evasion, is not as serious as some crimes that ultimately trigger civil forfeiture actions. On the other hand, Defendant clearly fits into the class of persons targeted by the Bank Secrecy Act, namely those evading taxes through the use of offshore bank accounts. *See Bajakajian,* 524 U.S. at 338. In *Bajakajian,* the Supreme Court emphasized that the civil forfeiture at issue violated the Eighth Amendment because the defendant, Bajakajian, did not fit into the class of persons for whom the forfeiture statute was principally designed: money launderers, drug traffickers, and tax evaders. *Id.* Moreover, in the instant case, Defendant has not carried her burden to show that the money at issue was derived from a lawful source, which would trigger stronger Eight Amendment protections. *See Balice,* 203 F.3d at 684.

ii. *Maximum Criminal and Civil Penalties*

The maximum criminal penalty for Defendant's crime, tax evasion, militates in favor of finding that the Government's Assessment violates the Excessive Fines Clause. *See Bajakajian,* 524 U.S. at 338. Under 31 U.S.C § 5322(a), the maximum authorized penalty for a willful criminal violation of 31 U.S.C. § 5314 is a five year sentence and a $250,000 fine. 31 U.S.C § 5322(a). Defendant's FBAR penalty is $1,221,806, which is almost five times the maximum amount allowed in the criminal statute.

In conducting the Eighth Amendment inquiry, the Court also considers the maximum penalty authorized by the civil statute applicable to Defendant's conduct. *See Bajakajian,* 524 U.S. at 33740. Under 31 U.S.C. § 5321(a)(5)(C), the IRS can assess a civil penalty of up to 50% of the balance of an account at issue, for a willful violation of the tax statute. Under this provision, Defendant should have been subjected to a maximum penalty of $1,120,513.00, which is $101,293 less than the Assessment amount.

iii. *Harm Caused*

Defendant argues that the only harm here is her alleged failure to report the Subject Account to the Government. (Opp'n 16.) Defendant further contends that her omission cannot be considered fraud because the Government was already aware of the Subject Account, and any harm caused by the failure to pay taxes is minimal. (Opp'n 16.)

The Court disagrees with Defendant's contentions. In *Bajakajian,* the harm caused was minimal because there was no fraud on the Government and no loss to the public. The Government charged Bajakajian with attempting to leave the United States without reporting that he was transporting more than $10,000 in currency outside the United States, as required by 31 U.S.C. § 5316(a)(1)(A). Had his crime gone undetected, the Government would have been deprived of the information that $357,144.00 had left the country. Here, on the other hand, the Defendant willfully committed fraud by failing to report her interests in the Subject Account in her 2006 tax return. This action imposed a tax loss on the public. *See Vasudeva v. United States,* 214 F.3d 1155, 1161–62 (9th Cir.2000).

iv. *Conclusion on Defendant's Excessive Fines Claim*

***9** After weighing each of the factors relevant to the Excessive Fines inquiry, the Court concludes that the Assessment imposed by the Government raises some Eighth Amendment concerns because the Assessment exceeds the maximum penalty set out in the applicable criminal and civil statutes. The Court **GRANTS IN PART** and **DENIES IN PART** the Government's Motion for Summary Judgment, **GRANTS** Defendant's Motion on the Eighth Amendment claim, and decreases the penalty imposed from $1,221,806 to $1,120,513. *Cf.* 18 U.S.C. § 983(g)(4) (2006) ("If the court finds that the forfeiture is grossly disproportional to the offense it shall reduce or eliminate the forfeiture as necessary to avoid a violation of the Excessive Fines Clause of the Eighth Amendment of the Constitution.") This amount represents the maximum amount permitted under the applicable civil statute.

g. *Treaty with Switzerland*

Defendant's Motion vaguely asserts that the Government illegitimately obtained information concerning Defendant's Swiss Account from the Swiss government. (Def's Mot. 8.) Defendant contends that, pursuant to a treaty between the United States and Switzerland, the United States government can only receive information from the Swiss government pertaining to tax violations.

To the extent Defendant attempts to make out an affirmative defense based on the treaty between the United States and Switzerland, the Court **GRANTS** summary judgment to the Government and **DENIES** Defendant's Motion on this affirmative defense. The instant case is clearly a tax collection case, and it is unclear how the Government's conduct runs aground of the treaty.

IV. *RULING*

For the foregoing reasons, the Court **DENIES IN PART** and **GRANTS IN PART** the Government's Motion for Summary Judgment. Defendant also filed a Motion for Judgment on the Pleadings while the Government's Motion for Summary Judgment was pending before this Court. The Court **DENIES IN PART** and **GRANTS IN PART** Defendant's Motion. The Court notes that the Defendant is liable for interest on the penalty amount of $1,120,513. (Mot.14.) Within ten (10) days from the date of this order, the Government shall file a proposed judgment consistent with the Court's findings and conclusions.

IT IS SO ORDERED.

All Citations

Not Reported in Fed. Supp., 2015 WL 9957826, 117 A.F.T.R.2d 2016-439

Footnotes

[1] Defendant exceeded the twenty-page limit, in violation of the Court's Initial Standing Order. In the interest of considering the Motion on its merits, the Court adjudicates the two pages that exceeded the twenty page limit, but cautions Defendant to carefully read and comply with the Court's Standing Order.

[2] Pursuant to Federal Rule of Evidence 201, the Court takes judicial notice of Exhibits 18 through 23 of the Index of Exhibits filed concurrently with the Government's Request for Judicial Notice. (*See generally* Index.) Each of these Exhibits represents a publicly available record or filing, and is therefore not reasonably subject to dispute. *See* Fed.R.Evid. 201(b)(2).

[3] Defendant named herself as the beneficial owner of the Subject Account, and Defendant also had signature authority over the Subject Account. (*See* Index, Ex. 4.) Thus, Defendant had a financial interest in the Subject Account.

[4] Defendant stipulates and agrees not to argue against the allegation that the maximum balance in the Subject Account for the 2006 tax year was $2,241,027. (Index, Ex. 11 ¶ 5.)

[5] Defendants did not expressly plead in their answer defenses based on due process, the ex post facto clause, or the improper use of evidence based on a treaty with Switzerland. (*See* Answer, ECF No. 9.) In the interest of deciding this case on the merits, the Court addresses and ultimately denies these defenses.

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127 S.Ct. 2201
Supreme Court of the United States

SAFECO INSURANCE COMPANY
OF AMERICA et al., Petitioners,
v.
Charles BURR et al.
GEICO General Insurance
Company, et al., Petitioners,
v.
Ajene Edo.

Nos. 06–84, 06–100.
|
Argued Jan. 16, 2007.
|
Decided June 4, 2007.

Synopsis
Background: Consumers brought class actions against insurers in connection with automobile or homeowners policies, alleging violation of Fair Credit Reporting Act (FCRA) via failure to transmit adverse action notices reflecting negative credit reports. The United States District Court for the District of Oregon, Anna J. Brown, J., granted summary judgment for insurers in both actions, 2003 WL 22722061, and consumers appealed. Appeals were consolidated. The Court of Appeals, per curiam, 140 Fed.Appx. 746, and after withdrawing its prior opinion at 416 F.3d 1097, per Reinhardt, Circuit Judge, 435 F.3d 1081, reversed and remanded. Certiorari was granted.

Holdings: The Supreme Court, Justice Souter, held that:

[1] willful failure covered violation committed in reckless disregard of FCRA notice obligation, abrogating *Wantz v. Experian Information Solutions*, 386 F.3d 829, and *Phillips v. Grendahl*, 312 F.3d 357;

[2] initial rates charged for new insurance policies may be "adverse actions" under FCRA; and

[3] one insurer did not violate FCRA, and while the other insurer might have, it did not act recklessly.

Reversed and remanded.

Justice Stevens filed opinion concurring in part and concurring in judgment in which Justice Ginsburg joined.

Justice Thomas filed opinion concurring in part in which Justice Alito joined.

****2202 *47** *Syllabus* [*]

The Fair Credit Reporting Act (FCRA) requires notice to a consumer subjected to "adverse action ... based in whole or in part on any information contained in a consumer [credit] report." 15 U.S.C. § 1681m(a). As applied to insurance companies, "adverse action" is "a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for." § 1681a(k)(1)(B)(i). FCRA provides a private right of action against businesses that use consumer reports but fail to comply. A negligent violation entitles a consumer to actual damages, § 1681*o* (a), and a willful one entitles the consumer to actual, statutory, and even punitive damages, § 1681n(a).

Petitioners in No. 06–100 (GEICO) use an applicant's credit score to select the appropriate subsidiary insurance company and the particular rate at which a policy may be issued. GEICO sends an adverse action notice only if a neutral credit score would have put the applicant in a lower priced tier or company; the applicant is not otherwise told if he would have gotten better terms with a better credit score. Respondent Edo's credit score was taken into account when GEICO issued him a policy, but GEICO sent no adverse action notice because his company and tier placement would have been the same with a ****2203** neutral score. Edo filed a proposed class action, alleging willful violation of § 1681m(a) and seeking statutory and punitive damages under § 1681n(a). The District Court granted GEICO summary judgment, finding no adverse action because the premium would have been the same had Edo's credit history not been considered. Petitioners in No. 06–84 (Safeco) also rely on credit reports to set initial insurance premiums. Respondents Burr and Massey—whom Safeco offered higher than the best rates possible without sending adverse action notices—joined a proposed class action, alleging willful violation of § 1681m(a) and seeking statutory and punitive damages under § 1681n(a). The District Court granted Safeco summary judgment on the ground that offering a single, initial rate for insurance ***48** cannot be "adverse action." The Ninth Circuit reversed both judgments. In GEICO's case, it held that an adverse action occurs whenever a consumer would have received a lower rate had his consumer report contained more favorable information. Since that would have happened to Edo, GEICO's failure to give notice was an adverse action. The court also held that an insurer willfully fails to comply with FCRA if it acts in reckless disregard of a consumer's FCRA rights, remanding for further proceedings on the reckless disregard issue. Relying on its decision in GEICO's case, the Ninth Circuit rejected the District Court's position in the Safeco case and remanded for further proceedings.

Held:

1. Willful failure covers a violation committed in reckless disregard of the notice obligation. Where willfulness is a statutory condition of civil liability, it is generally taken to cover not only knowing violations of a standard, but reckless ones as well. See, *e.g., McLaughlin v. Richland Shoe Co.,* 486 U.S. 128, 133, 108 S.Ct. 1677, 100 L.Ed.2d 115. This construction reflects common law usage. The standard civil usage thus counsels reading § 1681n(a)'s phrase "willfully fails to comply" as reaching reckless FCRA violations, both on the interpretive assumption that Congress knows how this Court construes statutes and expects it to run true to form, see *Commissioner v. Keystone Consol. Industries, Inc.,* 508 U.S. 152, 159, 113 S.Ct. 2006, 124 L.Ed.2d 71, and under the rule that a common law term in a statute comes with a common law meaning, absent anything pointing another way, *Beck v. Prupis,* 529 U.S. 494, 500–501, 120 S.Ct. 1608, 146 L.Ed.2d 561. Petitioners claim that § 1681n(a)'s drafting history points to a reading that liability attaches only to knowing violations, but the text as finally adopted points to the traditional understanding of willfulness in the civil sphere. Their other textual and structural arguments are also unpersuasive. Pp. 2208 – 2210.

2. Initial rates charged for new insurance policies may be adverse actions. Pp. 2210 – 2214.

(a) Reading the phrase "increase in any charge for ... any insurance, existing or applied for," § 1681a(k)(1)(B)(i), to include a disadvantageous rate even with no prior dealing fits with the ambitious objective of FCRA's statement of purpose, which uses expansive terms to describe the adverse effects of unfair and inaccurate credit reporting and the responsibilities of consumer reporting agencies. See § 1681(a). These descriptions do nothing to suggest that remedies for consumers disadvantaged by unsound credit ratings should be denied to first-time victims, and the legislative histories of both FCRA's original enactment and a 1996 amendment reveal no reason to confine attention to customers and businesses with prior dealings. Finally, nothing about insurance ****2204** contracts suggests that Congress meant to differentiate applicants ***49** from existing customers when it set the notice requirement; the newly insured who gets charged more owing to an erroneous report is in the same boat with the renewal applicant. Pp. 2210 – 2212.

(b) An increased rate is not "based in whole or in part on" a credit report under § 1681m(a) unless the report was a necessary condition of the increase. In common talk, "based on" indicates a but-for causal relationship and thus a necessary logical condition. Though some textual arguments point another way, it makes more sense to suspect that Congress meant to require notice and prompt a consumer challenge only when the consumer would gain something if the challenge succeeded. Pp. 2212.

(c) In determining whether a first-time rate is a disadvantageous increase, the baseline is the rate that the applicant would have received had the company not taken his credit score into account (the "neutral score" rate GEICO used in Edo's case). That baseline comports with the understanding that § 1681m(a) notice is required only when the credit report's effect on the initial rate is necessary to put the consumer in a worse position than other relevant facts would have decreed anyway. Congress was more likely concerned with the practical question whether the consumer's rate actually suffered when his credit report was taken into account than the theoretical question whether the consumer would have gotten a better rate with the best possible credit score, the baseline suggested by the Government and respondent-plaintiffs. The Government's objection to this reading is rejected. Although the rate initially offered for new insurance is an "increase" calling for notice if it exceeds the neutral rate, once a consumer has learned that his credit report led the insurer to charge more, he need not be told with each renewal if his rate has not changed. After initial dealing between the consumer and the insurer, the baseline for "increase" is the previous rate or charge, not the "neutral" baseline that applies at the start. Pp. 2213 – 2214.

3. GEICO did not violate the statute, and while Safeco might have, it did not act recklessly. Pp. 2214 – 2216.

(a) Because the initial rate GEICO offered Edo was what he would have received had his credit score not been taken into account, GEICO owed him no adverse action notice under § 1681m(a). Pp. 2214 – 2215.

(b) Even if Safeco violated FCRA when it failed to give Burr and Massey notice on the mistaken belief that § 1681m(a) did not apply to initial applications, the company was not reckless. The common law has generally understood "recklessness" in the civil liability sphere as conduct violating an objective standard: action entailing "an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Farmer v. Brennan,* 511 U.S. 825, 836, 114 S.Ct. 1970, 128 L.Ed.2d 811. There being no ***50** indication that Congress had something different in mind, there is no reason to deviate from the common law understanding in applying the statute. See *Beck v. Prupis, supra*, at 500–501, 120 S.Ct. 1608. Thus, a company does not act in reckless disregard of FCRA unless the action is not only a violation under a reasonable reading of the statute, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless. The negligence/recklessness line need not be pinpointed here, for Safeco's reading of the statute, albeit erroneous, was not objectively unreasonable. Section 1681a(k)(1)(B)(i) is silent on the point from ****2205** which to measure "increase," and Safeco's reading has a foundation in the statutory text and a sufficiently convincing justification to have persuaded the District Court to adopt it and rule in Safeco's favor. Before these cases, no court of appeals had spoken on the issue, and no authoritative guidance has yet come from the Federal Trade Commission. Given this dearth of guidance and the less-than-pellucid statutory text, Safeco's reading was not objectively unreasonable, and so falls well short of raising the "unjustifiably high risk" of violating the statute necessary for reckless liability. Pp. 2214 – 2216.

140 Fed.Appx. 746; 435 F.3d 1081, reversed and remanded.

SOUTER, J., delivered the opinion of the Court, in which ROBERTS, C. J., and KENNEDY and BREYER, JJ., joined, in which SCALIA, J., joined as to all but footnotes 11 and 15, in which THOMAS and ALITO, JJ., joined as to all but Part III–A, and in which STEVENS and GINSBURG, JJ., joined as to Parts I, II, III–A, and IV–B. STEVENS, J., filed an opinion concurring in part and concurring in the judgment, in which GINSBURG, J., joined, *post*, p. 2216. THOMAS, J., filed an opinion concurring in part, in which ALITO, J., joined, *post*, p. 2217.

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Opinion

Justice SOUTER delivered the opinion of the Court. [*]

***52** The Fair Credit Reporting Act (FCRA or Act) requires notice to any consumer subjected to "adverse action ... based in whole or in part on any information contained in a consumer [credit] report." 15 U.S.C. §

1681m(a). Anyone who "willfully fails" to provide notice is civilly liable to the consumer. § 1681n(a). The questions in these consolidated cases are whether willful failure covers a violation committed in reckless disregard of the notice obligation, and, if so, whether petitioners Safeco and GEICO committed reckless violations. We hold that reckless action is covered, that GEICO did not violate the statute, and that while Safeco might have, it did not act recklessly.

I

A

Congress enacted FCRA in 1970 to ensure fair and accurate credit reporting, promote efficiency in the banking system, and protect consumer privacy. See 84 ****2206** Stat. 1128, 15 U.S.C. § 1681; *TRW Inc. v. Andrews,* 534 U.S. 19, 23, 122 S.Ct. 441, 151 L.Ed.2d 339 (2001). The Act requires, among other things, that "any person [who] takes any adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report" must notify the affected consumer.[1] ***53** 15 U.S.C. § 1681m(a). The notice must point out the adverse action, explain how to reach the agency that reported on the consumer's credit, and tell the consumer that he can get a free copy of the report and dispute its accuracy with the agency. *Ibid.* As it applies to an insurance company, "adverse action" is "a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of, any insurance, existing or applied for." § 1681a(k)(1)(B)(i).

FCRA provides a private right of action against businesses that use consumer reports but fail to comply. If a violation is negligent, the affected consumer is entitled to actual damages. § 1681*o* (a) (2000 ed., Supp. IV). If willful, however, the consumer may have actual damages, or statutory damages ranging from $100 to $1,000, and even punitive damages. § 1681n(a) (2000 ed.).

B

Petitioner GEICO[2] writes auto insurance through four subsidiaries: GEICO General, which sells "preferred" policies at low rates to low-risk customers; Government Employees, which also sells "preferred" policies, but only to government employees; GEICO Indemnity, which sells standard policies to moderate-risk customers; and GEICO Casualty, which sells nonstandard policies at higher rates to high-risk customers. Potential customers call a toll-free number answered by an agent of the four affiliates, who takes information and, with permission, gets the applicant's credit score.[3] ***54** This information goes into GEICO's computer system, which selects any appropriate company and the particular rate at which a policy may be issued.

For some time after FCRA went into effect, GEICO sent adverse action notices to all applicants who were not offered "preferred" policies from GEICO General or Government Employees. GEICO changed its practice, however, after a method to "neutralize" an applicant's credit score was devised: the applicant's company and tier placement is compared with the company and tier placement he would have been assigned with a "neutral" credit score, that is, one calculated without reliance ****2207** on credit history.[4] Under this new scheme, it is only if using a neutral credit score would have put the applicant in a lower priced tier or company that GEICO sends an adverse action notice; the applicant is not otherwise told if he would have gotten better terms with a better credit score.

Respondent Ajene Edo applied for auto insurance with GEICO. After obtaining Edo's credit score, GEICO offered him a standard policy with GEICO Indemnity (at rates higher than the most favorable), which he accepted. Because Edo's company and tier placement would have been the same with a neutral score, GEICO did not give Edo an adverse action notice. Edo later filed this proposed class action against GEICO, alleging willful failure to give notice in violation of § 1681m(a); he claimed no actual harm, but sought statutory and punitive damages under § 1681n(a). The District Court granted summary judgment for GEICO, finding ***55** there was no adverse action when "the premium charged to [Edo] ... would have been the same even if GEICO Indemnity did not consider information in [his] consumer credit history." *Edo v. GEICO Casualty Co.,* CV 02–678–BR, 2004 WL 3639689, *4, 2004 U.S. Dist. LEXIS 28522, *12 (D.Ore., Feb. 23, 2004), App. to Pet. for Cert. in No. 06–100, p. 46a.

Like GEICO, petitioner Safeco [5] relies on credit reports to set initial insurance premiums, [6] as it did for respondents Charles Burr and Shannon Massey, who were offered higher rates than the best rates possible. Safeco sent them no adverse action notices, and they later joined a proposed class action against the company, alleging willful violation of § 1681m(a) and seeking statutory and punitive damages under § 1681n(a). The District Court ordered summary judgment for Safeco, on the understanding that offering a single, initial rate for insurance cannot be "adverse action."

The Court of Appeals for the Ninth Circuit reversed both judgments. In GEICO's case, it held that whenever a consumer "would have received a lower rate for his insurance had the information in his consumer report been more favorable, an adverse action has been taken against him." *Reynolds v. Hartford Financial Servs. Group, Inc.,* 435 F.3d 1081, 1093 (2006). Since a better credit score would have placed Edo with GEICO General, not GEICO Indemnity, the appeals court held that GEICO's failure to give notice was an adverse action.

The Ninth Circuit also held that an insurer "willfully" fails to comply with FCRA if it acts with "reckless disregard" of a consumer's rights under the Act. *Id.,* at 1099. It explained that a company would not be acting recklessly if it "diligently and in good faith attempted to fulfill its statutory ***56** obligations" and came to a "tenable, albeit erroneous, interpretation of the statute." *Ibid.* The court went on to say that "a deliberate failure to determine ****2208** the extent of its obligations" would not ordinarily escape liability under § 1681n, any more than "reliance on creative lawyering that provides indefensible answers." *Ibid.* Because the court believed that the enquiry into GEICO's reckless disregard might turn on undisclosed circumstances surrounding GEICO's revision of its notification policy, the Court of Appeals remanded the company's case for further proceedings. [7]

In the action against Safeco, the Court of Appeals rejected the District Court's position, relying on its reasoning in GEICO's case (where it had held that the notice requirement applies to a single statement of an initial charge for a new policy). *Spano v. Safeco Corp.,* 140 Fed.Appx. 746 (2005). The Court of Appeals also rejected Safeco's argument that its conduct was not willful, again citing the GEICO case, and remanded for further proceedings.

We consolidated the two matters and granted certiorari to resolve a conflict in the Circuits as to whether § 1681n(a) reaches reckless disregard of FCRA's obligations, [8] and to clarify the notice requirement in § 1681m(a). 548 U.S. 942, 127 S.Ct. 36, 165 L.Ed.2d 1014 (2006). We now reverse in both cases.

II

[1] **[2]** GEICO and Safeco argue that liability under § 1681n(a) for "willfully fail[ing] to comply" with FCRA goes only to acts ***57** known to violate the Act, not to reckless disregard of statutory duty, but we think they are wrong. We have said before that "willfully" is a "word of many meanings whose construction is often dependent on the context in which it appears," *Bryan v. United States,* 524 U.S. 184, 191, 118 S.Ct. 1939, 141 L.Ed.2d 197 (1998) (internal quotation marks omitted); and where willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well, see *McLaughlin v. Richland Shoe Co.,* 486 U.S. 128, 132–133, 108 S.Ct. 1677, 100 L.Ed.2d 115 (1988) ("willful," as used in a limitation provision for actions under the Fair Labor Standards Act, covers claims of reckless violation); *Trans World Airlines, Inc. v. Thurston,* 469 U.S. 111, 125–126, 105 S.Ct. 613, 83 L.Ed.2d 523 (1985) (same, as to a liquidated damages provision of the Age Discrimination in Employment Act of 1967); cf. *United States v. Illinois Central R. Co.,* 303 U.S. 239, 242–243, 58 S.Ct. 533, 82 L.Ed. 773 (1938) ("willfully," as used in a civil penalty provision, includes " 'conduct marked by careless disregard whether or not one has the right so to act' " (quoting *United States v. Murdock,* 290 U.S. 389, 395, 54 S.Ct. 223, 78 L.Ed. 381 (1933))). This construction reflects common law usage, which treated actions in "reckless disregard" of the law as "willful" violations. See W. Keeton, D. Dobbs, R. Keeton, & D. Owen, Prosser and Keeton on Law of Torts § 34, p. 212 (5th ed.1984) (hereinafter Prosser and Keeton) ("Although efforts have been ****2209** made to distinguish" the terms "willful," "wanton," and "reckless," "such distinctions have consistently been ignored, and the three terms have been treated as meaning the same thing, or at least as coming out at the same legal exit"). The standard civil usage thus counsels reading the phrase "willfully fails to comply" in § 1681n(a) as reaching reckless FCRA violations,[9] and this is so both on ***58** the interpretive assumption that Congress knows how we construe statutes and expects us to run true to form, see *Commissioner v. Keystone Consol. Industries, Inc.,* 508 U.S. 152, 159, 113 S.Ct. 2006, 124 L.Ed.2d 71 (1993), and under the general rule that a common law term in a statute comes with a common law meaning, absent anything pointing another way, *Beck v. Prupis,* 529 U.S. 494, 500–501, 120 S.Ct. 1608, 146 L.Ed.2d 561 (2000).

GEICO and Safeco argue that Congress did point to something different in FCRA, by a drafting history of § 1681n(a) said to show that liability was supposed to attach only to knowing violations. The original version of the Senate bill that turned out as FCRA had two standards of liability to victims: grossly negligent violation (supporting actual damages) and willful violation (supporting actual, statutory, and punitive damages). S. 823, 91st Cong., 1st Sess., § 1 (1969). GEICO and Safeco argue that since a "gross negligence" standard is effectively the same as a "reckless disregard" standard, the original bill's "willfulness" standard must have meant a level of culpability higher than "reckless disregard," or there would have been no requirement to show a different state of mind as a condition of the potentially much greater liability; thus, "willfully fails to comply" must have referred to a knowing violation. Although the gross negligence standard was reduced later in the legislative process to simple negligence (as it now appears in § 1681*o*), the provision ***59** for willful liability remains unchanged and so must require knowing action, just as it did originally in the draft of § 1681n.

Perhaps. But Congress may have scaled the standard for actual damages down to simple negligence because it thought gross negligence, being like reckless action, was covered by willfulness. Because this alternative reading is possible, any inference from the drafting sequence is shaky, and certainly no match for the following clue in the text as finally adopted, which points to the traditional understanding of willfulness in the civil sphere.

The phrase in question appears in the preamble sentence of § 1681n(a): "Any person who willfully fails to comply with any requirement imposed under this subchapter ****2210** with respect to any consumer is liable to that consumer ... ." Then come the details, in paragraphs (1)(A) and (1)(B), spelling out two distinct measures of damages chargeable against the willful violator. As a general matter, the consumer may get either actual damages or "damages of not less than $100 and not more than $1,000." § 1681n(a)(1)(A). But where the offender is liable "for obtaining a consumer report under false pretenses or knowingly without a permissible purpose," the statute sets liability higher: "actual damages ... or $1,000, whichever is greater." § 1681n(a)(1)(B).

If the companies were right that "willfully" limits liability under § 1681n(a) to knowing violations, the modifier "knowingly" in § 1681n(a)(1)(B) would be superfluous and incongruous; it would have made no sense for Congress to condition the higher damages under § 1681n(a) on knowingly obtaining a report without a permissible purpose if the general threshold of any liability under the section were knowing misconduct. If, on the other hand, "willfully" covers both knowing and reckless disregard of the law, knowing violations are sensibly understood as a more serious subcategory of willful ones, and both the preamble and the subsection have distinct jobs to do. See ***60** *United States v. Menasche,* 348 U.S. 528, 538–539, 75 S.Ct. 513, 99 L.Ed. 615 (1955) (" '[G]ive effect, if possible, to every clause and word of a statute' " (quoting *Montclair v. Ramsdell,* 107 U.S. 147, 152, 2 S.Ct. 391, 27 L.Ed. 431 (1883))).

The companies make other textual and structural arguments for their view, but none is persuasive. Safeco thinks our reading would lead to the absurd result that one could, with reckless disregard, knowingly obtain a consumer report without a permissible purpose. But this is not so; action falling within the knowing subcategory does not simultaneously fall within the reckless alternative. Then both GEICO and Safeco argue that the reference to acting "knowingly and willfully" in FCRA's criminal enforcement provisions, §§ 1681q and 1681r, indicates that "willfully" cannot include recklessness. But we are now on the criminal side of the law, where the paired modifiers are often found, see, *e.g.,* 18 U.S.C. § 1001 (2000 ed. and Supp. IV) (false statements to federal investigators); 20 U.S.C. § 1097(a) (embezzlement of student loan funds); 18 U.S.C. § 1542 (2000 ed. and Supp. IV) (false statements in a passport application). As we said before, in the criminal law "willfully" typically narrows the otherwise sufficient intent, making the government prove something extra, in contrast to its civil law usage, giving a plaintiff a choice of mental states to show in making a case for liability, see n.

9, *supra*. The vocabulary of the criminal side of FCRA is consequently beside the point in construing the civil side.

III

A

Before getting to the claims that the companies acted recklessly, we have the antecedent question whether either company violated the adverse action notice requirement at all. In both cases, respondent-plaintiffs' claims are premised on initial rates charged for new insurance policies, which are not "adverse" actions unless quoting or charging a first-time ***61** premium is "an increase in any charge for ... any insurance, existing or applied for." 15 U.S.C. § 1681a(k)(1)(B)(i).

In Safeco's case, the District Court held that the initial rate for a new insurance policy cannot be an "increase" because there is no prior dealing. The phrase "increase in any charge for ... insurance" is readily understood to mean a change in ****2211** treatment for an insured, which assumes a previous charge for comparison. See Webster's New International Dictionary 1260 (2d ed.1957) (defining "increase" as "[a]ddition or enlargement in size, extent, quantity, number, intensity, value, substance, etc.; augmentation; growth; multiplication"). Since the District Court understood "increase" to speak of change just as much as of comparative size or quantity, it reasoned that the statute's "increase" never touches the initial rate offer, where there is no change.

The Government takes the part of the Court of Appeals in construing "increase" to reach a first-time rate. It says that regular usage of the term is not as narrow as the District Court thought: the point from which to measure difference can just as easily be understood without referring to prior individual dealing. The Government gives the example of a gas station owner who charges more than the posted price for gas to customers he does not like; it makes sense to say that the owner increases the price and that the driver pays an increased price, even if he never pulled in there for gas before. See Brief for United States as *Amicus Curiae* 26.[10] The Government implies, then, that reading "increase" requires a choice, and the chosen reading should be the broad one in order to conform to what Congress had in mind.

[3] ***62** We think the Government's reading has the better fit with the ambitious objective set out in the Act's statement of purpose, which uses expansive terms to describe the adverse effects of unfair and inaccurate credit reporting and the responsibilities of consumer reporting agencies. See § 1681(a) (inaccurate reports "directly impair the efficiency of the banking system"; unfair reporting methods undermine public confidence "essential to the continued functioning of the banking system"; need to "insure" that reporting agencies "exercise their grave responsibilities" fairly, impartially, and with respect for privacy). The descriptions of systemic problem and systemic need as Congress saw them do nothing to suggest that remedies for consumers placed at a disadvantage by unsound credit ratings should be denied to first-time victims, and the legislative histories of FCRA's original enactment and of the 1996 amendment reveal no reason to confine attention to customers and businesses with prior dealings. Quite the contrary.[11] Finally, there is nothing about insurance contracts to suggest that Congress might have meant to differentiate applicants from existing customers when it set the notice requirement; the newly insured who gets charged more owing to an erroneous report is in the same boat with the renewal applicant.[12] We therefore ****2212** hold ***63** that the "increase" required for "adverse action," 15 U.S.C. § 1681a(k)(1)(B)(i), speaks to a disadvantageous rate even with no prior dealing; the term reaches initial rates for new applicants.

B

Although offering the initial rate for new insurance can be an "adverse action," respondent-plaintiffs have another hurdle to clear, for § 1681m(a) calls for notice only when the adverse action is "based in whole or in part on" a credit report. GEICO argues that in order to have adverse action "based on" a credit report, consideration of the report must be a necessary condition for the increased rate. The Government and respondent-plaintiffs do not explicitly take a position on this point.

To the extent there is any disagreement on the issue, we accept GEICO's reading. In common talk, the phrase "based on" indicates a but-for causal relationship and thus a necessary logical condition. Under this most natural reading of § 1681m(a), then, an increased rate is not "based in whole or in part on" the credit report unless the report was a necessary condition of the increase.

As before, there are textual arguments pointing another way. The statute speaks in terms of basing the action "in part" as well as wholly on the credit report, and this phrasing could mean that adverse action is "based on" a credit report whenever the report was considered in the rate-setting process, even without being a necessary condition for the rate increase. But there are good reasons to think Congress preferred GEICO's necessary-condition reading.

If the statute has any claim to lucidity, not all "adverse actions" require notice, only those "based ... on" information in a credit report. Since the statute does not explicitly call for notice when a business acts adversely merely after consulting a report, conditioning the requirement on action "based ... on" a report suggests that the duty to report arises from some practical consequence of reading the report, ***64** not merely some subsequent adverse occurrence that would have happened anyway. If the credit report has no identifiable effect on the rate, the consumer has no immediately practical reason to worry about it (unless he has the power to change every other fact that stands between himself and the best possible deal); both the company and the consumer are just where they would have been if the company had never seen the report.[13] And if examining reports that make no difference was supposed to trigger a reporting requirement, it would be hard to find any practical point in imposing the "based ... on" restriction. So it makes more sense to suspect that Congress meant to require notice and prompt a challenge by the consumer only when the consumer would gain something if the challenge succeeded.[14]

****2213** C

To sum up, the difference required for an increase can be understood without reference to prior dealing (allowing a ***65** first-time applicant to sue), and considering the credit report must be a necessary condition for the difference. The remaining step in determining a duty to notify in cases like these is identifying the benchmark for determining whether a first-time rate is a disadvantageous increase. And in dealing with this issue, the pragmatic reading of "based ... on" as a condition necessary to make a practical difference carries a helpful suggestion.

The Government and respondent-plaintiffs argue that the baseline should be the rate that the applicant would have received with the best possible credit score, while GEICO contends it is what the applicant would have had if the company had not taken his credit score into account (the "neutral score" rate GEICO used in Edo's case). We think GEICO has the better position, primarily because its "increase" baseline is more comfortable with the understanding of causation just discussed, which requires notice under § 1681m(a) only when the effect of the credit report on the initial rate offered is necessary to put the consumer in a worse position than other relevant facts would have decreed anyway. If Congress was this concerned with practical consequences when it adopted a "based ... on" causation standard, it presumably thought in equally practical terms when it spoke of an "increase" that must be defined by a baseline to measure from. Congress was therefore more likely concerned with the practical question whether the consumer's rate actually suffered when the company took his credit report into account than the theoretical question whether the consumer would have gotten a better rate with perfect credit.[15]

***66** The Government objects that this reading leaves a loophole, since it keeps first-time applicants who actually deserve better-than-neutral credit scores from getting notice, even when errors in credit reports saddle them with unfair rates. This is true; the neutral-score baseline will leave some consumers without a notice ****2214** that might lead to discovering errors. But we do not know how often these cases will occur, whereas we see a more demonstrable and serious disadvantage inhering in the Government's position.

Since the best rates (the Government's preferred baseline) presumably go only to a minority of consumers, adopting the Government's view would require insurers to send slews of adverse action notices; every young applicant who had yet to establish a gilt-edged credit report, for example, would get a notice that his charge had been "increased" based on his credit report. We think that the consequence of sending out notices on this scale would undercut the obvious policy behind the notice requirement, for notices as common as these would take on the character of formalities, and formalities tend to be ignored. It would get around that new insurance usually comes with an adverse action notice, owing to some legal quirk, and instead of piquing an applicant's interest about the accuracy of his credit record, the commonplace notices would mean just about nothing and go the way of junk mail. Assuming that Congress meant a notice of adverse ***67** action to get some attention, we think the cost of closing the loophole would be too high.

While on the subject of hypernotification, we should add a word on another point of practical significance. Although the rate initially offered for new insurance is an "increase" calling for notice if it exceeds the neutral rate, did Congress intend the same baseline to apply if the quoted rate remains the same over a course of dealing, being repeated at each renewal date?

We cannot believe so. Once a consumer has learned that his credit report led the insurer to charge more, he has no need to be told over again with each renewal if his rate has not changed. For that matter, any other construction would probably stretch the word "increase" more than it could bear. Once the gas station owner had charged the customer the above-market price, it would be strange to speak of the same price as an increase every time the customer pulled in. Once buyer and seller have begun a course of dealing, customary usage does demand a change for "increase" to make sense.[16] Thus, after initial dealing between the consumer and the insurer, the baseline for "increase" is the previous rate or charge, not the "neutral" baseline that applies at the start.

IV

A

[4] In GEICO's case, the initial rate offered to Edo was the one he would have received if his credit score had not been ***68** taken into account, and GEICO owed him no adverse action notice under § 1681m(a).[17]

****2215** B

Safeco did not give Burr and Massey any notice because it thought § 1681m(a) did not apply to initial applications, a mistake that left the company in violation of the statute if Burr and Massey received higher rates "based in whole or in part" on their credit reports; if they did, Safeco would be liable to them on a showing of reckless conduct (or worse). The first issue we can forget, however, for although the record does not reliably indicate what rates they would have obtained if their credit reports had not been considered, it is clear enough that if Safeco did violate the statute, the company was not reckless in falling down in its duty.

[5] While "the term recklessness is not self-defining," the common law has generally understood it in the sphere of civil liability as conduct violating an objective standard: action entailing "an unjustifiably high risk of harm that is either known or so obvious that it should be known."[18] *Farmer v. Brennan,* 511 U.S. 825, 836, 114 S.Ct. 1970, 128 L.Ed.2d 811 (1994); see Prosser and Keeton ***69** § 34, at 213–214. The Restatement, for example, defines reckless disregard of a person's physical safety this way:

> "The actor's conduct is in reckless disregard of the safety of another if he does an act or intentionally fails to do an act which it is his duty to the other to do, knowing or having reason to know of facts which would lead a reasonable man to realize, not only that his conduct creates an unreasonable risk of physical harm to another, but also that such risk is substantially greater than that which is necessary to make his conduct negligent." 2 Restatement (Second) of Torts § 500, p. 587 (1963–1964).
>
> It is this high risk of harm, objectively assessed, that is the essence of recklessness at common law. See Prosser and Keeton § 34, at 213 (recklessness requires "a known or obvious risk that was so great as to make it highly probable that harm would follow").

There being no indication that Congress had something different in mind, we have no reason to deviate from the common law understanding in applying the statute. See *Prupis,* 529 U.S., at 500–501, 120 S.Ct. 1608. Thus, a company subject to FCRA does not act in reckless disregard of it unless the action is not only a violation under a reasonable reading of the statute's terms, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless.

[6] Here, there is no need to pinpoint the negligence/recklessness line, for Safeco's reading of the statute, albeit erroneous, was not objectively unreasonable. As we said, § 1681a(k)(1)(B)(i) is silent on the point from which to measure "increase." On the rationale that "increase" presupposes prior dealing, Safeco took the definition as excluding initial rate offers for new insurance, and so sent no adverse action notices to Burr and Massey. While we disagree with Safeco's analysis, we recognize ****2216** that its reading has a foundation ***70** in the statutory text, see *supra,* at 2216, and a sufficiently convincing justification to have persuaded the District Court to adopt it and rule in Safeco's favor.

This is not a case in which the business subject to the Act had the benefit of guidance from the courts of appeals or the Federal Trade Commission (FTC) that might have warned it away from the view it took. Before these cases, no court of appeals had spoken on the issue, and no authoritative guidance has yet come from the FTC[19] (which in any case has only enforcement responsibility, not substantive rulemaking authority, for the provisions in question, see 15 U.S.C. §§ 1681s(a)(1), (e)). Cf. *Saucier v. Katz,* 533 U.S. 194, 202, 121 S.Ct. 2151, 150 L.Ed.2d 272 (2001) (assessing, for qualified immunity purposes, whether an action was reasonable in light of legal rules that were "clearly established" at the time). Given this dearth of guidance and the less-than-pellucid statutory text, Safeco's reading was not objectively unreasonable, and so falls well short of raising the "unjustifiably high risk" of violating the statute necessary for reckless liability.[20]

* * *

***71** The Court of Appeals correctly held that reckless disregard of a requirement of FCRA would qualify as a willful violation within the meaning of § 1681n(a). But there was no need for that court to remand the cases for factual development. GEICO's decision to issue no adverse action notice to Edo was not a violation of § 1681m(a), and Safeco's misreading of the statute was not reckless. The judgments of the Court of Appeals are therefore reversed in both cases, which are remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice STEVENS, with whom Justice GINSBURG joins, concurring in part and concurring in the judgment.

While I join the Court's judgment and Parts I, II, III–A, and IV–B of the Court's opinion, I disagree with the reasoning in Parts III–B and III–C, as well as with Part IV–A, which relies on that reasoning.

****2217** An adverse action taken after reviewing a credit report "is based in whole or in part on" that report within the meaning of 15 U.S.C. § 1681m(a). That is true even if the company would have made the same decision without looking at the report, because what the company actually did is more relevant than what it might have done. I find nothing in the statute making the examination of a credit report a "necessary condition" of any resulting increase. *Ante,* at 2211. The more natural reading is that reviewing a report is only a sufficient condition.

***72** The Court's contrary position leads to a serious anomaly. As a matter of federal law, companies are free to adopt whatever "neutral" credit scores they want. That score need not (and probably will not) reflect the median consumer credit score. More likely, it will reflect a company's assessment of the creditworthiness of a run-of-the-mill applicant who lacks a credit report. Because those who have yet to develop a credit history are unlikely to be good credit risks, "neutral" credit scores will in many cases be quite low. Yet under the Court's reasoning, only those consumers with credit scores even lower than what may already be a very low "neutral" score will ever receive adverse action notices.[1]

While the Court acknowledges that "the neutral-score baseline will leave some consumers without a notice that might lead to discovering errors," *ante,* at 2213 – 2214, it finds this unobjectionable because Congress was likely uninterested in "the theoretical question whether the consumer would have gotten a better rate with perfect credit," *Ibid.*[2] The Court's decision, however, disserves not only those consumers with "gilt-edged credit report[s]," *ante,* at 2214, but also the much larger category of consumers with better-than-"neutral" scores. I find it difficult to believe that Congress ***73** could have intended for a company's unrestrained adoption of a "neutral" score to keep many (if not most) consumers from ever hearing that their credit reports are costing them money.

In my view, the statute's text is amenable to a more sensible interpretation.

Justice THOMAS, with whom Justice ALITO joins, concurring in part.

I agree with the Court's disposition and most of its reasoning. Safeco did not send notices to new customers because it took the position that the initial insurance rate it offered a customer could not be an "increase in any charge for ... insurance" under 15 U.S.C. § 1681a(k)(1)(B)(i). The Court properly holds that regardless of the merits of this interpretation, it is not an unreasonable one, and Safeco therefore did not act willfully. *Ante,* at 2214 – 2216. I **2218 do not join Part III–A of the Court's opinion, however, because it resolves the merits of Safeco's interpretation of § 1681a(k)(1)(B)(i)—an issue not necessary to the Court's conclusion and not briefed or argued by the parties.

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Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

[*] Justice SCALIA joins all but footnotes 11 and 15 of this opinion.

[1] So far as it matters here, the Act defines "consumer report" as "any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, [or] credit capacity ... which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for ... credit or insurance to be used primarily for personal, family, or household purposes." 15 U.S.C. § 1681a(d)(1) (footnote omitted). The scope of this definition is not at issue.

[2] The specific petitioners are subsidiary companies of the GEICO Corporation; for the sake of convenience, we call them "GEICO" collectively.

[3] The Act defines a "credit score" as "a numerical value or a categorization derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default." 15 U.S.C. § 1681g(f)(2)(A) (2000 ed., Supp. IV). Under its contract with its credit information providers, GEICO learned credit scores and facts in the credit reports that significantly influenced the scores, but did not have access to the credit reports themselves.

[4] A number of States permit the use of such "neutral" credit scores to ensure that consumers with thin or unidentifiable credit histories are not treated disadvantageously. See, *e.g.,* N.Y. Ins. Law Ann. §§ 2802(e), (e)(1) (West 2006) (generally prohibiting an insurer from "consider[ing] an absence of credit information," but allowing it to do so if it "treats the consumer as if the applicant or insured had neutral credit information, as defined by the insurer").

[5] Again, the actual petitioners are subsidiary companies, of Safeco Corporation in this case; for convenience, we call them "Safeco" collectively.

[6] The parties do not dispute that the credit scores and credit reports relied on by GEICO and Safeco are "consumer reports" under 15 U.S.C. § 1681a(d)(1).

[7] Prior to issuing its final opinion in this case, the Court of Appeals had issued, then withdrawn, two opinions in which it held that GEICO had "willfully" violated FCRA as a matter of law. *Reynolds v. Hartford Financial Servs. Group, Inc.,* 416 F.3d 1097 (C.A.9 2005); *Reynolds v. Hartford Financial Servs. Group, Inc.,* 426 F.3d 1020 (C.A.9 2005).

[8] Compare, *e.g., Cushman v. Trans Union Corp*., 115 F.3d 220, 227 (C.A.3 1997) (adopting the "reckless disregard" standard), with *Wantz v. Experian Information Solutions,* 386 F.3d 829, 834 (C.A.7 2004) (construing "willfully" to require that a user "knowingly and intentionally violate the Act"); *Phillips v. Grendahl,* 312 F.3d 357, 368 (C.A.8 2002) (same).

[9] It is different in the criminal law. When the term "willful" or "willfully" has been used in a criminal statute, we have regularly read the modifier as limiting liability to knowing violations. See *Ratzlaf v. United States,* 510 U.S. 135, 137, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994); *Bryan v. United States,* 524 U.S. 184, 191–192, 118 S.Ct. 1939, 141 L.Ed.2d 197 (1998); *Cheek v. United States,* 498 U.S. 192, 200–201, 111 S.Ct. 604, 112 L.Ed.2d 617 (1991). This reading of the term, however, is tailored to the criminal law, where it is characteristically used to require a criminal intent beyond the purpose otherwise

required for guilt, *Ratzlaf, supra,* at 136–137, 114 S.Ct. 655; or an additional " 'bad purpose,' " *Bryan, supra,* at 191, 118 S.Ct. 1939; or specific intent to violate a known legal duty created by highly technical statutes, *Cheek, supra,* at 200–201, 111 S.Ct. 604. Thus we have consistently held that a defendant cannot harbor such criminal intent unless he "acted with knowledge that his conduct was unlawful." *Bryan, supra,* at 193, 118 S.Ct. 1939. Civil use of the term, however, typically presents neither the textual nor the substantive reasons for pegging the threshold of liability at knowledge of wrongdoing. Cf. *Farmer v. Brennan,* 511 U.S. 825, 836–837, 114 S.Ct. 1970, 128 L.Ed.2d 811 (1994) (contrasting the different uses of the term "recklessness" in civil and criminal contexts).

10 Since the posted price seems to be addressed to the world in general, one could argue that the increased gas price is not the initial quote. But the same usage point can be made with the example of the clothing model who gets a call from a ritzy store after posing for a discount retailer. If she quotes a higher fee, it would be natural to say that the uptown store will have to pay the "increase" to have her in its ad.

11 See S.Rep. No. 91–517, p. 7 (1969) ("Those who ... charge a higher rate for credit or insurance wholly or partly because of a consumer report must, upon written request, so advise the consumer ..."); S.Rep. No. 103–209, p. 4 (1993) (adverse action notice is required "any time the permissible use of a report results in an outcome adverse to the interests of the consumer"); H.R.Rep. No. 103–486, p. 26 (1994) ("[W]henever a consumer report is obtained for a permissible purpose ..., any action taken based on that report that is adverse to the interests of the consumer triggers the adverse action notice requirements").

12 In fact, notice in the context of an initially offered rate may be of greater significance than notice in the context of a renewal rate; if, for instance, insurance is offered on the basis of a single, long-term guaranteed rate, a consumer who is not given notice during the initial application process may never have an opportunity to learn of any adverse treatment.

13 For instance, if a consumer's driving record is so poor that no insurer would give him anything but the highest possible rate regardless of his credit report, whether or not an insurer happened to look at his credit report should have no bearing on whether the consumer must receive notice, since he has not been treated differently as a result of it.

14 The history of the Act provides further support for this reading. The originally enacted version of the notice requirement stated: "Whenever ... the charge for ... insurance is increased either wholly or partly because of information contained in a consumer report ..., the user of the consumer report shall so advise the consumer ... ." 15 U.S.C. § 1681m(a) (1976 ed.). The "because of" language in the original statute emphasized that the consumer report must actually have caused the adverse action for the notice requirement to apply. When Congress amended FCRA in 1996, it sought to define "adverse action" with greater particularity, and thus split the notice provision into two separate subsections. See 110 Stat. 3009–426 to 3009–427, 3009–443 to 3009–444. In the revised version of § 1681m(a), the original "because of" phrasing changed to "based ... on," but there was no indication that this change was meant to be a substantive alteration of the statute's scope.

15 While it might seem odd, under the current statutory structure, to interpret the definition of "adverse action" (in § 1681a(k)(1)(B)(i)) in conjunction with § 1681m(a), which simply applies the notice requirement to a particular subset of "adverse actions," there are strong indications that Congress intended these provisions to be construed in tandem. When FCRA was initially enacted, the link between the definition of "adverse action" and the notice requirement was clear, since "adverse action" was defined within § 1681m(a). See 15 U.S.C. § 1681m(a) (1976 ed.). Though Congress eventually split the provision into two parts (with the definition of "adverse action" now located at § 1681a(k)(1)(B)(i)), the legislative history suggests that this change was not meant to alter Congress's intent to define "adverse action" in light of the notice requirement. See S.Rep. No. 103–209, at 4 ("The Committee bill ... defines an 'adverse action' as any action that is adverse to the interests of the consumer and is based in whole or in part on a consumer report"); H.R.Rep. No. 103–486, at 26 ("[A]ny action based on [a consumer] report that is adverse to the interests of the consumer triggers the adverse action notice requirements").

16 Consider, too, a consumer who, at the initial application stage, had a perfect credit score and thus obtained the best insurance rate, but, at the renewal stage, was charged at a higher rate (but still lower than the rate he would have received had his credit report not been taken into account) solely because his credit score fell during the interim. Although the consumer clearly suffered an "increase" in his insurance rate that was "based on" his credit score, he would not be entitled to an adverse action notice under the baseline used for initial applications.

17 We reject Edo's alternative argument that GEICO's offer of a standard insurance policy with GEICO Indemnity was an "adverse action" requiring notice because it amounted to a "denial" of insurance through a lower cost, "preferred" policy with GEICO General. See § 1681a(k)(1)(B)(i) (defining "adverse action" to include a "denial ... of ... insurance"). An applicant calling GEICO for insurance talks with a sales representative who acts for all the GEICO companies. The record has no indication that GEICO tells applicants about its corporate structure, or that applicants request insurance from one of the several companies or even know of their separate existence. The salesperson takes information from the applicant

and obtains his credit score, then either denies any insurance or assigns him to one of the companies willing to provide it; the other companies receive no application and take no separate action. This way of accepting new business is clearly outside the natural meaning of "denial" of insurance.

[18] Unlike civil recklessness, criminal recklessness also requires subjective knowledge on the part of the offender. *Brennan,* 511 U.S., at 836–837, 114 S.Ct. 1970; ALI, Model Penal Code § 2.02(2)(c) (1985).

[19] Respondent-plaintiffs point to a letter, written by an FTC staff member to an insurance company lawyer, that suggests that an "adverse action" occurs when "the applicant will have to pay more for insurance at the inception of the policy than he or she would have been charged if the consumer report had been more favorable." Letter from Hannah A. Stires to James M. Ball (Mar. 1, 2000), http://www.ftc.gov/os/statutes/fcra/ball.htm (as visited May 17, 2007, and available in Clerk of Court's case file). But the letter did not canvass the issue, and it explicitly indicated that it was merely "an informal staff opinion ... not binding on the Commission." *Ibid.*

[20] Respondent-plaintiffs argue that evidence of subjective bad faith must be taken into account in determining whether a company acted knowingly or recklessly for purposes of § 1681n(a). To the extent that they argue that evidence of subjective bad faith can support a willfulness finding even when the company's reading of the statute is objectively reasonable, their argument is unsound. Where, as here, the statutory text and relevant court and agency guidance allow for more than one reasonable interpretation, it would defy history and current thinking to treat a defendant who merely adopts one such interpretation as a knowing or reckless violator. Congress could not have intended such a result for those who followed an interpretation that could reasonably have found support in the courts, whatever their subjective intent may have been.

Both Safeco and GEICO argue that good-faith reliance on legal advice should render companies immune to claims raised under § 1681n(a). While we do not foreclose this possibility, we need not address the issue here in light of our present holdings.

[1] Stranger still, companies that automatically disqualify consumers who lack credit reports will never need to send any adverse action notices. After all, the Court's baseline is "what the applicant would have had if the company had not taken his credit score into account," *ante,* at 2213, but from such companies, what the applicant "would have had" is no insurance at all. An offer of insurance at *any* price, however inflated by a poor and perhaps incorrect credit score, will therefore never constitute an adverse action.

[2] The Court also justifies its deviation from the statute's text by reasoning that frequent adverse action notices would be ignored. See *ante,* at 2213 – 2214. To borrow a sentence from the Court's opinion: "Perhaps." *Ante,* at 2209. But rather than speculate about the likely effect of "hypernotification," *ante,* at 2214, I would defer to the Solicitor General's position, informed by the Federal Trade Commission's expert judgment, that consumers by and large benefit from adverse action notices, however common. See Brief for United States as *Amicus Curiae* 27–29.

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696 Fed.Appx. 228
This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 9th Cir. Rule 36-3.
United States Court of Appeals,
Ninth Circuit.

UNITED STATES of America, Plaintiff-Appellee,
v.
David KALAI, Defendant-Appellant.
United States of America, Plaintiff-Appellee,
v.
Nadav Kalai, Defendant-Appellant.

No. 15-50375, No. 15-50381
|
Submitted August 10, 2017 * Pasadena, California
|
Filed August 16, 2017

Synopsis

Background: Defendants were convicted in the United States District Court for the Central District of California, Terry J. Hatter, J., No. 2:11-cr-00930-TJH-2 and No. 2:11-cr-00930-TJH-3, of conspiracy to defraud the United States and willful failure to file reports of foreign bank and financial accounts. Defendants appealed.

Holdings: The Court of Appeals held that:

[1] finding that defendant was competent to stand trial was supported by the record;

[2] instructions were not misleading or inadequate; and

[3] evidence was sufficient to convict defendant of willful failure to file reports of foreign bank and financial accounts.

Affirmed.

***229** Appeal from the United States District Court for the Central District of California, Terry J. Hatter, District Judge, Presiding, D.C. No. 2:11-cr-00930-TJH-2, D.C. No. 2:11-cr-00930-TJH-3

Attorneys and Law Firms

L. Ashley Aull, Assistant U.S. Attorney, DOJ—Office of the U.S. Attorney, Los Angeles, CA, Sandra R. Brown, Assistant U.S. Attorney, USLA—Office of the U.S. Attorney, Los Angeles, CA, Gregory Victor Davis, S. Robert Lyons, Christopher S. Strauss, Attorneys, Joseph Brian Syverson, DOJ—U.S. Department of Justice, Tax Division/Appellate Section, Washington, DC, for Plaintiff-Appellee

Michael Tanaka, Deputy Federal Public Defender, FPDCA—Federal Public Defender's Office (Los Angeles), Los Angeles, CA, for Defendant-Appellant

Before: CALLAHAN and OWENS, Circuit Judges, and GILLIAM, ** District Judge.

MEMORANDUM ***

David Kalai (David) appeals from his jury convictions for one count of conspiracy to defraud the United States, in violation of 18 U.S.C. § 371, and two counts of willful failure to file reports of foreign bank and financial accounts (FBARs), in violation of 31 U.S.C. §§ 5314, 5322(a). David contends that the district court clearly erred by finding him competent to stand trial. David's son, Nadav Kalai (Nadav), was convicted of the same charges, but appeals only from his jury convictions ***230** for the two FBAR counts. Nadav argues that the district court's jury instructions for those counts were erroneous and that there was insufficient evidence to convict him. Because the parties are familiar with the facts, we do not recount them here. We have jurisdiction pursuant to 28 U.S.C. § 1291, and we affirm.

[1] 1. The district court's finding that David was competent to stand trial was supported by ample evidence in the record. The only disagreement among the four experts for the government and defense was whether David could reasonably assist counsel in his defense, in light of a cognitive impairment that caused memory issues. In assessing these expert opinions, the district court was "free to assign greater weight to the findings of experts produced by the Government than to the opposing opinions of the medical witnesses produced by the defendant." *United States v. Frank*, 956 F.2d 872, 875 (9th Cir. 1991). Therefore, David's focus on conflicts in the record and on discrediting the government's experts does not establish clear error. *Id.*

Moreover, the record as a whole supports the district court's competency finding. David was able to engage in logical, detailed discussions regarding his case, and was easily redirected back to the topic at hand when he digressed or repeated himself. Furthermore, he demonstrated the ability to thoughtfully consider his legal options and to weigh advice from his lawyer and others. Although the record indicates David could be difficult to work with, was in poor health, and struggled with memory lapses and focus, it also reflects his ability to think logically and coherently and thereby assist in his defense. Therefore, the district court did not clearly err by finding David competent to stand trial.

[2] 2. Regarding Nadav's appeal, the jury instructions given by the district court for the FBAR counts were not "misleading or inadequate." *United States v. Hofus*, 598 F.3d 1171, 1174 (9th Cir. 2010) (citation omitted). A conviction for willful failure to file a FBAR requires proof that "the defendant acted with knowledge that his conduct was unlawful," meaning he intentionally violated "a known legal duty." *Ratzlaf v. United States*, 510 U.S. 135, 137, 141-42, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994). The district court appropriately instructed the jury that (1) the government had to prove Nadav "willfully failed to file a [FBAR]" and (2) "willfully" meant Nadav "knew federal law imposed a duty on him to file a [FBAR] ... [and] intentionally and voluntarily violated that duty." Nadav's proposed additions to those instructions were superfluous, because the jury could not find that Nadav intentionally violated a known duty without also finding that he knew the foreign account at issue contained over $10,000—the amount that triggered the requirement to file a FBAR.

The district court's additional instruction to review the blank FBAR form in evidence in response to a jury question further demonstrates the adequacy of the instructions, because that form stated that "[n]o report is required if the aggregate value of the [foreign] accounts did not exceed $10,000." *See Beardslee v. Woodford*, 358 F.3d 560, 590 (9th Cir. 2004) ("Written instructions in response to juror notes may be treated as jury instructions for purposes of review."). Moreover, the jury heard testimony on FBAR filing requirements, and Nadav's counsel argued in closing that Nadav could only be convicted if he knew the account contained over $10,000. *Cf. United States v. Johnson*, 680 F.3d 1140, 1148 (9th Cir. 2012) (separate perjury instruction not required in part because the defense "pointed out [the witness's] alleged perjury to the jury"). Accordingly, ***231** viewed "as a whole in the context of the entire trial," *id.* at 1147 (citation omitted), the jury instructions were both correct and adequate, and there are no grounds for reversal on this basis.

[3] 3. Sufficient evidence supported Nadav's convictions on the FBAR counts. Although the government did not introduce direct evidence of Nadav's knowledge of the amount in the foreign account at issue, it provided sufficient circumstantial evidence from which the jury could reasonably infer that Nadav knew the account contained more than $10,000, and therefore knew of his duty to file FBARs. *See Jackson v. Virginia*, 443 U.S. 307, 319, 99 S.Ct. 2781, 61 L.Ed.2d 560 (1979)

In particular, the evidence of Nadav's established methods for helping wealthy clients evade tax liability, and evidence that Nadav used those methods in opening the foreign account, would reasonably allow the jury to infer that Nadav knew the foreign account contained more than $10,000 and sought to hide that income from the Internal Revenue Service. *Cf. Karme v. Comm'r of Internal Revenue*, 673 F.2d 1062, 1064 (9th Cir. 1982) (in tax case, testimony unrelated to particular transaction was admissible because it "tend[ed] to establish a pattern or practice of tax planning of which [the] transaction was a part"). Such inferences were especially reasonable in light of Nadav's statements that his strategy was only useful for wealthy clients, as well as evidence that the money involved in his clients' accounts far exceeded $10,000. The jury could reasonably rely on that evidence, as well as its experience and common sense, and find that Nadav knew the foreign account contained more than $10,000.

Evidence that Nadav had signatory authority over the account and was informed of at least one transfer of funds further supported the jury's conclusion that Nadav's failure to file was willful. Furthermore, the steps Nadav took to conceal the foreign account could allow the jury to infer knowledge of the account balance and therefore find willfulness. *Cf. Hawkins v. Franchise Tax Bd. of Cal.*, 769 F.3d 662, 668 (9th Cir. 2014) (holding that willfulness in the context of felony tax evasion may be shown through "any kind of conduct, the likely effect of which would be to mislead or conceal" (quoting *Spies v. United States*, 317 U.S. 492, 499, 63 S.Ct. 364, 87 L.Ed. 418 (1943))). Accordingly, sufficient evidence supported Nadav's convictions on the FBAR counts.

AFFIRMED.

All Citations

696 Fed.Appx. 228

Footnotes

[*] The panel unanimously concludes this case is suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2).

[**] The Honorable Haywood S. Gilliam, Jr., United States District Judge for the Northern District of California, sitting by designation.

[***] This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

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131 T.C. 54
United States Tax Court.

Joseph B. WILLIAMS, III, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

No. 2202–08.
|
Oct. 2, 2008.

Synopsis
Background: Taxpayer filed timely petition seeking redetermination of deficiencies in income tax, and also seeking certain other relief. IRS moved to dismiss in part.

Holdings: The Tax Court, Gustafson, J., held that:

[1] Court lacked jurisdiction to determine tax liability for taxable year that was not included in notice of deficiency;

[2] Court lacked jurisdiction over petition to extent it sought relief pertaining to interest that "may" be assessed; and

[3] Court lacked jurisdiction to review Secretary of Treasury's determination as to taxpayer's liability for foreign bank account report (FBAR) penalties.

Motion granted.

***54** P filed a petition timely seeking redetermination of deficiencies in income tax for 1993–2000 and attempting to put at issue certain liabilities for which he received no notice from R: P's income tax liability for 2001, his potential liability for unassessed interest on asserted tax liabilities, and his liability for a so-called FBAR penalty under 31 U.S.C. sec. 5321(a). R moved to dismiss in part, as to the three liabilities not included in the deficiency notice.

Held: The Tax Court lacks jurisdiction to redetermine P's income tax liability for 2001, liability for unassessed interest, and liability for the FBAR penalty.

Attorneys and Law Firms

David H. Dickieson, for petitioner.

John C. McDougal, for respondent.

OPINION

GUSTAFSON, Judge:

This matter is before us on respondent's "Motion To Dismiss for Lack of Jurisdiction and To Strike as to the Taxable Year 2001, as to Interest, and as to FBAR [foreign bank account report] Penalties" (the motion). Petitioner objects (the objection). We shall grant the motion.

Background

By notice of deficiency dated October 29, 2007, respondent determined deficiencies in petitioner's 1993 through 2000 Federal income tax, along with penalties and additions to tax. By the petition, petitioner assigned error to those determinations. We have jurisdiction to consider petitioner's assignments of error.

The petition, however, also addresses three other matters that are the subject of respondent's motion: (1) Petitioner appears to seek relief as to the year 2001 (the first year after the years that are the subject of the notice of deficiency). He states that the "Tax periods involved in this Petition are income taxes for 1993, 1994, 1995, 1996, 1997, 1998, 1999, 2000, *2001* ". (Emphasis added.) (2) He "seeks an abatement of any interest which may be assessed" for certain periods on ***55** the deficiencies at issue here; and he cites section 6404(e),[1] "Abatement of Interest Attributable to Unreasonable Errors and Delays by the Internal Revenue Service". (3) He discusses penalties imposed on him under 31 U.S.C. section 5321, for failure to file foreign bank account reports (FBARs) disclosing Swiss bank accounts. The petition ends with a prayer "that any tax deficiency, FBAR penalty, and/or interest be abated."

Discussion

[1] The Tax Court is a court of limited jurisdiction. We may therefore exercise jurisdiction only to the extent expressly provided by statute. *Breman v. Commissioner,* 66 T.C. 61, 66, 1976 WL 3667 (1976). Congress has not conferred jurisdiction on this Court to consider the matters that are the subject of the motion.

1. *Tax Year 2001*

[2] In a case seeking redetermination of a deficiency, jurisdiction depends on the issuance by the Commissioner of a notice of deficiency. Secs. 6212(a), 6214(a). The objection acknowledges that taxable year 2001 is not included in the notice of deficiency. Because it is not, the Court does not have jurisdiction to determine petitioner's tax liability for taxable year 2001, and we shall deem stricken from paragraph 3 of the petition the reference to 2001. See Rule 52 ("the Court may order stricken from any pleading any insufficient claim or * * * any * * * immaterial [or] impertinent * * * matter"); cf. Fed.R.Civ.P. 12(f); *Bernal v. Commissioner,* 120 T.C. 102, 103 n. 2, 2003 WL 365901 (2003).

2. *Interest*

[3] **[4]** This Court has only limited jurisdiction to address issues related to statutory interest. See *Bax v. Commissioner,* 13 F.3d 54, 56 (2d Cir.1993). Here petitioner invokes section 6404(e), which authorizes the Commissioner to "abate the assessment of all or any part of such interest". By implication, petitioner invokes section 6404(h), which authorizes this Court, in certain circumstances, to "determine whether the Secretary's failure to abate interest under this section was an ***56** abuse of discretion". However, the petition seeks not an abatement of interest that has been assessed but rather "an abatement of any interest which *may be* assessed".[2] (Emphasis added.)

The remedy available under section 6404(e) is for the Commissioner to "abate the *assessment* " of interest. (Emphasis added.) Thus, as this Court has observed, "Section 6404(e), by its very terms, does not operate until after there has been an assessment of interest". *508 Clinton St. Corp. v. Commissioner,* 89 T.C. 352, 355, 1987 WL 43893 (1987). As a result, jurisdiction under section 6404(h) for this Court to review the Commissioner's determination under section 6404(e) is lacking unless and until an assessment of interest has occurred and the Secretary has mailed his "final determination not to abate such interest". Sec. 6404(h)(1); see Rule 280; *Bourekis v. Commissioner,* 110 T.C. 20, 26–27, 1998 WL 7744 (1998).

Petitioner seeks instead a preassessment review by this Court, which Congress has not empowered the Court to undertake. Rather, the Supreme Court has characterized section 6404(h) as "a precisely drawn, detailed statute [that] pre-empts more general remedies." *Hinck v. United States,* 550 U.S. 501, ——, 127 S.Ct. 2011, 2015, 167 L.Ed.2d 888 (2007) (quoting *EC Term of Years Trust v. United States,* 550 U.S. 429, ——, 127 S.Ct. 1763, 1767, 167 L.Ed.2d 729 (2007)). We therefore lack jurisdiction over the petition to the extent it seeks relief pertaining to interest, and we shall deem stricken from the petition paragraphs 5(d) and 54–66, and the reference to interest in the prayer for relief.

3. *FBAR Penalties*

[5] The FBAR penalties that the petitioner alleges have been imposed on him are authorized in Title 31 ("Money and Finance") of the United States Code, not Title 26 (the Internal Revenue Code). The FBAR provisions originated in the Bank Secrecy Act, Pub.L. 91–508, 84 Stat. 1114 (1970); and after the terrorist attacks of September 11, 2001, Congress directed, in the USA Patriot Act,[3] that attempts should ***57** be made to improve compliance with these provisions. Title 31 U.S.C. sec. 5314 (2000) authorizes the Secretary of the Treasury to "require a * * * citizen of the United States * * * to * * * keep records and file reports, when the * * * citizen * * * maintains a relation for any person with a foreign financial agency." The Secretary of the Treasury exercised that authority by requiring that citizens report their foreign bank accounts, see 31 C .F.R. sec. 103.24 (2007), and by ordering that the reports be made on forms to be filed with the Internal Revenue Service (IRS), see *id.* sec. 103.27(c)-(e).

Section 5321(a) of Title 31 provides for civil penalties for violations of the reporting requirements of section 5314, and section 5321(b)(1) provides that the Secretary of the Treasury may assess those penalties. (Section 5321(b)(2) provides that the Secretary may "commence a civil action to recover" the penalty.) The Secretary's authority to assess the civil FBAR penalties has been delegated to the IRS. See 31 C.F.R. sec. 103.56(g) (2007).

The petition states that such FBAR penalties were "imposed" on the petitioner (not specifying whether they have been assessed, or merely proposed); states that the IRS Appeals Office in Baltimore upheld the imposition of the penalties; urges that the Appeals Office abused its discretion in so doing; and asks this Court to "abate" the FBAR penalties. We cannot do so. "The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title" (i.e., Title 26) and predecessor internal revenue statutes. See sec. 7442. Petitioner does not point to any grant of jurisdiction to this Court that would extend to FBAR penalties, and we find none.

The FBAR penalties provided in Title 31 are nowhere made subject to the deficiency procedures of Title 26, see secs. 6212–6214, on which procedures the bulk of this Court's jurisdiction is predicated. For certain taxes, section 6212(a) authorizes the Commissioner to issue a notice of deficiency. Section 6213(a) provides that the tax may not be assessed until such a notice has been issued, and it provides that the assessment of the tax must be delayed pending a possible redetermination by the Tax Court if the taxpayer files a ***58** timely petition with the Court. However, under sections 6212(a) and 6213(a), such a notice of deficiency is to be sent in the case of "a deficiency in respect of any tax imposed by subtitle A ["Income Taxes"] or B ["Estate and Gift Taxes"] or chapter 41, 42, 43, or 44 [in subtitle D, "Miscellaneous Excise Taxes"]". By negative implication, any other taxes —even if imposed in Title 26—fall outside this Court's deficiency jurisdiction. [4]

The same conclusion must be reached as to the FBAR penalties imposed in Title 31: The Secretary of the Treasury is authorized by 31 U.S.C. sec. 5321(b)(1) to assess the FBAR penalty; no notice of deficiency is authorized by section 6212(a) nor required by section 6213(a) before that assessment may be made; and the penalty therefore falls outside our jurisdiction to review deficiency determinations.

Petitioner does not allege here that he received any notice of deficiency for the FBAR penalties, nor does he allege having received any other notice that might confer jurisdiction on this Court, such as a notice pertaining to a lien under section 6321 or to a levy under section 6331 (both of which are procedures applicable to "any person liable to pay any *tax* " (emphasis added)). [5] Such collection activities give rise to a notice and opportunity for a hearing under section 6320 or section 6330 (both of which explicitly presume "unpaid tax"). That notice may result in an agency determination that this Court would then have jurisdiction to review, in the lien and levy context. See secs. 6320(c), 6330(d)(1). Under section 6330(d)(1), this Court's authority to review IRS collection ***59** activity depends on the Commissioner's prior issuance of such a notice of "determination" under section 6330(c)(3), see *Goza v. Commissioner,* 114 T.C. 176, 182, 2000 WL 283864 (2000); and in the absence of such a notice, this Court lacks jurisdiction to review the Commissioner's collection activity.

The statutes creating the "collection due process" procedures, and the statutes creating the lien and levy collection mechanisms reviewed by those procedures, all explicitly pertain to "tax", [6] not to the FBAR penalty that petitioner attempts to put at issue here. Petitioner does not allege that he received any notice of determination under section 6320 or 6330 upholding any lien or proposed levy as to FBAR penalties, nor does he allege any action whatsoever by the Secretary leading toward the collection of the FBAR penalty.

The Tax Court has no jurisdiction to review the Secretary's determination as to petitioner's liability for FBAR penalties. As a result, respondent's motion must be granted, and we shall deem stricken from the petition paragraphs 5(e) and 67–73, and the reference to FBAR penalty in the prayer for relief.

To reflect the foregoing,

An appropriate order will be issued.

All Citations

131 T.C. No. 6, 131 T.C. 54, Tax Ct. Rep. (CCH) 57,547, Tax Ct. Rep. Dec. (RIA) 131.6

Footnotes

[1] Except as otherwise noted, section references are to the Internal Revenue Code (26 U.S.C.), and Rule references are to the Tax Court Rules of Practice and Procedure.

[2] The petition also states: “The sheer size of this *potential* interest liability mandates that any errors on its calculation be raised in this petition and addressed by the Tax Court.” (Emphasis added.)

[3] See USA Patriot Act, Pub.L. 107–56, sec. 361(b), 115 Stat. 272 (2001):

> The Secretary of the Treasury shall study methods for improving compliance with the reporting requirements established in section 5314 of title 31, United States Code, and shall submit a report on such study to the Congress by the end of the 6–month period beginning on the date of enactment of this Act and each 1–year period thereafter.

[4] For example, the “Assessable Penalties” provided under Chapter 68 (i.e., within Subtitle F, “Procedure and Administration”) fall outside the deficiency notice regime of sections 6212 to 6214 and thus fall outside this Court's deficiency jurisdiction. See, e.g., sec. 6682(c) (“Deficiency Procedures Not to Apply”); sec. 6703 (“deficiency procedures * * * shall not apply with respect to the assessment or collection of the penalties provided by sections 6700, 6701, and 6702”); *Van Es v. Commissioner,* 115 T.C. 324, 329, 2000 WL 1520321 (2000) (the Tax Court does not have jurisdiction to redetermine liability for sec. 6702 penalties); *Wilt v. Commissioner,* 60 T.C. 977, 1973 WL 2678 (1973) (trust fund recovery penalties under sec. 6672 fall outside the Tax Court's deficiency jurisdiction). Whether the Tax Court's “collection due process” jurisdiction extends to the review of collection efforts directed to the assessable penalties is a different question, to which the answer is now affirmative, in view of a 2006 amendment to section 6330(d)(1). See *Callahan v. Commissioner,* 130 T.C. 44, 48, (2008).

[5] The lien created in section 6321 arises only in the case of “any *tax* * * * (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto)”. (Emphasis added.) The “assessable penalt[ies]” referred to in section 6321 are evidently those denominated as such in Chapter 68, Subchapter B (“Assessable Penalties,” sections 6671–6725). Similarly, collection by levy is authorized in section 6331(a) only for “any *tax* * * * (and such further sum as shall be sufficient to cover the expenses of the levy)”. (Emphasis added.)

[6] The definition of the word “tax” in sections 6320, 6321, 6330, and 6331 is broadened by section 6665(a) to include “additions to the tax, additional amounts, and penalties provided by this chapter [i.e., ch. 68 (secs.6651–6751)]”; but we are aware of no statute that would expand “tax” as used in the lien and levy statutes in Title 26 to include the FBAR penalty of Title 31. The collection mechanism authorized in the FBAR statute itself is not lien or levy but “a civil action to recover a civil penalty”. 31 U.S.C. sec. 5321(b)(2).

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T.C. Memo. 2014-157
United States Tax Court.

WHISTLEBLOWER 22231–12W, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

No. 22231–12W.
|
Aug. 4, 2014.

Synopsis
Background: In a whistleblower award case, the IRS moved to dismiss for lack of jurisdiction.

Holdings: The Tax Court, Lauber, J., held that:

[1] e-mail exchanges with Appeals Office analyst did not constitute determination, and

[2] policy decision concerning Report of Foreign Bank and Financial Accounts (FBAR) payments did not constitute de facto determination.

Decision for IRS.

Attorneys and Law Firms

Robert F. Katzberg, for petitioner.

Charles J. Butler, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

LAUBER, Judge:

***1** This whistleblower award case is before the Court on a motion by the Internal Revenue Service (IRS or respondent) to dismiss for lack of jurisdiction. Petitioner received several emails from the IRS Whistleblower Office (Office) that petitioner asserts constitute a determination regarding one of his [*2] claims. [1] The issue we must decide is whether the IRS made a "determination regarding an award" within the meaning of section 7623(b)(4) sufficient to confer jurisdiction on this Court. [2]

FINDINGS OF FACT

These findings of fact are based on the parties' pleadings, a stipulation of facts with accompanying exhibits, and an evidentiary hearing. At the hearing the Court received testimony from Stephen Whitlock, Director of the Office. He testified about the Office's procedures for processing claims generally and about its handling of the particular claim at issue here. We found his testimony instructive and credible in all respects.

Petitioner filed Form 211, Application for Award for Original Information, with the Office in November 2010. On the application petitioner asserted that he was cooperating with the Department of Justice and the IRS Criminal Investiga[*3]tion Division in connection with the ongoing investigation of two Swiss bankers. Petitioner alleged that his cooperation with those agencies had led to, and would lead to more, information about these bankers' involvement in tax evasion by U.S. persons having undeclared offshore financial accounts.

On December 1, 2010, the Office notified petitioner that it had received the Form 211 and assigned unique claim numbers to his claims regarding the two Swiss bankers. [3] The Office advised petitioner that if it initiated an investigation as a result of the information, final resolution of his claims could take several years. No award could be paid until the IRS had collected any taxes or other amounts assessed by virtue of the information petitioner had supplied.

Subsequent communications (letters, emails, and phone calls) ensued between Cindy Stuart, the Office analyst assigned to petitioner's claims, and petitioner's counsel. Petitioner's counsel tried to convince Ms. Stuart and the Office that petitioner's cooperation was the linchpin in the prosecution of the two Swiss bankers, which allegedly led to the Government's receiving incriminating information about numerous U.S. taxpayers.

[*4] On August 23, 2011, petitioner filed with the Office a third claim for an award, which is the subject of the present controversy. Petitioner filed this claim after learning that Taxpayer 1 had agreed to pay a substantial penalty in

conjunction with a guilty plea for filing a false tax return. Taxpayer 1 admitted that one of the Swiss bankers had helped him open Swiss bank accounts to conceal his income and assets from U.S. authorities. By the guilty plea, Taxpayer 1 agreed to pay a multimillion-dollar civil penalty for failing to file Form TD F 90–22.1, Report of Foreign Bank and Financial Accounts (FBAR). *See* 31 U.S.C. sec. 5321(a) (2006). Taxpayer 1 also agreed to pay the IRS a relatively small amount of restitution, reflecting unpaid Federal income tax due on income earned from the Swiss bank accounts. Petitioner claimed entitlement to an award based upon the aggregate amount paid by Taxpayer 1, given petitioner's alleged involvement in the Swiss banker's arrest, which led to Taxpayer 1's arrest. On January 11, 2012, the Office assigned this claim a unique claim number ending in 67 (Taxpayer 1 claim).

***2** On January 26, 2012, petitioner's counsel sent Ms. Stuart a detailed memorandum outlining petitioner's asserted connection with Taxpayer 1 and urging that an award for the Taxpayer 1 claim be finalized without delay. On January 31 Ms. Stuart mailed petitioner's counsel a letter confirming receipt of the January 26[*5] letter. She informed him that “[t]he claim for award under Section 7623 is still open and under active consideration” and that “a number of actions * * * must be completed before a determination is made.”

Petitioner's counsel sent Ms. Stuart a number of follow-up letters between February and June 2012. In her replies Ms. Stuart stated that the Office had not yet received the information necessary to make a determination; that the Taxpayer 1 claim was not yet ready for decision; and that section 6103 prevented her from discussing certain matters with petitioner's counsel. In an email dated August 8, 2012, Ms. Stuart closed her message by stating: “As for your inquiry regarding [the Taxpayer 1] claim * * *, I believe you spoke to [an Office employee] about your concerns. I have included the Service's position on this topic. If you still have concerns you can contact me.”

One concern petitioner's counsel had expressed was whether FBAR payments would be includable in “collected proceeds (including penalties, interest, additions to tax, and additional amounts)” that form the basis for an award under section 7623(b)(1). Aware of this concern, Ms. Stuart attached to her email a memorandum prepared for Stephen Whitlock by Mark S. Kaizen, Associate Chief Counsel, IRS General Legal Services, dated April 23, 2012. This memorandum articulates the legal foundation for the Office's position that FBAR payments, [*6] because they are made pursuant to title 31 rather than title 26 of the U.S.Code, are not “collected proceeds” within the meaning of section 7623(b)(1). The Office received this advice after it had sought guidance on the matter. Ms. Stuart attached this document to her email as a courtesy to petitioner.

Petitioner's counsel responded to Ms. Stuart by email the next day as follows: “Please confirm our reading of your email below that based on the Service's position expressed in the April 23, 2012 memo you attached your Office has now officially denied [the Taxpayer 1] Claim.” At that time the Office had not determined whether the Taxpayer 1 claim merited an award because it had not yet learned from the operating side of the IRS whether or how petitioner's information was used, if at all, with respect to Taxpayer 1. Ms. Stuart accordingly responded to petitioner's counsel by email the next day, August 10, 2012, as follows:

> The [Taxpayer 1] claim * * * remains open. When the Whistleblower Office has made a determination related to the claims for award filed by [petitioner] you will be issued official written correspondence. At this point we have not made a determination regarding * * * any of the related claims. The Service's position expressed in the April 23, 2012 memo that I provided you was simply to let you know that at the point a determination can be made proceeds collected under Title 18 and/or Title 31 would not be considered as part of the claim.

***3** Because the bulk of the proceeds collected from Taxpayer 1 consisted of FBAR payments for violation of title 31, petitioner decided that there was nothing [*7] meaningful left for the Office to investigate with respect to this claim. Petitioner thus viewed Ms. Stuart's emails as a de facto determination that the Taxpayer 1 claim had been denied.

On September 6, 2012, petitioner filed a petition in this Court to challenge that supposed determination. On

December 21, 2012, respondent filed a motion to dismiss this case for lack of jurisdiction. This motion contends that the IRS had not yet made a determination regarding an award sufficient to confer jurisdiction on this Court and that, in any event, petitioner's claim relates to title 31 and falls outside the scope of section 7623.

During July or August 2013 the Office received information from the IRS Criminal Investigation Division and the IRS Large Business and International Division that the Government had not used petitioner's information as a basis for taking action against Taxpayer 1. The Office thereafter issued to petitioner, on September 6, 2013, a letter that both parties agree constitutes a "determination" that petitioner's Taxpayer 1 claim has been denied. Petitioner filed a petition from that determination, and the matter is currently pending before the Court. *See Whistleblower 22716–13W v. Commissioner,* dkt. No. 22716–13W.

Petitioner nevertheless opposes respondent's motion to dismiss the instant case for lack of jurisdiction. We agree with the parties that, despite the filing of [*8] the second petition, the instant case is not moot but continues to present a justiciable case or controversy. Thus, we may decide whether to dismiss the instant case for lack of jurisdiction.

OPINION

[1] **[2]** This Court always has jurisdiction to determine whether it has jurisdiction. *Cooper v. Commissioner,* 135 T.C. 70, 73, 2010 WL 2697125 (2010). The Tax Court is a court of limited jurisdiction, and we must ascertain whether the case before us is one that Congress has authorized us to consider. *See* sec. 7442; *Estate of Young v. Commissioner,* 81 T.C. 879, 881, 1983 WL 14898 (1983). We may not enlarge upon the statutory grant of our authority. *See Breman v. Commissioner,* 66 T.C. 61, 66, 1976 WL 3667 (1976). In this case, we must decide whether communications between petitioner's counsel and Ms. Stuart establish that the IRS had made, as of August 10, 2012, a "determination regarding an award" within the meaning of section 7623(b)(4) sufficient to confer jurisdiction on this Court.

I. *Statutory Framework*

The IRS has long had authority to pay awards to persons, now called "whistleblowers," who provide information leading to the recovery of unpaid taxes. *See* sec. 7623 (1954). The payment of such awards was solely discretionary for many years. In response to concerns about the management of the [*9] discretionary award regime, Congress enacted legislation in 2006 to address perceived problems with the whistleblower program. Tax Relief and Health Care Act of 2006, Pub.L. No. 109–432, div. A, sec. 406, 120 Stat. at 2958 (effective Dec. 20, 2006). The 2006 legislation added to section 7623 a new subsection (b), which requires the payment of nondiscretionary whistleblower awards in specified circumstances and provides this Court jurisdiction to review IRS determinations regarding such awards. *See Cooper,* 135 T.C. at 73. A claimant who does not meet the section 7623(b) requirements for a nondiscretionary award remains eligible for an award at the IRS' discretion under section 7623(a).

***4** **[3]** Section 7623(b)(1) requires payment of an award if the IRS proceeds with an administrative or judicial action to collect taxes "based on information brought to the Secretary's attention by an individual." The award amount must be at least 15% and not more than 30% of "the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action" or settlement thereof. *Ibid.* The determination of the amount "shall depend upon the extent to which the individual substantially contributed to such action." *Ibid.* [4]

[*10] Section 7623(b)(5) defines the universe of claims that are subject to the nondiscretionary award program established in subsection (b). The IRS must pay claims on a nondiscretionary basis only with respect to actions against a taxpayer whose "gross income exceeds $200,000 for any taxable year subject to such action" and only "if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." Sec. 7623(b)(5)(A) and (B).

Section 7623(b)(4), captioned "Appeal of Award Determination," governs our jurisdiction over whistleblower claims. It provides: "Any determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter)." By referring to determinations "under paragraph (1), (2), or (3)," section 7623(b)(4) makes clear that we have jurisdiction to review only determinations concerning nondiscretionary awards authorized by subsection (b).

II. *Analysis*

As jurisdictional provisions go, section 7623(b)(4) is rather unusual. Unlike most other sections of the Internal Revenue Code that confer jurisdiction on this [*11] Court, section 7623(b)(4) does not prescribe any particular form of notice to the would-be petitioner. Indeed, it does not literally require that the IRS provide that person with written notice of any kind, but simply that it make a "determination." The statute's failure to specify an unambiguous "ticket to the Tax Court" has created serious interpretative and practical problems, both for whistleblowers and for the Court.

We addressed certain of these problems in *Cooper v. Commissioner,* 135 T.C. at 75. We there held that we have jurisdiction to review not only an IRS determination concerning the amount of an award but also "any determination to deny an award." In ascertaining whether the IRS has made a determination to deny an award, we held that "the labeling [of an IRS communication is] not dispositive" and "does not control whether the document constitutes a determination." *Ibid.* We found that the letter issued in *Cooper,* while not labeled a determination, "states respondent's final conclusion that petitioner is not entitled to an award and provides an explanation for this conclusion." *Id.* at 76. Because the letter constituted "a final administrative decision regarding petitioner's whistleblower claims in accordance with the established procedures," we held that it constituted a "determination regarding an award" within the meaning of section [*12] 7623(b)(4) and that we accordingly had jurisdiction to review it. 135 T.C. at 76. [5]

***5** **[4]** Under these standards, it seems clear that the email exchanges between Ms. Stuart and petitioner's counsel do not establish that the Office had made, as of August 10, 2012, a "determination" to deny the Taxpayer 1 claim. To the contrary, Ms. Stuart's email of that date stated that the Taxpayer 1 claim "remains open" and that petitioner would "be issued official written correspondence" once the Office *did make* a determination regarding this claim. As of August 10, 2012, the Office was still waiting to hear from the relevant IRS operating divisions whether the information petitioner supplied had led to the action against Taxpayer 1. This is an essential element that must be satisfied before the IRS can make a non-discretionary award determination under section 7623(b)(1). Since the Office was still investigating this issue, it had not yet made "a final administrative decision [*13] regarding petitioner's whistleblower claim[ ] in accordance with the established procedures." *See Cooper,* 135 T.C. at 76.

In urging a contrary conclusion, petitioner relies on what he regards as the plain meaning of the word "any." *See* sec. 7623(b)(4). According to petitioner: "Congress chose not to limit this broadest of jurisdictional delegations with modifiers on the word 'any' such as 'dispositive' or 'material.' " Petitioner contends that we should not read into the statute any limiting language and that " 'any determination regarding an award' means just that."

[5] We are not persuaded. In her August 10, 2012, email, Ms. Stuart informed petitioner's counsel that the Office had received legal advice that FBAR payments cannot be included in "collected proceeds" for purposes of making awards under section 7623(b). She accordingly advised him that, "at the point a determination can be made," proceeds collected under title 31 "would not be considered as part of the claim." As we held in *Cooper,* 135 T.C. at 75, a "determination regarding an award" means a determination as to "the amount of an award" or a determination "to deny an award." Congress cannot possibly have intended that this phrase would embrace every subsidiary finding of fact or conclusion of law that enters into the Office's ultimate decision as to whether an award is appropriate and (if so) the amount thereof.

[6] [*14] Even if the Office's policy decision concerning FBAR payments, considered in isolation, does not constitute a "determination regarding an award," petitioner insists that it constitutes a de facto determination on the particular facts of this case. That is so, petitioner contends, because more than 99% of the aggregate recovery from Taxpayer 1 consisted of FBAR payments. According to petitioner, this demonstrates that the Office had "nothing left to investigate" regarding this claim once it concluded that the FBAR component could not qualify.

Contrary to petitioner's assertion, there *was* something left for the Office to investigate—namely, whether the action against Taxpayer 1 was "based on information brought to the Secretary's attention by [petitioner]" and, if so, whether the information petitioner provided had "substantially contributed" to that recovery. *See* sec. 7623(b)(1). Section 7623(b)(4) gives us jurisdiction to review "any determination regarding an award under paragraph (1), (2), or (3)." The IRS cannot make a "determination" under paragraph (1) until it has completed its review of all elements specified in that paragraph. The Office did not receive from the IRS operating divisions, until July or August 2013, the information necessary to ascertain whether the action against Taxpayer 1 was "based on information brought to the Secretary's attention by [petitioner]" or whether petitioner's information "sub [*15] stantially contributed" to that recovery. Only then was the Office in a position to make a conclusive "determination" regarding the Taxpayer 1 claim.

***6** **[7]** This holding is supported not only by the statute's language but also by sound principles of judicial policy. It is the policy of this Court "to try all the issues raised in a case in one proceeding to avoid piecemeal and protracted litigation." *Haft Trust v. Commissioner,* 62 T.C. 145, 147, 1974 WL 2626 (1974). The goal of this policy is to avoid the inefficiency and duplication of effort, with its "attendant delay and waste of time," that piecemeal litigation inevitably entails. *See Kovens v. Commissioner,* 91 T.C. 74, 78, 1988 WL 73717 (1988). As the facts of this case show, our assumption of jurisdiction before the Office has concluded its entire investigation would necessarily lead to piecemeal litigation.

When petitioner filed his petition in our Court, the Office had not yet ascertained whether his information had led to action against Taxpayer 1. Suppose that we had taken jurisdiction of this case and decided the question petitioner poses—whether FBAR payments constitute "additional amounts" within the meaning of section 7623(b)(1) and (5)(B) and are thus properly includable in the basis for a nondiscretionary award. We now know that the Office concluded, after petitioner filed the instant petition, that his information did not lead to the recovery from Taxpayer 1, so that he would not be entitled to an award regardless of whether [*16] FBAR payments constitute "additional amounts." If that conclusion is correct, the FBAR question would then be moot, and our opinion addressing this issue would be an advisory opinion. This demonstrates the practical importance of allowing the Office to conclude all aspects of its investigation and render "a final administrative decision * * * in accordance with the established procedures," *Cooper,* 135 T.C. at 76, before we undertake review of an award determination.

[8] Accepting petitioner's interpretation of section 7623 would produce absurd or futile results, and a well-established rule of statutory construction is to avoid such outcomes. *See Colestock v. Commissioner,* 102 T.C. 380, 387, 1994 WL 59262 (1994) (citing *United States v. Am. Trucking Ass'ns,* 310 U.S. 534, 543–544, 60 S.Ct. 1059, 84 L.Ed. 1345 (1940). Undertaking premature review of whistleblower claims would inevitably lead to piece-meal litigation and prevent us from trying all issues in one case. Both the plain language of the statute and principles of judicial policy thus support the conclusion that the instant petition is premature and that we lack jurisdiction over it.

III. *Foreign Bank Account Reporting*

In the alternative, respondent contends that this Court lacks jurisdiction because payments under title 31 are outside the scope of section 7623(b)(5)(B) and are therefore outside the scope of our jurisdiction under section 7623(b)(4). Petitioner agrees that this issue is jurisdictional and urges that the Court resolve it. [*17] Because we have concluded that the Office did not make a "determination" within the meaning of section 7623(b)(4) sufficient to confer jurisdiction on this Court, we need not decide whether FBAR payments are "additional amounts" for purposes of ascertaining whether the monetary threshold in section 7623(b)(5) has been met, or whether that question is a jurisdictional one. *See Friedland v. Commissioner,* T.C. Memo.2011–217, 102 T.C.M. (CCH) 247, 249 (not addressing the monetary threshold question when granting respondent's motion to dismiss for lack of jurisdiction).

***7** To reflect the foregoing,

An order of dismissal for lack of jurisdiction will be entered.

All Citations

T.C. Memo. 2014-157, 2014 WL 3819081, 108 T.C.M. (CCH) 124, T.C.M. (RIA) 2014-157, 2014 RIA TC Memo 2014-157

Footnotes

[1] The Court granted petitioner's motion to proceed anonymously in this case. In an effort to preserve petitioner's anonymity, the parties in their briefs and other filings refer to the U.S. taxpayer who is the subject of the relevant whistleblower claim as “Taxpayer 1.” We will employ the same convention in this opinion. When referring to Taxpayer 1 and to petitioner, we will employ the masculine pronoun and possessive adjective without intending to create any implication concerning the gender of either person.

[2] All statutory references are to the Internal Revenue Code in effect at the relevant times. All dollar amounts are rounded to the nearest dollar.

[3] The Office subsequently informed petitioner that “the claim number assignment is strictly for control purposes * * * and no inference should be drawn of the applicability of any award payment.”

[4] The IRS may determine a lower percentage award if the whistleblower makes a less substantial contribution to the recovery or if the whistleblower planned and initiated the activities leading to the underpayment of tax. Sec. 7623(b)(2) and (3). The IRS is directed to deny an award altogether if the whistleblower is convicted criminally for planning and initiating such activities. Sec. 7623(b)(3).

[5] Consistently with our Opinion in *Cooper,* 135 T.C. at 75, we have held that the labeling of an IRS communication is not dispositive in ascertaining whether it has made a “determination” sufficient to afford us jurisdiction under other Code provisions. *See, e.g., SECC v. Commissioner,* 142 T.C. ——, ——, (slip op. at 7) (Apr. 3, 2014) (IRS letter was a “determination” concerning worker classification for purposes of section 7436(a)); *Corbalis v. Commissioner,* 142 T.C. ——, ——, (slip op. at 21–22) (Jan. 27, 2014) (IRS letter was a “determination” concerning interest abatement for purposes of section 6404(h)).

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2015 WL 5697552
United States District Court,
S.D. Ohio, Western Division,
Western Division at Dayton.

Mark Crawford, et al., Plaintiffs,
v.
United States Department of
the Treasury, et al., Defendants.

Case No. 3:15-cv-250
|
Signed 09/29/2015

ENTRY AND ORDER DENYING PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION, ECF. 8.

THOMAS M. ROSE, UNITED STATES DISTRICT JUDGE

***1** Plaintiffs request that the Court enjoin Defendants from enforcing the Foreign Account Tax Compliance Act("FATCA"), the intergovernmental agreements ("IGAs") negotiated by the United States Department of the Treasury ("Treasury Department") to supplant FATCA in the signatory countries, and the Report of Foreign Bank and Financial Accounts ("FBAR") administered by the United States Financial Crimes Enforcement Network ("FinCEN"). FATCA mandates that foreign financial institutions report the tax return information of their U.S. citizen account holders directly to the IRS using the FATCA Report (Form 8966). 26 U.S.C.§ 1471(b)(1)(C); 26 C.F.R. §§ 1.1471-4(d)(3)(v),-4(d)(3)(vi).

Plaintiffs seek preliminary injunctive relief on all claims. The first claim challenges the validity of the Canadian, Czech, Israeli, and Swiss IGAs used by the Treasury Department. The second claim addresses the information reporting provisions FATCA and the IGAs impose not on Plaintiffs, but on foreign financial institutions. The third claim aims at the heightened reporting requirements for foreign bank accounts under FATCA, the IGAs, and the FBAR. These reporting requirements require U.S. citizens to report information about their foreign bank accounts. The fourth claim challenges the 30% tax imposed by FATCA on payments to foreign financial institutions from U.S. sources when these foreign institutions choose not to report to the IRS about the bank accounts of their U.S. customers (the "FFI Penalty"). Similarly, the fifth claim challenges the 30% tax imposed by FATCA on account holders who exercise their rights under the statute not to identify themselves as American citizens to their banks and to refuse to waive privacy protections afforded their accounts by foreign law (the "Passthrough Penalty"). The sixth claim challenges the penalty imposed under the Bank Secrecy Act for "willful" failures to file an FBAR for foreign accounts, which can be as much as the greater of $100,000 or 50% of the value of the unreported account (the "Willfulness Penalty").

I. Background

A. FATCA Statute and Regulations

Congress passed the Foreign Accounts Tax Compliance Act (FATCA) in 2010 to improve compliance with tax laws by U.S. taxpayers holding foreign accounts. FATCA accomplishes this through two forms of reporting: (1) by foreign financial institutions (FFIs) about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest, 26 U.S.C. § 1471; and, (2) by U.S. taxpayers about their interests in certain foreign financial accounts and offshore assets. 26 U.S.C. § 6038D.

1. FATCA

President Obama signed FATCA into law on March 18, 2010. Senator Carl Levin, a co-sponsor of the FATCA legislation, declared that "offshore tax abuses [targeted by FATCA] cost the federal treasury an estimated $100 billion in lost tax revenues annually" 156 Cong. Rec. 5 S1745-01 (2010). FATCA became law as the IRS began its Offshore Voluntary Disclosure Program (OVDP), which since 2009 has allowed U.S. taxpayers with undisclosed overseas assets to disclose them and pay reduced penalties. By 2014, the OVDP collected $6.5 billion through voluntary disclosures from 45,000 participants. "IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance," http://www.irs.gov/uac/Newsroom/IRS-Makes-Changes-to-Offshore-Programs;-Revisions-Ease-Burden-and-Help-More-Taxpayers-Come-into-Compliance (last visited Sept. 15, 2015). The success of the voluntary program has likely been enhanced by the existence of FATCA.

2. Foreign Financial Institution Reporting Under FATCA

***2** Foreign Financial Institution reporting encourages FFIs to disclose information on U.S. taxpayer accounts. If the FFI does not, then a 30% withholding tax may apply to U.S.-sourced payments to the non-reporting FFI. A 30% withholding tax may also apply to FFI account holders who refuse to identify themselves as U.S. taxpayers.

> In the case of any withholdable payment to a foreign financial institution which does not meet the requirements of subsection (b) [specifying reporting criteria], the withholding agent with respect to such payment shall deduct and withhold from such payment a tax equal to 30 percent of the amount of such payment.

26 U.S.C. § 1471(a).

Section 1471(b)(1) then provides that, "[t]he requirements of this subsection are met with respect to any foreign financial institution if an agreement is in effect between such institution and the Secretary [of the Treasury] under which such institution agrees" to make certain information disclosures and "to deduct and withhold a tax equal to 30 percent of...[a]ny [pass-through] payment which is made by such institution to a recalcitrant account holder or another foreign financial institution which does not meet the requirements of this subsection[.]" § 1471(b)(1)(D)(i); see also § 1471(d)(7) (defining "pass[-through] payment"). A "recalcitrant account holder" is one who "[f]ails to comply with reasonable requests for information" that is either information an FFI needs to determine if the account is a U.S. account (§ 1471(b)(1)(A)) or basic information like the account holder's name, address, and taxpayer identification number (§ 1471(c)(1)(A)). Section 1471(c)(1) specifies the "information required to be reported on U.S. accounts," including "account balance or value." § 1471(c)(1)(C). Plaintiffs seek a preliminary injunction against enforcement of § 1471(a), (b)(1)(D), (c)(1), and (c)(1)(C). Prayer for Relief (part O).

Under § 1471(b)(2), "Financial Institutions Deemed to Meet Requirements in Certain Cases," an FFI "may be treated by the Secretary as meeting the requirements of this subsection if … such institution is a member of a class of institutions with respect to which the Secretary has determined that the application of this section is not necessary to carry out the purposes of this section." That means that an FFI that is treated this way is not subject to the reporting criteria in § 1471(b)(1). The Secretary can statutorily exempt FFIs from "attempt[ing] to obtain a valid and effective waiver" of foreign nondisclosure laws from each account holder and can exempt FFIs from "close such account...if a waiver...is not obtained from each such holder within a reasonable period of time." § 1471(b)(1)(F).[1] The Secretary's exemption of an FFI under § 1471(b)(2) also means that the FFI no longer has to make the report described in § 1471(c)(1) because that report is based on "[t]he agreement described in subsection (b)" that an FFI that the Secretary has exempted does not need to have in place to avoid withholding. Furthermore, the FATCA statute provides that, "[t]he Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of, and prevent the avoidance of, this chapter," i.e., §§ 1471-74. 26 U.S.C. § 1474(f). The Government asserts that the intergovernmental agreements (IGAs) constitute the Secretary's exercise of the statutory discretion afforded by §§ 1471(b)(2) and 1474(f).

***3** Plaintiffs also seek to enjoin enforcement of 26 C.F.R. § 1.1471-2T(a)(1). The "[g]eneral rule of withholding" under § 1471(a) is largely reiterated by 26 C.F.R. § 1.1471-2T(a)(1), which Plaintiffs also target. Prayer for Relief (part R). Plaintiffs seek to enjoin enforcement of 26 C.F.R. §§ 1.1471-4(a)(1), 1.1471-4(d), and 1.1471-4(d)(3)(ii), which repeat the content of § 1471(b) and (c). Prayer for Relief (part S). In addition, Plaintiffs seek an injunction against 26 C.F.R. § 1.1471-4T(b)(1), which addresses the 30% withholding tax for recalcitrant account holders established by the statute. Prayer for Relief (part T). Plaintiffs also seek to enjoin the IRS's use of Form 8966, "FATCA Report," the form on which FFIs make disclosures under § 1471(c). See 26 C.F.R. § 1.1471-4(d)(3)(v); Prayer for Relief (part V). In Plaintiffs' view, these FATCA regulations "primarily elaborate on the [ ] requirements of the statutory provisions and clarify the statutory requirements." Complaint ¶ 95(a).

3. Individual Reporting Under FATCA

There is a companion individual reporting requirement to § 1471's FFI reporting requirement located at 26 U.S.C. § 6038D. Under § 6038D, individuals holding more than $50,000 of aggregate value in "specified foreign financial assets," § 6038D(b), must file a report with their annual tax returns (§ 6038D(a)) that includes, for each asset "[t]he maximum value of the asset during the taxable year." § 6038D(c)(4). Plaintiffs seek to enjoin this asset-value reporting requirement. Prayer for Relief (part P). Section 6038D(h) also provides that, "[t]he Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section...." Plaintiffs seek to enjoin enforcement of the regulation that states this same reporting requirement. 26 C.F.R. § 1.6038D-4(a)(5); see Prayer for Relief (part U). Plaintiffs also target two other regulatory reporting requirements: disclosing whether a depository or custodial account was opened or closed during the taxable year (26 C.F.R. § 1.6038D-4(a)(6)); and "[t]he amount of any income, gain, loss, deduction, or credit recognized for the taxable year with respect to the reported specified foreign financial asset," (26 C.F.R. § 1.6038D-4(a)(8)). Prayer for Relief (part U).

B. The Canadian, Czech, Israeli, and Swiss Intergovernmental Agreements

Once FATCA became law, the Government began requiring coordination with FFIs and foreign governments. To facilitate FATCA implementation, the United States has concluded over 70 intergovernmental agreements (IGAs) with foreign governments addressing the exchange of tax information. Plaintiffs seek to enjoin IGAs with Canada, the Czech Republic, Israel, and Switzerland in their entirety. Prayer for Relief (parts A, E, I, M). Alternatively, they seek to enjoin parts of those IGAs. Prayer for Relief (parts B-D, FH, J-L, N).

The Canadian, Czech and Israeli IGAs are similar because they are all "Model 1" IGAs, whereas the Swiss IGA is a "Model 2" IGA. The key distinction is that under Model 1 IGAs, foreign governments agree to collect their FFIs' U.S. account information and to send it to the IRS, whereas under Model 2 IGAs, foreign governments agree to modify their laws to the extent necessary to enable their FFIs to report their U.S. account information directly to the IRS. All four IGAs, in their preambulatory clauses, recognize the partner governments' mutual "desire to conclude an agreement to improve international tax compliance" or, in the case of Switzerland, a "desire to conclude an agreement to improve their cooperation in combating international tax evasion." IGA Preambles (first clause).

All four IGAs mention the Tax Information Exchange Agreements (TIEAs) that the United States has with these four countries as part of preexisting treaties. IGA Preambles (second clause).[2] All four IGAs similarly note the need for "an intergovernmental approach to FATCA implementation" (or, in the Swiss case, "intergovernmental cooperation to facilitate FATCA implementation").

***4** The three Model 1 IGAs (Canadian, Czech and Israeli) define "Obligations to Obtain and Exchange Information with Respect to Reportable Accounts" in Article 2. In addition to seeking to enjoin Article 2 in full (Prayer for Relief, parts B, F, and J), Plaintiffs attack the agreement that IGA partners, with respect to each "U.S. Reportable Account" of its FFIs, will report, "in the case of any Depository Account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period[.]" Canadian IGA Art. 2, § 2(a)(6); Czech IGA Art. 2, § 2(a)(6); Israeli IGA Art. 2, § 2(a)(6); see Prayer for Relief (parts C, G, K). If Model 1 partner countries comply with Article 2 as well as the "Time and Manner of Exchange of Information" agreed to in Article 3 and other rules, then their reporting FFIs "shall be treated as complying with, and not subject to withholding under, section 1471," nor will they be required to withhold "with respect to an account held by a recalcitrant account holder" under § 1471. Canadian IGA Art. 4, §§ 1, 2; Czech IGA Art. 4 §§ 1, 2; Israeli IGA Art. 4, §§ 1, 2. This is consistent with the Treasury Secretary's power to deem FFIs to be in compliance with § 1471 if statutory purposes are met. 26 U.S.C. § 1471(b)(2)(B).

The Israeli IGA is not yet in force. See Israeli IGA, Art. 10, § 1. However, the Government asserts that the Treasury Secretary has exercised his discretion not to impose § 1471 withholding against Israeli FFIs or recalcitrant account holders.

The Swiss IGA is different in that under its Article 3—which Plaintiffs seek to enjoin (Prayer for Relief, part N)—the Swiss government agrees to "direct all Reporting Swiss Financial Institutions" to report certain information directly to the IRS. Swiss IGA, Art. 3, § 1. Under Article 5—which Plaintiffs also seek to enjoin

(Prayer for Relief, part N)—the U.S. government "may make group requests...based on the aggregate information reported to the IRS pursuant to" Article 3. Swiss IGA Art. 5, § 1. "Such requests shall be made pursuant to Article 26 of the [Swiss] Convention, as amended by the Protocol," and, "such requests shall not be made prior to the entry into force of the Protocol[.]" Swiss IGA, Art. 5, § 2. The "Protocol" being "the Protocol Amending the [Swiss] Convention that was signed at Washington on September 23, 2009." Swiss IGA, preamble (clause 3). That Protocol has not yet been approved by the Senate, and because of that, Article 5 of the Swiss IGA cannot yet be implemented.

C. Report of Foreign Bank and Financial Account

The third body of law at issue in this case pertains to the Report of Foreign Bank and Financial Account (FBAR) requirements. U.S. persons who hold a financial account in a foreign country that exceeds $10,000 in aggregate value must file an FBAR with the Treasury Department reporting the account. See 31 U.S.C. § 5314; 31 C.F.R. § 1010.350; 31 C.F.R. § 1010.306(c). The current FBAR form is FinCEN Form 114. The form has been due by June 30 of each year regarding accounts held during the previous calendar year. § 1010.306(c). Beginning with the 2016 tax year, the due date of the form will be April 15. Pub. L. No. 114-41, § 2006(b)(11). A person who fails to file a required FBAR may be assessed a civil monetary penalty. 31 U.S.C. § 5321(a)(5)(A). The amount of the penalty is capped at $10,000 unless the failure was willful. See § 5321(a)(5)(B)(i), (C). A willful failure to file increases the maximum penalty to $100,000 or half the value in the account at the time of the violation, whichever is greater. § 5321(a)(5)(C). In either case, whether to impose the penalty and the amount of the penalty are committed to the Secretary's discretion. See § 5321(a)(5)(A) ("The Secretary of the Treasury may impose a civil money penalty[.]") & § 5321(a)(5)(B) ("[T]he amount of any civil penalty...shall not exceed" the statutory ceiling). Plaintiffs seek to enjoin enforcement of the willful FBAR penalty under § 5321(a)(5). Prayer for Relief, part Q. They also ask for an injunction against "the FBAR account-balance reporting requirement" of FinCen Form 114. Prayer for Relief, part W.

The Government asserts that the information in the FBAR assists law enforcement and the IRS in identifying unreported taxable income of U.S. taxpayers that is held in foreign accounts as well as investigating money laundering and terrorism.

II. Legal Standard for Preliminary Injunctions

***5** The standard for determining whether to issue a preliminary injunction involves the examination of: (1) the likelihood of plaintiff's success on the merits; (2) whether or not the injunctive relief will save plaintiff from irreparable injury; (3) whether or not the injunctive relief will harm others; and (4) whether or not public interest will be served by the injunction. See *Rock and Roll Hall of Fame and Museum, Inc. v. Gentile Prods*., 134 F.3d 749, 753 (6th Cir. 1998); *In re DeLorean Motor Co*., 755 F.2d 1223, 1228 (6th Cir. 1985). These factors are not prerequisites, but elements balanced by the Court. *Frisch's Restaurants, Inc. v. Shoney's Inc*., 759 F.2d 1261, 1263 (6th Cir. 1985) and *DeLorean Motor Co*., 755 F.2d at 1229. The Court will evaluate each of these factors.

A. Likelihood of Prevailing on the Merits

Defendants initially contend that Plaintiffs are not likely to prevail on the merits of their claim because they lack standing to bring their action. Federal courts may only decide actual cases or controversies. *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 341 (2006). "One element of the case-or-controversy requirement" is that plaintiffs "must establish that they have standing to sue." *Raines v. Byrd*, 521 U.S. 811, 818 (1997). The standing requirement protects the "time-honored concern about keeping the Judiciary's power within its proper constitutional sphere." Id. at 820. "[S]tanding inquir[ies are] especially rigorous when reaching the merits of the dispute would force [a court] to decide whether an action taken by one of the other two branches of the Federal Government was unconstitutional." *Clapper v. Amnesty Int'l USA*, 133 S. Ct. 1138, 1146 (2013).

Standing contains three elements:

> First, plaintiffs must have suffered an injury in fact—an invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of—the injury has to

> be fairly traceable to the challenged action of the defendant, and not the result of the independent action of some third party not before the court. Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by favorable decision.

Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61 (1992) (citations and internal quotation omitted).

As for the first consideration, a "threatened injury must be certainly impending to constitute injury in fact," and "'[a]llegations of possible future injury' are not sufficient." *Clapper*, 133 S. Ct at 1147 (quoting *Whitmore v. Arkansas*, 495 U.S. 149, 158 (1990)) (emphasis in original). Similarly, "a plaintiff raising only a generally available grievance about government—claiming only harm to his and every citizen's interest in proper application of the Constitution and laws, and seeking relief that no more directly and tangibly benefits him than it does the public at large—does not state an Article III case or controversy." *Lujan*, 504 U.S. at 573-74; see also id. at 577 (rejecting attempt "to convert the undifferentiated public interest in executive officers' compliance with the law into an 'individual right' vindicable in the courts"). Also, plaintiffs generally cannot establish standing indirectly when their injury is the result of "the independent action of some third party not before the court." *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 42 (1976); see also *Lujan*, 504 U.S. at 560-61 (same); *Shearson v. Holder*, 725 F.3d 588, 592 (6th Cir. 2013) (same); *Ammex, Inc. v. United States*, 367 F.3d 530, 533 (6th Cir. 2004) (no standing to challenge excise tax assessed against third party, since "alleged injury...in the form of increased fuel costs was not occasioned by the Government").

***6** As to the second consideration, "a plaintiff must 'assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties."' *Coyne*, 183 F.3d at 494 (quoting *Warth v. Seldin*, 422 U.S. 490, 499 (1975)); see also *United States v. Ovalle*, 136 F.3d 1092, 1100-01 (6th Cir. 1998); *Powers v. Ohio*, 499 U.S. 400, 410 (1991). The rare exception to this requirement arises where a plaintiff can "show that (1) it has suffered an injury in fact; (2) it has a close relationship to the third party; and (3) there is some hindrance to the third party's ability to protect his or her own interests." *Mount Elliott Cemetery Ass'n v. City of Troy*, 171 F.3d 398, 404 (6th Cir. 1999); see also *Connection Distrib. Co. v. Reno*, 154 F.3d 281, 295 (6th Cir. 1998).

"A plaintiff bears the burden of demonstrating standing and must plead its components with specificity." *Coyne*, 183 F.3d at 494; see also *Lujan*, 504 U.S. at 561. A plaintiff "must demonstrate standing separately for each form of relief sought." *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 185 (2000). The Supreme Court has "always insisted on strict compliance with this jurisdictional standing requirement," *Raines*, 521 U.S. at 819. Moreover, "suits challenging, not specifically identifiable Government violations of law, but the particular programs agencies establish to carry out their legal obligations are, even when premised on allegations of several instances of violations of law, rarely if ever appropriate for federal-court adjudication." *Lujan*, 504 U.S. at 568 (quotation omitted).

Senator Paul seeks to base legal standing for Counts 1 and 2 in his role as a U.S. Senator, charged with the institutional task of advice and consent under the Constitution. He contends that the IGAs exceed the proper scope of Executive Branch power and should have been submitted for Senate approval. ¶¶ 28, 29.

Senator Paul's argument that the Executive Branch is usurping Congress's powers by not submitting the IGAs for a vote—that he has a "right to vote"—is a claim that the Executive Branch is not acting in accordance with the law and that he may remedy such violation in his official capacity as a senator. In *Raines v. Byrd*, several members of Congress challenged the constitutionality of the Line Item Veto Act of 1996, asserting that the statute infringed on their power as legislators. 521 U.S. at 816. The Supreme Court held that they lacked Article III standing. It noted that their claim asserted "a type of institutional injury (the diminution of legislative power), which necessarily damages all Members of Congress and both Houses of Congress equally." *Id.* at 821. Because Plaintiffs' "claim of standing [was] based on a loss of political power, not loss of any private right," their asserted injury was not "concrete" for the purposes of Article III standing. *Id.* *Raines* bars Senator Paul's claims. This is true even if he frames the conduct he challenges as a "usurpation" of congressional authority. See *Chenoweth v. Clinton*, 181 F.3d 112, 116 (D.C. Cir. 1999) (a claim of usurpation of congressional authority is not sufficient to satisfy the standing requirement); see also *Walker v. Cheney*, 230

F. Supp. 2d 51, 73 (D.D.C. 2002) ("the role of Article III courts has not historically involved adjudication of disputes between Congress and the Executive Branch based on claimed injury to official authority or power.").

Senator Paul has not been authorized to sue on behalf of the Senate. This fact also weighs against finding standing. See *Raines*, 521 U.S. at 829 ("We attach some importance to the fact that appellees have not been authorized to represent their respective Houses of Congress in this action[.]"). Members of Congress possess an adequate remedy (since they may repeal the Act or exempt appropriations bills from funding its implementation). *Raines*, 521 U.S. at 829.

***7** Nor can Senator Paul base his standing on a more generalized interest in "vindication of the rule of law." See *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 106 (1998); see also *Hollingsworth v. Perry*, 133 S. Ct. 2652, 2662 (2013) ("[A]n asserted right to have the Government act in accordance with law is not sufficient, standing alone[.]" (quotation omitted)). A legislator does not hold any legally protected interest in proper application of the law that is distinct from the interest held by every member of the public. Senator Paul thus fails to allege a particularized, legally cognizable injury by his claim that the Executive Branch is not adhering to the law. See *Campbell v. Clinton*, 203 F.3d 19, 22 (D.C. Cir. 2000) (Congressional plaintiffs do not "have standing anytime a President allegedly acts in excess of statutory authority").

Senator Paul has "not been singled out for specially unfavorable treatment." *Raines*, 521 U.S. at 821. All Plaintiffs here, including Senator Paul, have an adequate remedy to challenge the reporting requirements and penalties that they oppose: they may work toward repeal of the laws through the legislative process. *Id.* Of course, FATCA, the IGAs, and the FBAR requirements are not exempt from constitutional challenge, but they must be challenged by an individual who has suffered a judicially cognizable injury. *Id.* Plaintiffs in this case do not qualify.

In sum, Paul has alleged no injury to himself as an individual, the institutional injury he alleges is wholly abstract and widely dispersed, and his attempt to litigate this dispute at this time and in this form is contrary to historical experience. *Raines*, 521 U.S. at 829

None of the other Plaintiffs has alleged that he or she has suffered or is about to suffer injury under the FATCA withholding tax: none is an FFI to which the tax under § 1471(a) applies, and none has been assessed, or informed that IRS intends to assess, the recalcitrant account holder withholding tax imposed by § 1471(b). Moreover, all Plaintiffs but Crawford live in jurisdictions where FFIs are not currently subject to the § 1471(b) withholding tax. No plaintiff has alleged that he or she is subject to § 6038D reporting due to an aggregate asset value exceeding $50,000 or FBAR reporting due to a bank account exceeding $10,000 in value.

Mark Crawford decries his bank's policy against taking U.S. citizens as clients and claims the denial of his application for a brokerage account may have "impacted Mark financially," ¶ 21, any such harm is not fairly traceable to an action by Defendants, which are not responsible for decisions that foreign banks make about whom to accept as clients. Crawford cannot establish standing indirectly when third parties are the causes of his alleged injuries. See *Shearson*, 725 F.3d at 592. Moreover, his discomfort with complying with the disclosures required by FATCA, see ¶ 23, does not establish the concrete, particularized harm that confers standing to sue. See, e.g., *Lujan*, 504 U.S. at 561 (requiring "concrete and particularized" and "actual or imminent" injury). Even if Crawford fears "unconstitutionally excessive fines imposed by 31 U.S.C. § 5321 if he willfully fails to file an FBAR," ¶ 24, there is no allegation that he failed to file any FBAR that may have been required, much less that the Government has assessed an "excessive" FBAR penalty against him. Any harm that may come his way from imagined future events is speculative and cannot form the foundation for his lawsuit.

Crawford states that he is a United States citizen who lives in Albania and maintains a residence in Dayton, Ohio. ¶ 13. The United States does not have a FATCA IGA with Albania, and Crawford does not allege that he has a bank account in any of the four countries whose IGAs are challenged in the complaint. That means that Crawford has no standing to assert the violations alleged in Counts 1, 2, or 8, which exclusively concern those four IGAs.

***8** Crawford seeks to invalidate FATCA and the FBAR requirements on three bases: (1) his brokerage firm cannot accept U.S. citizens—including Crawford himself—as clients, due to a relationship with a bank that has a policy against taking on American clients, see ¶ 21; (2) he does not want the "financial details of his accounts" disclosed to the U.S. government, see ¶ 23; and (3) he fears "unconstitutionally excessive fines imposed by 31 U.S.C. § 5321 if he willfully fails to file an FBAR," see ¶ 24.

Roger Johnson states that he is a U.S. citizen who resides in the Czech Republic. ¶ 31. He seeks to invalidate the Czech IGA, FATCA, and the FBAR reporting requirements because: (1) his wife, who is not a plaintiff, "strongly objected to having her financial affairs disclosed to the United States government," leading to the couple's decision to separate their assets, see ¶ 35; (2) he does not want the financial details of his accounts disclosed, see ¶ 38; and (3) he fears "unconstitutionally excessive fines" if he willfully fails to file an FBAR, see ¶ 39.

The harm Johnson alleges resulted from his wife's objections to FATCA and the choices that they made in response; this is not traceable to the Government. See *Simon*, 426 U.S. at 41-42. The Johnsons are free to reverse the separation of their assets at any time, regardless of FATCA, and the lack of legal compulsion defeats any claim to third-party standing. Johnson's personal discomfort with reporting requirements of American law does not support standing, as he does not allege any concrete constitutional injury. See *Lujan*, 504 U.S. at 561. Nor is the prospect of the hypothetical imposition of an excessive fine, if he willfully fails to file a required FBAR, sufficient. *Clapper*, 133 S. Ct at 1147 ("Allegations of possible future injury" do not convey standing). In effect, Johnson seeks an advisory opinion that future, hypothetical conduct by the Government would violate his constitutional rights.

Stephen J. Kish states that he is a dual citizen of the United States and Canada who lives in Toronto. ¶ 41. Kish alleges that his wife "strongly opposes the disclosure of her personal financial information" under FATCA. ¶ 47. His wife is not a plaintiff. Kish may not assert claims on her behalf. See *Coyne*, 183 F.3d at 494. That he has allegedly suffered some "discord" in his marriage, see ¶ 47, is too vague and indirect of a harm to establish standing. As explained above, reluctance to comply with the reporting requirements of American law, see ¶ 48, and theoretical "excessive fines" that would be imposed if he willfully violated the law, see ¶ 49, do not convey standing.

Daniel Kuettel states that he is a citizen of Switzerland who renounced his U.S. citizenship in 2012. ¶ 51. He claims that he decided to renounce due to "difficulties caused by FATCA," and he complains that "many Swiss banks have been unwilling to accept American clients because of FATCA." ¶ 55. He blames this practice of the Swiss banks for his "mostly unsuccessful" efforts to obtain mortgage refinancing prior to his renunciation of citizenship. *Id*. The only ongoing injury that Kuettel alleges is related to a college savings account for his daughter that he maintains at a Swiss bank. See ¶ 56. The account balance is currently only about $8,400, which is below the $10,000 threshold for FBAR reporting. Kuettel's daughter is ten years old, see ¶ 54, and is not a plaintiff in this case. Supposedly the account would receive "several advantages such as better interest rates and discounts for local businesses" if it were titled in her name. ¶ 56. The Complaint states Kuettel would like to transfer ownership of the account to his daughter, but he will not do so out of a concern that she might in the future be subjected to willful FBAR penalties, that she might be subject to an alleged harm. ¶ 57.13 Kuettel could obviate this concern by filing an FBAR for the account on his daughter's behalf, but "Daniel objects to filing an FBAR as required by FinCEN because he is not a U.S. citizen and would not do so for his daughter's account." ¶ 57. His wife similarly objects. His daughter is said to be too young to renounce her own U.S. citizenship. ¶ 57. Neither his wife, nor his daughter are named as plaintiffs, however. Thus, having renounced his own American citizenship, Kuettel now seeks relief based on his daughter's ineligibility for preferable interest rates and local discounts. The relief for any wrong here is either for Kuettel's daughter to sue her Swiss bank for disparate treatment, if Swiss law provides such protection, or to seek recourse in the power of the market moving her accounts to an institution that wishes to compete for her business.

***9** None of the allegations states that Kuettel is presently being harmed by FATCA or the Swiss IGA, and neither FATCA nor the IGA apply to him as a non-U.S. citizen. See ¶¶ 51-58. His assertion of past harm because he was "mostly unsuccessful" in refinancing his mortgage due to FATCA does not convey standing. If that was a harm, it was due to actions of third-party foreign banks not those of Defendants. Regardless, having now renounced his American citizenship and obtained refinancing on terms he found acceptable, any past harm is not redressable here. See *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 210-11 (1995) ("[T]he fact of past injury...does nothing to establish a real and immediate threat that he would again suffer similar injury in the future." (quotation omitted)). This leaves Kuettel's claims concerning the FBAR requirement, in Counts 3 and 6, for which the Government concedes Kuettel has standing. Response, ECF 16, at 15, PAGEID 216.

Kuettel also lacks standing to challenge the FBAR reporting requirements that might apply not to him, but to his daughter. The reporting requirement would be hers, and any harm to the account is a detriment to her. Advantages his daughter might receive if Kuettel or his wife filed an FBAR on his daughter's behalf are based on a bank policy, not conduct of Defendants. The failure to reap those advantages is due to the Bank's policies regarding someone like Kuettel's reluctance to comply with the FBAR requirements, not any action fairly traceable to the Government. In any event, Kuettel has not established standing to sue on behalf of his daughter. See *Ovalle*, 136 F.3d at 1100-01.

Donna-Lane Nelson is a citizen of Switzerland who has also renounced her U.S. citizenship. ¶ 59. She alleges that her Swiss bank "notified her that she would not be able to open a new account if she ever closed her existing one because she was an American. Fearing that she would eventually not be able to bank in the country where she lived, she decided to relinquish her U.S. citizenship." ¶ 65. After she renounced, a Swiss bank "offered investment opportunities that were not available to her as an American." *Id.* She "resents having to provide" "explanations" to Swiss banks that have requested information on her past U.S. citizenship and payments to her daughter, who lives in the United States, and she sees "threats implied by these requests which appear to be prompted by FATCA." ¶ 68. Like other Plaintiffs, Nelson does not want to disclose financial information to the Government, and she fears willful FBAR penalties, even though no such penalty has been imposed or threatened against her. ¶¶ 69, 70. Unlike the preceding Plaintiffs, however, she adds that she fears the 30% withholding tax may be imposed against her "if her business partner," who is now her husband, and with whom she has joint accounts, "opts to become a recalcitrant account holder." ¶ 71.

Nelson's allegations of harm stem from third-party conduct and do not grant her standing against Defendants. Fear of hypothetical events that might have befallen her if she had not renounced her U.S. citizenship does not constitute concrete harm sufficient to confer Article III standing. Her claim "that she had to choose between having the ability to access local financial services where she lived or be a U.S. citizen" is refuted by her admission that UBS would have allowed her to continue banking in Switzerland as before, using her existing account, regardless of her citizenship. ¶ 65. Discretionary decisions of a foreign bank do not create standing. If her business partner and husband causes Nelson to be subjected to FBAR penalties by his future conduct that will be his fault, not Defendants'. Having renounced her U.S. citizenship and without standing to assert these claims, Nelson cannot air her "resentment" of U.S. law in this Court.

L. Marc Zell states that he is a practicing attorney and a citizen of both the United States and Israel who lives in Israel. He alleges that: (1) he and his firm have been required by Israeli banking institutions to complete IRS withholding forms for individuals whose funds his firm holds in trust, regardless of whether the forms are legally required, causing certain clients to leave his firm, ¶¶ 79 & 81; (2) Israeli banks have required his firm to close accounts, refused to open others, and requested conduct contrary to banking regulations, ¶¶ 79-80; and, (3) the compelled disclosure of his fiduciary relationship with clients impinges on the attorney-client relationship, ¶ 82. On request of clients, who claim their rights are violated by FATCA, Zell "has decided not to comply with the FATCA disclosure requirements whenever that alternative exists." ¶ 83. He fears that the FATCA 30% withholding tax on pass-through payments to recalcitrant account holders could be imposed due to his refusal to provide identifying information about a client to an Israeli bank. ¶ 84. He also has refused to provide information to his own bank and "fears that he will be classified as a recalcitrant account holder," ¶ 85. Like the other Plaintiffs, he does not want his financial information disclosed, ¶ 86, and fears an FBAR penalty if the IRS determines that he willfully failed to file an FBAR, ¶ 87.

***10** The majority of Zell's allegations concern conduct of Israeli banks and his belief that these actions have been unfair to him or his clients. But conduct of third parties (even if related to the banks' compliance with FATCA) does not confer standing to bring suit against Defendants. See, e.g., *Ammex Inc. v. United States*, 367 F.3d 530, 533

(6th Cir. 2004). Nor may Zell seek redress on behalf of third parties who have allegedly suffered harm, including unidentified clients. See *Warth v. Seldin*, 422 U.S. 490, 499 (1975). The third parties who have allegedly suffered harm are not plaintiffs, thus, alleged harm to them does not provide a basis for Zell to maintain this suit.

The contention that disclosure of the identity of clients for whom Zell holds funds in trust violates the attorney-client privilege is also without merit. He gives no example of harm that has occurred or how he was harmed by disclosure of clients' identities. He cannot raise the attorney-client privilege on his clients' behalf, nor is the fact of representation privileged. See *In re Special Sept. 1978 Grand Jury (II)*, 640 F.2d 49, 62 (7th Cir. 1980) ("[A]ttorney-client privilege belongs to the client alone[.]"); *United States v. Robinson*, 121 F.3d 971, 976 (5th Cir. 1997) ("The fact of representation...is generally not within the privilege."). It is the fiduciary relationship, not the attorney-client relationship, that is the basis for the reporting requirement.

The claims that Zell asserts on his own behalf fare no better. His compliance with a client's wish to avoid the FATCA reporting requirements potentially subjects the client—not Zell—to the risk of imposition of a 30% tax. See 26 U.S.C. § 1471(b)(1)(D). Zell himself has not been assessed a 30% withholding tax under FATCA, nor could he (or his clients) be, because 30% withholding under § 1471 is not presently being imposed against Israeli FFIs or their recalcitrant account holders. Zell has not had a penalty imposed against him for any willful failure to file an FBAR either. He has therefore suffered no concrete and particularized injury sufficient to convey standing. See *Lujan*, 504 U.S. at 560. Taking the allegations of the complaint at face value, Zell is losing clients because of discriminatory actions of the Israeli banks. Indeed, in their Reply, Plaintiffs admit it is Zell's client, a non-party, who objects to reporting. Reply at 4.

In their reply, Plaintiffs are more focused, directing all of their ire at the invasion of their privacy:

> A central burden is extensive financial disclosure that Plaintiffs do not want. … This opposition to disclosure provides standing to challenge provisions (including IGAs) expressly *requiring* disclosure…. So [P]laintiffs have standing to challenge FATCA, IGAs, and FBAR disclosure requirements, and they have standing to challenge the FFI Penalty (30% tax on payments to non-compliant FFIs)…because those FFIs disclose account holders' information *because of* that penalty.

Reply at 3. They continue, "Plaintiffs object to disclosure and also object to this penalty specifically designed to compel them to this disclosure, providing them standing." Reply at 4.

> But Plaintiffs verified that they do not want their financial affairs disclosed to the U.S. Government under FATCA, including [26 U.S.C. 6038D(a)], the necessary implication of which is either that Plaintiffs are doing such disclosure and want to cease or that Plaintiffs have arranged their affairs so as to avoid such disclosure that would otherwise have occurred, either of which gives them standing. (See, e.g., Doc. No. 1, PageID 12 (¶ 23), 14-15 (¶¶ 35, 37) (altered financial affairs to avoid disclosure), 15 (¶ 38).) Moreover, individuals may report otherwise qualifying accounts under that amount, are encouraged to do so, and the Government has not said that it would refuse such reports.
>
> ***11** The Government claims Plaintiffs may not challenge the FBAR requirement's Willfulness Penalty, 31 U.S.C. 5321(b)(C)(i), because none alleged "a bank account exceeding $10,000 in value." (Doc. No. 16, PageID 213.) But Plaintiffs alleged that they reasonably feared they would be subject to the Willfulness Penalty for willful failure to file FBARs.

Reply at 5.

Plaintiffs also contend that the existence of applicable statutory requirements and penalties might suffice for standing to challenge the unconstitutional provisions. Reply at 6 (citing *Susan B. Anthony List v. Driehaus*, 134 S. Ct. 2334, 2341-46 (2014); *Babbitt v. United Farm Workers Nat'l Union*, 442 U.S. 289, 298 (1979) and *Doe v. Bolton*, 410 U.S. 179, 188 (1973)). However, this only applies where petitioners have alleged "an intention to engage in a course of conduct arguably affected with a constitutional interest." *Susan B. Anthony List*, 134

S. Ct. at 2332. Plaintiffs here have not identified a constitutionally protected interest.

The Supreme Court has held that depositors have no "reasonable expectation of privacy" in "information kept in bank records" because documents like "financial statements and deposit slips[ ] contain only information voluntarily conveyed to the banks and exposed to their employees in the ordinary course of business." *United States v. Miller*, 425 U.S. 435, 442 (1976); see also *id.* at 440 (noting that the depositor "can assert neither ownership nor possession" over the records at issue); *Smith*, 442 U.S. at 743-44 (1979) ("[A] person has no legitimate expectation of privacy in information he voluntarily turns over to third parties."). [3]

The only Plaintiff to have standing then is Kuettel, who is limited to claims concerning the FBAR requirement present in Count Three and Count Six.

Count Three challenges what it characterizes as heightened reporting requirements for foreign financial accounts denying U.S. citizens living abroad the equal protection of the laws. Plaintiffs quote both the Administrative Procedure Act and the Constitution. Under section 706 of the Administrative Procedure Act ("APA"), a court must "hold unlawful and set aside agency action...found to be –...(B) contrary to constitutional right, power, privilege, or immunity." 5 U.S.C. § 706. In the Constitution, the Fifth Amendment provides that "No person shall...be deprived of life, liberty, or property, without due process of law...." U.S. Const. amend. V. The Due Process Clause of the Fifth Amendment includes a guarantee of equal protection equivalent to that expressly provided for under the Equal Protection Clause of the Fourteenth Amendment. "An equal protection claim against the federal government is analyzed under the Due Process Clause of the Fifth Amendment." *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 217 (1995); United *States v. Ovalle*, 136 F.3d 1092, 1095 (6th Cir. 1998). Thus, the federal government may not "deny to any person within its jurisdiction the equal protection of the laws," U.S. Const. amend. XIV, § 1.

"We begin, of course, with the presumption that the challenged statute"—FATCA—"is valid. Its wisdom is not the concern of the courts; if a challenged action does not violate the Constitution, it must be sustained[.]" *INS v. Chadha*, 426 U.S. 919, 944 (1983); see also *National Federation of Independent Business v. Sebelius* 132 S. Ct. 2566, 2594 (2012) ("'[E]very reasonable construction must be resorted to, in order to save a statute from unconstitutionality.'" (quoting *Hooper v. California*, 155 U.S. 648, 657 (1895))).

***12** Plaintiffs contend the only financial information the IRS requires to be reported about domestic accounts is the amount of interest paid to the accounts during a calendar year, 26 U.S.C. §§ 6049(a), (b); 26 C.F.R. §§ 1.6049-4(a)(1), 1.6049-4T(b)(1). For a foreign account, the information reported to the IRS includes not only the interest paid to the account, 26 USC § 1471(c)(1)(C); 26 C.F.R. §§ 1.1471-4(d)(3)(ii),-4(d)(4)(iv); Canadian IGA, art. 2, § 2(a)(4); Czech IGA, art. 2, § 2(a)(4); Israeli IGA, art. 2, § 2(a)(4); Swiss IGA, arts. 3, 5, but also the amount of any income, gain, loss, deduction, or credit recognized on the account, 26 C.F.R. § 1.6038D-4(a)(8), whether the account was opened or closed during the year, id. § 1.6038D-4(a)(6), and the balance of the account, 26 USC §§ 1471(c)(1)(C), 6038D(c)(4); 26 CFR §§ 1.1471-4(d)(3)(ii), 1.6038D-4(a)(5); Canadian IGA, art. 2, § 2(a)(6); Czech IGA, art. 2, § 2(a)(6); Israeli IGA, art. 2, § 2(a)(6); Swiss IGA, arts. 3, 5; FinCEN, BSA Electronic Filing Requirements For Report of Foreign Bank and Financial Verified Complaint for Declaratory and Injunctive Relief 41 Case: 3:15-cv-00250-TMR Doc #: 1 Filed: 07/14/15 Page: 41 of 59 PAGEID #: 41 Accounts (FinCEN Form 114) 15 (June 2014), http://www.fincen.gov/forms/files/FBARL#ine0#Item0#FilingÏnstructions.pdf. Plaintiffs assert that comparable information is not required to be disclosed regarding domestic accounts of U.S. citizens.

Plaintiffs decry that U.S. citizens living in foreign countries are in this manner treated differently than U.S. citizens living in the United States. According to Plaintiffs, the federal government has no legitimate interest in knowing the amount of any income, gain, loss, deduction, or credit recognized on a foreign account, whether a foreign account was opened or closed during the year, or the balance of a foreign account.

Plaintiffs contend that the "heightened reporting requirements" imposed by FATCA, the FBAR information-reporting requirements, and the Canadian, Swiss, Czech, and Israeli IGAs, violate the Fifth Amendment rights of "U.S. citizens living in a foreign country" and should be enjoined. See Complaint ¶¶ 124-130.

Plaintiffs are unlikely to succeed on the merits of their claim that "U.S. citizens living in a foreign country are treated differently than U.S. citizens living in the United States," Complaint ¶ 128, without rational basis. A litigant may challenge federal government action under the Fifth Amendment's due process clause on the same grounds as a challenge to state action under the Fourteenth Amendment's equal protection clause. See *Weinberger v. Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975); see also *Buckley v. Valeo*, 424 U.S. 1, 93 (1976). "Under the Due Process Clause, if a statute has a reasonable relation to a proper legislative purpose, and [is] neither arbitrary nor discriminatory, the requirements of due process are satisfied." *Nebbia v. New York*, 291 U.S. 502, 537 (1934) (internal quotation marks and citations omitted). Likewise, under the Equal Protection Clause, a statute not directed at a suspect or quasi-suspect class must be upheld if it has a rational basis. *Clements v. Fashing*, 457 U.S. 957, 967 (1982) (citing *Williamson v. Lee Optical Co*., 348 U.S. 483, 489 (1955)). "U.S. citizens living in a foreign country" are not a suspect or semi-suspect class of people, so Defendants need only show that "the classification drawn by [a] statute is rationally related to a legitimate state interest." *City of Cleburne, Tex. v. Cleburne Living Ctr.*, 473 U.S. 432, 439 (1985); see also *Igartua de la Rosa v. United States*, 842 F. Supp. 607, 611 (D.P.R. 1994).

A court "will not overturn [government conduct] unless the varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purposes that [it] can only conclude that the [government's] actions were irrational." *Vance v. Bradley*, 440 U.S. 93, 97 (1979); see also *FCC v. Beach Communications, Inc*., 508 U.S. 307, 313-14 (1993) (a statute subject to rational basis review must be upheld "if there is any reasonably conceivable state of facts that could provide a rational basis for the classification."). A facial challenge, because of the extraordinary relief, requires a "heavy burden" and is "the most difficult challenge to mount successfully[.]" *United States v. Salerno*, 481 U.S. 739, 745 (1987).

***13** Plaintiffs' equal protection claims fail because the statutes, regulations, and executive agreements that they challenge simply do not make the classification they assert. None of the challenged provisions single out U.S. citizens living abroad. Instead, all Americans with specified foreign bank accounts or assets are subject to reporting requirements, no matter where they happen to live. The provisions Plaintiffs contend discriminate against "U.S. citizens living abroad" actually apply to all U.S. taxpayers, no matter their residence. Plaintiffs argue that "[i]n practice, the increased reporting requirements for foreign financial accounts discriminate against U.S. citizens living abroad," see Doc. No. 8-1 at 22 (PageID 160), suggesting a claim of discrimination based on disparate impact. But it is well-settled that "mere disparate impact is insufficient to demonstrate an equal protection violation." *Copeland v. Machulis*, 57 F.3d 476, 481 (6th Cir. 1995); see also *Washington v. Davis*, 426 U.S. 229, 244-45 (1976).

FATCA requires FFIs to provide specified information about "United States Accounts." See 26 U.S.C. § 1471(c)(1)(C). "United States Accounts" are defined in the statute as "any financial account which is held by one or more specified United States persons or United States owned foreign entities." 26 U.S.C. § 1471(d)(1)(A). Similarly, the individual reporting requirements of FATCA under § 6038D(c)(4) apply to "any individual who, during any taxable year, holds any interest in a specified foreign financial asset[.]" 26 U.S.C. § 6038D(a) (emphasis added). The Bank Secrecy Act, under which the FBAR reporting requirement arises, also applies to any taxpayer with a financial interest in, or signatory authority over, a foreign financial account exceeding certain monetary thresholds. See 31 U.S.C. § 5314; 31 C.F.R. §§ 1010.350 & 1010.306(c). Neither do the challenged regulations make the classification Plaintiffs challenge; they apply to all taxpayers holding certain foreign accounts or assets. See 26 C.F.R. § 1.1471-4(d)(3)(ii) (FFI reporting requirement regarding "accounts held by specified U.S. persons"); 26 C.F.R. § 1.6038D-4(a)(5), (6), & (8) (setting forth information to be reported in Statement of Specified Foreign Financial Assets). Neither do the IGAs distinguish between the residence of the account holders whose information must be reported.

Plaintiffs have not correctly identified the classification made by these laws. The most basic element of an equal protection claim is the existence of at least two classifications of persons treated differently under the law. See *Silver v. Franklin Twp. Bd. of Zoning Appeals*, 966 F.2d 1031, 1036 (6th Cir. 1992). But Plaintiffs fail to recognize that similarly situated persons to themselves

—U.S. taxpayers living in the United States who hold foreign accounts—are not treated differently. In fact, for U.S. citizens living abroad, the regulations under 26 C.F.R. § 1.6038D-2 do not kick in until higher reporting thresholds are reached, as the regulations recognize that such individuals are likely to have significant foreign accounts in the ordinary course of their lives. For married individuals filing jointly, the filing threshold goes from $50,000 for U.S. residents to $150,000 for non-U.S. residents. To the extent that the law treats U.S. citizens living abroad unequally, it is in their favor insofar as the reporting requirements for foreign accounts are actually less onerous.

The distinction that the regulations do make is rationally related to a legitimate government interest. The U.S. tax system is based in large part on voluntary compliance: taxpayers are expected to disclose their sources of income annually on their federal tax returns. The information reporting required by FATCA is intended to address the use of offshore accounts to facilitate tax evasion, and to strengthen the integrity of the voluntary compliance system by placing U.S. taxpayers that have access to offshore investment opportunities in an equal position with U.S. taxpayers that invest within the United States. Third party information reporting is an important tool used by the IRS to close the tax gap between taxes due and taxes paid. The knowledge that financial institutions will also be disclosing information about an account encourages individuals to properly disclose their income on their tax returns. See Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 711 (2007). Unlike most countries, U.S. taxpayers are subject to tax on their worldwide income, and their investments have become increasingly global in scope. Absent the FATCA reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by hiding money in offshore accounts where, prior to FATCA, they were not subject to automatic reporting to the IRS by FFIs. The information required to be reported, including payments made or credited to the account and the balance or value of the account is to assist the IRS in determining previously unreported income and the value of such information is based on experience from the DOJ prosecution of offshore tax evasion. See *Senate Permanent Subcommittee on Investigations bipartisan report on "Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts,"* February 26, 2014; see also *Cal. Bankers Ass'n v. Shultz*, 416 U.S. 21, 29 (1974) ("when law enforcement personnel are confronted with the secret foreign bank account or the secret foreign financial institution they are placed in an impossible situation…they must subject themselves to time consuming and often times fruitless foreign legal process.").

***14** The FBAR reporting requirements, likewise, have a rational basis. As the Supreme Court noted in *California Bankers*, when Congress enacted the Bank Secrecy Act (which provides the statutory basis for the FBAR), it "recognized that the use of financial institutions, both domestic and foreign, in furtherance of activities designed to evade the regulatory mechanism of the United States, had markedly increased." *Id.* at 38. The Government has a legitimate interest in collecting information about foreign accounts, including account balances held by U.S. citizens, for the same reason that it requires reporting of information on U.S.-based accounts. The information assists law enforcement and the IRS, among other things, in identifying unreported taxable income of U.S. taxpayers that is held in foreign accounts. Without FBAR reporting, the Government's efforts to track financial crime and tax evasion would be hampered. Congress, through FBAR reporting, attempted to complement domestic reporting on financial transactions. U.S. taxpayers who place their funds in foreign accounts cannot put themselves on a better footing than U.S. taxpayers who conduct their transactions stateside. FBAR reporting prevents individuals from trying to evade domestic regulation and provides a deterrent for those who would use foreign accounts to engage in criminal activity.

The distinctions made by FATCA, the FBAR reporting requirements, and the IGAs simply do not evince, on their face, discrimination that is "so unjustifiable as to be violative of due process." *Schneider v. Rusk*, 377 U.S. 163, 168 (1964).

In Count Six, Plaintiffs contend that the FBAR "Willfullness Penalty" is unconstitutional under the Excessive Fines Clause. Plaintiffs decry that 26 U.S.C. § 5321 imposes a penalty of up to $100,000 or 50% of the balance of the account at the time of the violation, whichever is greater, for failures to file an FBAR as required by 26 U.S.C. § 5314 (the FBAR "Willfulness Penalty"). 31 U.S.C. § 5321(b)(5)(C)(i).

Plaintiffs allege the Willfulness Penalty is designed to punish and is therefore subject to the Excessive Fines Clause. Plaintiffs further allege the Willfulness Penalty is grossly disproportionate to the gravity of the offense.

Plaintiffs' Eighth Amendment claims, however, are not ripe for adjudication because no withholding or FBAR penalty has been imposed against any Plaintiff; indeed, the 30% FFI withholding tax under § 1471(a) will never be imposed against any of them because they are individuals, not FFIs. Additionally, Plaintiffs' claims fail because they cannot show that the FATCA taxes and the willful FBAR penalties are grossly disproportional to the gravity of their (as yet unspecified) conduct. See *United States v. Bajakajian*, 524 U.S. 321, 334 (1998).

"Ripeness is a justiciability doctrine designed to prevent the courts, through premature adjudication, from entangling themselves in abstract disagreements. Ripeness becomes an issue when a case is anchored in future events that may not occur as anticipated, or at all." *Kentucky Press Ass'n v. Kentucky*, 454 F.3d 505, 509 (6th Cir. 2006) (citation and internal quotation marks omitted). The Sixth Circuit has listed three factors to be considered when deciding whether claims are ripe for adjudication: (1) the likelihood that the harm alleged by the plaintiffs will ever come to pass; (2) whether the factual record is sufficiently developed to produce a fair adjudication of the merits of the parties' respective claim; and (3) the hardship to the parties if judicial relief is denied at this stage in the proceedings. *Id.*

Plaintiffs' Eighth Amendment challenges are not ripe under the *Kentucky Press Association* factors. First, it is not clear that any harm Plaintiffs contemplate will ever come to pass. With respect to the FATCA withholding tax in § 1471(b)(1), Plaintiffs can request a credit or refund of a future withheld amount on their federal income tax returns. See 26 U.S.C § 1474(a); 26 C.F.R. § 1.1474-3. Several Plaintiffs are United States citizens, so they must file federal income tax returns anyway. 26 C.F.R. § 1.6012-1(a)(1). Nelson and Kuettel, who renounced their U.S. citizenship, may possibly also be required to file returns if they have U.S.-source income. 26 C.F.R. § 1.6012-1(b)(1)(i). As for the willful FBAR penalty, whether it is imposed is entirely in IRS's discretion. See 31 U.S.C. § 5321(a)(5); 31 C.F.R. § 1010.810(g).

***15** Second, the factual record is not sufficiently developed to weigh whether the FATCA withholding taxes or FBAR penalty is grossly disproportionate, and such a factual record cannot reasonably be developed here. An Eighth Amendment proportionality analysis is "guided by objective criteria, including (i) the gravity of the offense and the harshness of the penalty; (ii) the [penalty] imposed on other [offenders] in the same jurisdiction; and (iii) the [penalty] imposed for commission of the same [offense] in other jurisdictions." *Solem v. Helm*, 463 U.S. 277, 292 (1983) (Cruel and Unusual Punishments Clause analysis); see also *Bajakajian*, 524 U.S. at 336 (drawing Excessive Fines Clause standard from Cruel and Unusual Punishments Clause jurisprudence). The first factor requires review of the circumstances of the offense "in great detail." *Solem*, 463 U.S. at 290-91. In this case, there are no circumstances to review, because no FATCA tax or FBAR penalty has been imposed. A fact-specific determination of excessiveness is impossible where any wrongful conduct is hypothetical.

Finally, Plaintiffs will not suffer appreciable hardship from the Court declining to hear their Eighth Amendment challenges. The Sixth Circuit has noted that, "[r]ipeness will not exist … when a plaintiff has suffered (or will immediately suffer) a small but legally cognizable injury, yet the benefits to adjudicating the dispute at some later time outweigh the hardship the plaintiff will have to endure by waiting." *Airline Profs. Ass'n of Int'l Broth. of Teamsters, Local No. 1224 v. Airborne, Inc.*, 332 F.3d 983, 988 n.4 (6th Cir. 2003). Challenges to statutes are not ripe where delaying judicial review results in no real harm. See *Nat'l Park Hosp. Ass'n v. Dep't of Interior*, 538 U.S. 803, 810-11 (2003). Once an amount is actually withheld from a payment, Plaintiffs can (after properly exhausting administrative remedies) file a refund suit if the IRS improperly fails to refund the withholding. See 26 U.S.C. § 7422. If an FBAR penalty is assessed against a Plaintiff, that Plaintiff may challenge the penalty at a later time. See *Moore v. United States*, No. C13-2063-RAJ, 2015 WL 1510007 at *12-*13 (W.D. Wash. Apr. 1, 2015) (rejecting Eighth Amendment challenge to non-willful FBAR penalty). At present, Plaintiffs have not established that their Eighth Amendment claims require immediate injunctive relief.

Because they have not alleged that any FATCA withholding taxes or willful FBAR penalties have actually been imposed against them, Plaintiffs appear to raise a facial challenge to those exactions under the Excessive Fines Clause. To prevail on a facial challenge, Plaintiffs must show that the statutes are "unconstitutional in all of [their] applications," *City of Los Angeles v. Patel*, 135 S. Ct. 2443, 2451 (2015) (internal quotation omitted). The FATCA taxes satisfy neither of the two *Bajakajian* factors: they are not fines, nor are they grossly disproportional. 524 U.S. at 334. The willful FBAR penalty, while arguably equivalent to a fine, is not grossly disproportional in all applications.

The FATCA withholding taxes in § 1471(a) and § 1471(d)(1)(B) are taxes, not penalties. The Eighth Amendment applies to payments that "constitute punishment for an offense." *Bajakajian*, 524 U.S. at 328. Neither taxes nor remedial fines are punishment for an offense, and thus are not subject to the Eighth Amendment. See *Austin v. United States*, 509 U.S. 602, 621-22 (1993) (a fine is not "punishment for an offense" if it serves a wholly remedial purpose).

The FATCA withholding tax rate of 30% is remedial because it is the same rate imposed on all fixed or determinable annual or periodic income paid from a U.S. source to a non-resident alien. 26 U.S.C. § 1441(a), (b). FATCA's withholding tax on FFIs effectively assumes that if an FFI refuses to disclose information to the IRS, all U.S.-sourced payments to its account holders may be subject to that rate of taxation. Similarly, FATCA's withholding tax on recalcitrant account holders under § 1471(b)(1)(D) merely extends the same withholding rate as § 1441 to accounts where the account holder refuses to be identified. The rate is effectively reduced if the FFI's country has a substantive tax treaty reducing the rate of tax on a particular payment, see 26 U.S.C. § 1474(b)(2)(A)(i), underlining that the FATCA withholdings are meant to collect tax, not to impose a punishment. Again, to the extent that one of the individual Plaintiffs has money withheld over and above what is necessary to pay his or her federal income tax, the withholding is refundable. 26 U.S.C. § 1474; 26 C.F.R. §§ 1.1474-3, 1.1474-5. At least as to these Plaintiffs, the FATCA withholding taxes serve the remedial purpose of protecting the fisc. See *Helvering v. Mitchell*, 303 U.S. 391, 400-01 (1938) (50% fraud penalty was remedial in nature because it was "provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation").

***16** Nor is the magnitude of the withholding tax grossly disproportional, since it roughly approximates the presumed tax loss from FATCA non-compliance. Congress's determination that a 30% withholding tax rate was appropriate is accorded substantial deference. See, e.g., *United States v. Dobrowolski*, 406 F. App'x 11, 12-13 (6th Cir. 2010) (citing cases) (noting traditional deference given to legislative policy determinations). A penalty that is equal to, and does not duplicate, the applicable tax rate on a given payment is proportional to the "offense" of failing to report information under FATCA—it certainly is not excessive in "all" applications. Therefore, Plaintiffs' facial Eighth Amendment challenge to the § 1471 taxes is rejected.

The willful FBAR penalty also survives a facial challenge because the maximum penalty will be constitutional in at least some circumstances. A maximum penalty fixed by Congress is due substantial deference from the courts. See *Bajakajian*, 524 U.S. at 336 ("[J]udgments about the appropriate punishment for an offense belong in the first instance to the legislature."); see also *United States v. 817 N.E. 29th Drive, Wilton Manors, Fla.*, 175 F.3d 1304, 1309 (11th Cir. 1999). Congress increased the maximum FBAR penalty to its present level in 2004. See 31 U.S.C. § 5321(a)(5)(C). Congress chose this penalty range because FBAR reporting furthers an important law enforcement goal. The Senate Finance Committee explained:

> The Committee understands that the number of individuals involved in using offshore bank accounts to engage in abusive tax scams has grown significantly in recent years .... The Committee is concerned about this activity and believes that improving compliance with this reporting requirement is vitally important to sound tax administration, to combating terrorism, and to preventing the use of abusive tax schemes and scams.

S. Rep. 108-257, at 32(2004) (explaining increase in maximum willful penalty and creation of new civil non-willful penalty). Indeed, FBARs are available not only to the IRS but also to a variety of law enforcement agencies investigating crimes like money laundering and terrorist financing. See, e.g., *Amendment to the Bank Secrecy*

Act Regulations–Reports of Foreign Financial Accounts, 75 Fed. Reg. 8844, 8844 (Feb. 26, 2010). Setting the maximum willful penalty as a substantial proportion of the account ensures that the willful penalty is not merely a cost of doing business for tax evaders, terrorists, and organized criminals.

A 50% willful FBAR penalty—the maximum permitted by statute—is severe. But given the ills it combats, it is an appropriate penalty in at least some circumstances. Accordingly, the Plaintiffs' facial challenge to it under the Eighth Amendment fails.

IV. Conclusion

Plaintiffs have failed to establish that they are entitled to a preliminary injunction. First, Plaintiffs are not likely to succeed on the merits. They lack standing, as the harms they allege are remote and speculative harms, most of which would be caused by third parties, illusory, or self-inflicted. Plaintiffs' allegations also fail as a matter of law, as there is no constitutionally recognized right to privacy of bank records.

Second, Plaintiffs are not likely to suffer irreparable injury if a preliminary injunction is not granted. Their lack of standing means that they lack a sufficiently concrete and particularized injury to sue in the first instance, much less an injury that is so imminent and irreparably harmful as to justify preliminary injunctive relief. The absence of the irreparable injury is reinforced by the facts that: their Fifth Amendment equal-protection allegation is based on a classification that does not exist; their Eighth Amendment claims are not ripe, with no FATCA withholding or willful FBAR penalties having been imposed against them; and their Fourth Amendment counts are based on information reporting that does not violate the Constitution.

***17** The third factor, the balance of the equities, also weighs against the entry of a preliminary injunction. That is because the fourth factor, the public interest, is best served by keeping the statutory provisions at issue, as well as their implementing regulations and international agreements, in place and enforceable during the pendency of this lawsuit. The FATCA statute, the IGAs, and the FBAR requirements encourage compliance with tax laws, combat tax evasion, and deter the use of foreign accounts to engage in criminal activity. A preliminary injunction would harm these efforts and intrude upon the province of Congress and the President to determine how best to achieve these policy goals. Thus, Plaintiffs' Motion for Preliminary Injunction, ECF 8, is **DENIED**.

DONE and **ORDERED** in Dayton, Ohio, this Tuesday, September 29, 2015.

All Citations

Not Reported in F.Supp.3d, 2015 WL 5697552, 116 A.F.T.R.2d 2015-6288, 2015-2 USTC P 50,499

Footnotes

[1] If the country enters into an intergovernmental agreement (IGA) this provision becomes irrelevant because consent is no longer a legal impediment under foreign law.

[2] See Convention Between the United States and Canada with Respect to Taxes on Income and on Capital done at Washington on September 26, 1980 (“Canadian Convention”), Article XXVII; Convention between the United States of America and the Czech Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, done at Prague on September 16, 1993 (“Czech Convention”), Article 29; Convention between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, done at Washington on November 20, 1975 (“Israeli Convention”), Article 29; and Convention between the United States and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, signed at Washington on October 2, 1996 (“Swiss Convention”), Article 26.

[3] Here, the Supreme Court's estimation of what a reasonable person might expect appears to be diverging from reality. “A 2003 study conducted by Christopher Slobogin and Joseph E. Schumacher found that the 217 subjects considered 'perusing bank records' as more intrusive than a patdown or even an arrest for 48 hours.” Samantha Arrington, *Expansion of the Katz Reasonable Expectation of Privacy Test Is Necessary to Perpetuate A Majoritarian View of the Reasonable Expectation of Privacy in Electronic Communications to Third Parties*, 90 U. Det. Mercy L. Rev. 179, 180 (2013). See also, e.g., Henry F. Fradella et. al., *Quantifying Katz: Empirically Measuring ‘Reasonable Expectations of Privacy‘ in the Fourth Amendment Context*, 38 Am. J. Crim. L. 289, 371 (2011) (“judges often fail to appreciate the degree to which 'society’ believes privacy should be protected from law enforcement intrusions.”).

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United States District Court, D. Hawai'i.

UNITED STATES of America, Plaintiff,
v.
Charles Alan PFLUEGER, (01) James Henry Pflueger, (02) Randall Ken Kurata, (03) Dennis Lawrence Duban, (04) Julie Ann Kam, (05), Defendants.

CR No. 10–00631 LEK.
|
March 29, 2012.

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ORDER DENYING DEFENDANT JAMES HENRY PFLUEGER'S MOTION TO DISMISS COUNT 14 OF THE INDICTMENT

LESLIE E. KOBAYASHI, District Judge.

***1** Before the Court is Defendant James Henry Pflueger's ("Defendant") Motion to Dismiss Count 14 of the Indictment ("Motion"), filed on February 16, 2012. The United States of America ("the Government") filed its memorandum in opposition under seal on March 2, 2012, and Defendant filed his reply on March 14, 2012. This matter came on for hearing on March 21, 2012. Appearing on behalf of Defendant was Steven Toscher, Esq., and appearing on behalf of the Government was Assistant United States Attorney Leslie Osborne, Jr. After careful consideration of the Motion, supporting and opposing memoranda, and the arguments of counsel, Defendant's Motion is HEREBY DENIED because whether Defendant was ignorant of the law or was unclear as to what his legal obligations were is not a basis for dismissing Count 14 but a matter for trial, as set forth more fully below.

BACKGROUND

On September 15, 2010, a grand jury sitting in the District of Hawai‘i returned a fourteen-count Indictment charging Defendant and four others with various criminal tax violations and conspiracy to commit these violations. The facts pertinent to the instant Motion are as follows: the Government alleges that, on or about July 1, 2008, Defendant was required by law but did not file a United States Department of the Treasury Report of Foreign Bank and Financial Accounts, Form TDF 90–22.1 (commonly referred to as an "FBAR") regarding his financial interest in and authority over a financial account in a bank account in Switzerland that had an aggregate value of more than $10,000. In Count 14, Defendant is charged with failing to file an FBAR regarding this bank account. [Indictment at ¶ 32.]

In the instant Motion, Defendant asks the Court to dismiss Count 14. Briefly, the Motion argues that: (1) as of June 30, 2008, the deadline for filing an FBAR for 2007, the law was not sufficiently clear as to whether Defendant was required to file an FBAR reporting his interest in the bank account in Switzerland; and (2) Count 14 requires the Government to prove that Defendant's failure to file an FBAR was "willful" and, because the law was unsettled at the time that the Government contends an FBAR should have been filed, the Government cannot, as a matter of law, prove that Defendant willfully failed to file a 2007 FBAR.

In opposition, the Government argues that it can and will marshal evidence sufficient to prove Defendant's willfulness in failing to file the required FBAR, and points out that Defendant fails to provide any case authority for the proposition that the law surrounding the FBAR filing requirement is too vague to be enforced. The Government submits that it has successfully prosecuted others for FBAR violations and that a challenge to the failure to prove a defendant's willfulness is for appeal and not a matter for pretrial motions.

In reply, Defendant reiterates that the instant Motion should be granted because he was not provided fair notice of his legal obligation to file an FBAR because the law was unclear and unsettled. Therefore, Defendant submits, the Government cannot prove a necessary element of the offense, namely, that Defendant willfully violated the FBAR requirements.

DISCUSSION

***2** The Ninth Circuit has stated:

> In examining a statute for vagueness, we must determine whether a person of average intelligence would reasonably understand that the charged conduct is proscribed. *United States v. Mazurie,* 419 U.S. 544, 553, 95 S.Ct. 710, 42 L.Ed.2d 706 (1975). The statute "must be examined in the light of the facts of the case at hand." *Id.* at 550, 95 S.Ct. 710.

United States v. Williams, 441 F.3d 716, 724 (9th Cir.2006).

As to 31 U.S.C. §§ 5314 and 5322(a), the statutes charged in Count 14 of the Indictment, Defendant cannot establish that these statutes are vague. In 1994, the Supreme Court held that to establish the willful violation of 31 U.S.C. § 5324, "the Government must prove that the defendant acted with knowledge that his conduct was unlawful." *Ratzlaf v. United States,* 510 U.S. 135, 136–37 (1994).[1] By inference, the Supreme Court extended this determination to a § 5314 violation by noting that willfulness is established by "reasonable inferences from the evidence of [the] defendant's conduct" and that "the Government has not found it 'impossible' to persuade a jury to make such inferences in prosecutions for willful violations of §§ 5313, 5314, or 5316." *Id.* at 149, n. 19 (citing *United States v. Dichne,* 612 F.2d 632, 636–638 (2d Cir.1979)).

"Willfulness may be proven through inference from conduct meant to conceal or mislead sources of income or other financial information." *United States v. Struman,* 951 F.2d 1466, 1476 (6th Cir.1991) (citing *Spies v. United States,* 317 U.S. 492, 499, 63 S.Ct. 364, 368, 87 L.Ed. 418 (1943)). Whether the Government can prove that Defendant knew that he was required to file a FBAR and knew that his failure to do so was unlawful is a matter for trial.

CONCLUSION

On the basis of the foregoing, Defendant James Henry Pflueger's Motion to Dismiss Count 14 of the Indictment, filed February 16, 2012, is HEREBY DENIED.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2012 WL 1082041

Footnotes

[1] In 1994, Congress amended 31 U.S.C. § 5322 to eliminate the willfulness requirement in § 5324 violations. *See, e.g., United States v. Ahmad,* 213 F.3d 805, 809 (4th Cir.2000) (citing Pub.L. No. 103–325, § 411(c)(1), 108 Stat. 2160, 2253 (1994)). The current version of § 5322(a) states:

> A person willfully violating this subchapter or a regulation prescribed or order issued under this subchapter (except section 5315 or 5324 of this title or a regulation prescribed under section 5315 or 5324), or willfully violating a regulation prescribed under section 21 of the Federal Deposit Insurance Act or section 123 of Public Law 91–508, shall be fined not more than $250,000, or imprisoned for not more than five years, or both.

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2017 WL 1361535
United States District Court,
E.D. Pennsylvania.

Arthur BEDROSIAN
v.
The UNITED STATES of America, Department of the Treasury, Internal Revenue Service

CIVIL ACTION NO. 15-5853
|
Filed 04/13/2017

Attorneys and Law Firms

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MEMORANDUM RE CROSS MOTIONS FOR SUMMARY JUDGMENT

Baylson, Judge

***1** In this tax penalty action, we must determine whether genuine disputes of material fact preclude summary judgment on behalf of Plaintiff, Arthur Bedrosian, or Defendant, the United States. Bedrosian initiated this suit, alleging that the United States committed illegal exaction by imposing an unwarranted tax penalty on him. The United States countersued for full payment of the penalty it had assessed. For the reasons discussed below, we deny summary judgment for both parties.

I. UNDISPUTED FACTS

The following is a fair account of the factual assertions at issue in this case, as taken from both parties Statements of Fact and not genuinely disputed. Bedrosian is a United States citizen who has had, over the past several decades, a successful career in the pharmaceutical industry. ECF No. 22, Def.'s Mot. for Summary Judgment ("Def.'s Mot."), Def.'s Statement of Facts ("DSOF") ¶¶ 1, 3. He currently holds the position of Chief Executive Officer at Lannett Company, Inc., a manufacturer and distributor of generic medications. Id., DSOF ¶¶ 6, 10. In this role, Bedrosian supervises approximately 100 employees, signs contracts and financial statements on behalf of Lannett, researches FDA regulations, and decides company policy with respect to FDA filings. Id., DSOF ¶¶ 9-10.

Bedrosian opened a savings account with Swiss Credit Corporation in Switzerland in the early 1970s, which account was transitioned to UBS when UBS acquired Swiss Credit Corporation. Id., DSOF ¶¶ 11-12. At some point, at least as early as 2005, a second account was added, although Bedrosian avers that he always considered them one account. Id., DSOF ¶ 14; ECF No. 26, Pl.'s Opp'n, Ex. A (Pl.'s Dep. Tr.) at 132:9-133:15. The client numbers for each account ended in 6167 and 5316. Def.'s Mot., DSOF ¶ 15. The parties dispute the extent of Bedrosian's involvement in the management of his UBS accounts, but it is at least clear that Bedrosian met with a UBS banker about once a year to review the accounts' performance. Id., DSOF ¶ 18; Pl.'s Opp'n, Ex. A at 58:6-21, 115:3-22. During 2007, the tax year at issue in this proceeding, both UBS accounts carried balances of significantly more than $10,000. Def.'s Mot., DSOF ¶ 19. In November 2008, Bedrosian requested that UBS close his account ending in 6167 and transfer all assets therein to another Swiss bank. Id., DSOF ¶ 20. The following month, he requested that UBS close his account ending in 5316 and transfer all assets therein to a domestic account at Wachovia. Id., DSOF ¶ 21.

Throughout the decades that Bedrosian maintained the Swiss accounts, he did not prepare his own tax returns; rather, two accountants did so—Seymour Handleman from 1972 until 2006, and Sheldon Bransky from 2007 onwards. Id., DSOF ¶¶ 22-23, 31. Bedrosian did not inform Handleman of the UBS accounts' existence until the 1990s, because, Bedrosian avers, "[Handleman] never asked." Id., Ex. S (Pl.'s Dep. Tr.) at 67:1-5. When Bedrosian did tell Handleman, the accountant said that "for the past 20 years, [Bedrosian had] been breaking the law" because he was "supposed to be marking [his] return that [he has] a foreign bank account and [he had not] been doing that." Id., Ex. S at 67:7-16. But, in response to Bedrosian asking what he should do to rectify the problem, Handleman allegedly told him "to just leave it alone because the damage was already done" and that, upon Bedrosian's death, the assets in the Swiss accounts would be repatriated as part of Bedrosian's estate and taxes would be paid on them then. Id., Ex. S at 69:18-24. Based on that advice, as well as his fear that he would be penalized for his years of noncompliance, Bedrosian did not report either Swiss account on his tax returns until 2007, when Handleman died and Bedrosian hired Bransky to take over his accounting work. Id., Ex. S at 72:1-5, 203:11-21.

***2** Bedrosian filed a federal income tax return for 2007 that reflected, for the first time, that he had assets in a foreign financial account in Switzerland. Id., DSOF ¶ 34. Specifically, on Schedule B of his return, Bedrosian answered "yes" to question 7a asking whether "[a]t any time during 2007, [he had] an interest in or signature or other authority over a financial account in a foreign country," and listed Switzerland as the foreign country in which the account was located. Id., Ex. N (Pl.'s 2007 Return and FBAR). Bedrosian also filed a Report of Foreign Bank and Financial Accounts, commonly referred to as an "FBAR," for the first time in 2007. Id., DSOF ¶ 38, Ex. N. But, critically, he only reported the existence of his Swiss account ending in 5316, which had assets totaling approximately $240,000, and did not report the account ending in 6167, which had assets totaling approximately $2.3 million. Id., DSOF ¶ 38, Ex. N. Bedrosian did not report any of the income that he earned on either Swiss account on his 2007 return. Id., DSOF ¶ 35.

Sometime after 2008, UBS told Bedrosian that it would be providing his account information to the United States government. Id., DSOF ¶ 41. Around this time, prior to the government's initiation of its investigation, Bedrosian hired an attorney to look into his reporting obligations as they pertained to the Swiss accounts. Id., Ex. S at 85:11-24, 184:11-185:23. In August 2010, Bedrosian filed an amended federal return for 2007 on which he reported the approximately $220,000 of income he had earned from the Swiss accounts. Id., DSOF ¶ 43, Ex. P (Pl.'s Amended 2007 Return). He also filed an amended FBAR for 2007 in August 2010, on which he reported both UBS accounts rather than just the one ending in 6167. Pl.'s Mot., PSOF ¶ 13, Ex. D (Pl.'s Amended 2007 FBAR). Although Bedrosian took this corrective action before the government began its audit, he did not do so until after the IRS had discovered the existence of the two accounts. Id., PSOF ¶ 38; Def.'s Mot., Ex. Q (IRS Memo) (stating that UBS supplied the IRS with information about the existence of the account ending in 6167 on July 19, 2010).

The IRS initiated its investigation of Bedrosian in April 2011, with a focus on tax year 2008. Pl.'s Mot., PSOF ¶ 14. Beginning then, Bedrosian engaged with the Service cooperatively, providing them with all documentation requested. Id., PSOF ¶¶ 17-19. The investigation culminated in a case panel of IRS agents recommending that Bedrosian be penalized for non-willful violations of the FBAR reporting requirement and that the case against him be closed. Id., PSOF ¶ 27, Ex. F (John West Dep. Tr.) at 51:10-16. For reasons unclear in the record, the case was not closed but instead was re-assigned to another IRS agent, Pamela Christensen, who conducted her own review and concluded that Bedrosian's violation of Section 5314 had been willful. Id., PSOF ¶¶ 29-30, Ex. G (Pamela Christensen Dep. Tr.) at 17:8-15, 21:18-21. On July 18, 2013, the IRS sent Bedrosian a letter stating that it was imposing a penalty for his willful failure to file TDF 90-22.1, the FBAR form, for tax year 2007. Id., PSOF ¶ 35, Ex. I (Letter from IRS). The proposed penalty was $975,789.17, 50% of the maximum value of the account ($1,951,578.34) and therefore the largest penalty possible under the regulations. Id., PSOF ¶ 36, Ex. I.

II. PROCEDURAL BACKGROUND

Bedrosian filed suit on October 27, 2015, alleging one count of illegal exaction (ECF No. 1). The United States answered on February 26, 2016 and asserted a counterclaim for full payment of the penalty it alleged was due, as well as accrued interest on such penalty, a late payment penalty, and other statutory additions to the penalty (ECF No. 5). Bedrosian filed an answer to the counterclaim on March 21, 2016 (ECF No. 7). Both parties then moved for summary judgment, the United States on November 30, 2016 (ECF No. 22) and Bedrosian on December 5, 2016 (ECF No. 25). Oppositions were filed on December 19, 2016 (ECF Nos. 26, 27) and the United States replied on December 23, 2016 (ECF No. 28).

III. LEGAL STANDARD

***3** A district court should grant a motion for summary judgment if the movant can show "that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A dispute is "genuine" if "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). A factual dispute is "material" if it "might affect the outcome of the suit under the governing law." Id.

A party seeking summary judgment always bears the initial responsibility for informing the district court of the basis for its motion and identifying those portions of the record that it believes demonstrate the absence of a genuine issue of material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). Where the non-moving party bears the burden of proof on a particular issue at trial, the moving party's initial burden can be met simply by "pointing out to the district court ... that there is an absence of evidence to support the nonmoving party's case." Id. at 325. After the moving party has met its initial burden, the adverse party's response must, "by citing to particular parts of materials in the record" set out specific facts showing a genuine issue for trial. Fed. R. Civ. P. 56(c)(1)(A). "Speculation and conclusory allegations do not satisfy [the non-moving party's] duty." Ridgewood Bd. of Educ. v. N.E. ex rel. M.E., 172 F.3d 238, 252 (3d Cir. 1999) (superseded by statute on other grounds as recognized by P.P. v. West Chester Area Sch. Dist., 585 F.3d 727, 730 (3d Cir. 2009)). Summary judgment is appropriate if the non-moving party fails to rebut by making a factual showing "that a genuine issue of material fact exists and that a reasonable factfinder could rule in its favor." Id. Under Rule 56, the Court must view the evidence presented on the motion in the light most favorable to the opposing party. Anderson, 477 U.S. at 255.

IV. DISCUSSION

A. Statutory Framework

Under Section 5314(a) and its corresponding regulations, United States citizens must report on an annual basis to the IRS any "financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country." 31 C.F.R. § 1010.350(a); 31 U.S.C. § 5314(a). The required form is the FBAR (TDF 90-22.1). 31 C.F.R. § 1010.350(a); 31 U.S.C. § 5314(a). Failure to timely file an FBAR for each foreign financial account in which a taxpayer has an interest of over $10,000 results in exposure to a civil money penalty that varies depending on the taxpayer's level of culpability. 31 C.F.R. § 1010.306(c); 31 U.S.C. § 5321(a)(5). Specifically, non-willful violations of the FBAR reporting requirement result in a penalty not to exceed $10,000, whereas willful violations can lead to a penalty that is the greater of $100,000 or fifty percent of the balance in the account at the time of the violation. 31 U.S.C. § 5321(a)(5)(B)(i), (a)(5)(C). A "reasonable cause" exception exists for non-willful violations, but not for willful ones. 31 U.S.C. § 5321(a)(5)(C)(ii).

B. Willfulness of Bedrosian's Violation of Section 5314

The crux of this case is Bedrosian's level of culpability in failing to file an FBAR for one of his two Swiss bank accounts in 2007; that is, did he act willfully under the pertinent statute and regulations, or non-willfully? The parties do not dispute that Bedrosian meets the other requirements of the relevant laws—(1) he is a citizen of the United States, (2) he had an interest in a financial account during 2007, (3) the account had a balance that exceeded $10,000 during 2007, (4) the account was in a foreign country, and (5) Bedrosian failed to disclose the account. See 31 C.F.R. § 1010.350; 31 U.S.C. § 5314. Therefore, the only issue in dispute is whether Bedrosian's violation of Section 5314 was willful.

***4** We start from the premise that the precise contours of the term "willful" as used in Section 5321, the civil penalty provision, have not been clearly established by statute or precedent. Authorities ranging from various federal courts, the Internal Revenue Manual, and the Office of Chief Counsel for the Internal Revenue Service reach different conclusions about the level of intent necessary to satisfy the willfulness requirement. To ground our discussion, we will summarize the approach taken by the only three federal courts to have engaged in this analysis thoroughly. See United States v. Williams, 489 Fed.Appx. 655 (4th Cir. 2012); United States v. Bohanec, No. 15-4347, 2016 WL 7167860 (C.D. Cal. Dec. 8, 2016); United States v. McBride, 908 F. Supp. 2d 1186 (D. Utah 2012).

Williams, Bohanec, and McBride all stand for the proposition that a defendant has willfully violated Section 5321 not only when he knowingly violates the rule but also when he recklessly does so. See Williams, 489 Fed.Appx. at 660; Bohanec, 2016 WL 7167860, at *5; McBride, 908 F. Supp. 2d at 1204. Those holdings are grounded on the Supreme Court's decision in Safeco Ins. Co. of America v. Burr, 551 U.S. 47 (2007), where the Court discussed how to determine civil liability for "willfully fail[ing] to comply" with the Fair Credit Reporting Act ("FCRA"). Id. at 57 (alteration in original). The Court there began by characterizing "willfully" as a "word of many meanings whose construction is often dependent on the context in which it appears." Id. (internal quotations omitted) (quoting Bryan v. United States, 524 U.S. 184, 191 (1998)). Importantly, it then stated that, "where willfulness is a statutory condition of civil liability, [the Court has] generally taken it to cover not only knowing violations of a standard, but reckless ones as well." Id. (collecting cases in which the Court so defined the term in the context of civil statutes). Consistent with that trend, the Court concluded that the FCRA's requisite willful intent was satisfied by a finding that the defendant recklessly violated the statute. Id. at 57-58.

Bedrosian does not reference Safeco in his motion or opposition to the United States' motion; rather, he relies on two Supreme Court cases that examine willfulness in the criminal tax penalty context to advocate for an identical definition in the civil one. He cites Cheek v. United States, 498 U.S. 192 (1991) and Ratzlaf v. United States, 510 U.S. 135 (1994), for the proposition that "[i]n order to sustain a 'willful' penalty under 31 U.S.C. § 5321(a)(5), the government must show that [P]laintiff's actions amount to a 'voluntary, intentional violation of a known legal duty.' " Pl.'s Mot. at 5 (quoting Cheek, 498 U.S. at 201). As noted, these cases arise in the criminal context, and we are highly skeptical that the Court's reasoning therein will be applicable in the instant case. Certain dicta in Safeco discussing the distinction between the civil and criminal contexts in terms of the willfulness standard compel that conclusion. Specifically, the Court in Safeco emphasized the importance of "limiting [criminal] liability to knowing violations" because, in order to harbor the requisite criminal intent, a defendant must "act[ ] with knowledge that his conduct was unlawful." Safeco, 551 U.S. at 57 n.9 (quoting Bryan, 524 U.S. at 193). It then stated "[c]ivil use of the term, however, typically presents neither the textual nor the substantive reasons for pegging the threshold of liability at knowledge of wrongdoing," and concluded that "[t]he standard civil usage ... counsels reading the phrase" to include reckless violations." Id. at 57, 57 n.9.

***5** At this juncture, we need not hold what the appropriate standard of willfulness is, but we note that the jurisprudential trend is towards one that would encompass reckless violations of Section 5314. Regardless, the key question here is whether either party has pointed to a lack of genuine dispute of material fact on their affirmative claims. We answer that in the negative. The determinative issue for both Bedrosian's illegal exaction claim and the United States' claim for payment of the proposed penalty is Bedrosian's intent. Whether Bedrosian willfully failed to submit an accurate FBAR for 2007 is an inherently factual question and one that cannot be resolved at this stage. Genuine disputes exist as to what Bedrosian knew regarding his reporting requirements, and when, especially as those issues relate to his relationship with his accountant, Seymour Handleman. Although there is no good cause exception for willful violations of Section 5314, we nevertheless find that Bedrosian's testimony regarding the information provided to him by Handleman and what exactly Bedrosian did with that information, if anything, would be relevant to a determination of Bedrosian's intent. For those reasons, summary judgment is not warranted as to either party.

V. CONCLUSION

For the foregoing reasons, both Bedrosian's Motion for Summary Judgment (ECF No. 25) and the United States' Motion for Summary Judgment (ECF No. 22) are denied.

All Citations

Slip Copy, 2017 WL 1361535, 119 A.F.T.R.2d 2017-1545, 2017-1 USTC P 50,225

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2018 WL 1611387
United States District Court, D. Connecticut.

UNITED STATES of America, Plaintiff,
v.
Diane M. GARRITY, Paul G. Garrity, Jr., and Paul M. Sterczala, as fiduciaries of the Estate of Paul G. Garrity, Sr., Defendants.

No. 3:15–CV–243(MPS)
|
Signed 04/03/2018

Synopsis
Background: United States filed action to reduce to judgment civil penalty that Internal Revenue Service (IRS) assessed against taxpayer for his alleged willful failure to report his interest in foreign account.

Holdings: The District Court, Michael P. Shea, J., held that:

[1] preponderance of evidence standard applied to determination of whether taxpayer willfully failed to report his interest in foreign bank account, and

[2] proof of taxpayer's reckless conduct was sufficient to satisfy element of willfulness.

Ordered accordingly.

Attorneys and Law Firms

Christine L. Sciarrino, U.S. Attorney's Office, New Haven, CT, Steven Marcus Dean, Carl Lewis Moore, Philip Leonard Bednar, U.S. Department of Justice, Tax Division, Washington, DC, for Plaintiff.

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MEMORANDUM AND ORDER

Michael P. Shea, U.S.D.J.

***1** Plaintiff, the United States of America (“the Government”), filed this suit to reduce to judgment a civil penalty the Internal Revenue Service assessed against Paul G. Garrity, Sr., under 31 U.S.C. § 5321(a)(5), for his alleged willful failure to report his interest in a foreign account he held in 2005, in violation of 31 U.S.C. § 5314. In anticipation of trial, which is scheduled for June, the Court ordered the parties to submit briefs addressing the legal question of what standard of proof governs this case—preponderance of the evidence or clear and convincing evidence. (ECF No. 99.) The Government argues that the standard of proof is preponderance of the evidence. Defendants Diane M. Garrity, Paul G. Garrity, Jr., and Paul M. Sterczala (collectively, “Defendants”), as fiduciaries of the Estate of Paul G. Garrity, Sr., argue that the standard of proof is clear and convincing evidence. In addition, although not ordered by the Court to do so, the parties have also briefed the separate question of whether the Government must show that Mr. Garrity, Sr. intentionally violated a known legal duty to establish a “willful” violation of Section 5314 or whether the Government may satisfy its burden of proof by showing that Mr. Garrity, Sr. acted recklessly. Defendants urge the former standard, while the Government urges the latter.

For the reasons discussed below, I agree with the Government on both issues.

I. Background

A. Procedural Background

The Government filed this action on February 20, 2015 to collect an outstanding civil penalty, known as the Report of Foreign Bank and Financial Accounts (“FBAR”) penalty, from the estate of Mr. Garrity, Sr., who died in 2008. The Government had assessed the penalty against Mr. Garrity, Sr. for his allegedly willful failure to timely report his financial interest in, and/or his authority over, a foreign bank account for the 2005 calendar year, as required by 31 U.S.C. § 5314 and its implementing regulations. (ECF No. 1.) The balance of the penalty as of February 20, 2015 was $1,061,181.09. Jury selection is currently scheduled for June 6, 2018.

B. Section 5321(a)(5)

The relevant portions of subsection (a)(5) of 31 U.S.C. § 5321, the statute under which the United States sues to recover a civil FBAR penalty, provide:

> (A) Penalty authorized.—The Secretary of the Treasury may impose a civil money penalty on any person who violates, or causes any violation of, any provision of section 5314.
>
> (B) Amount of penalty.—
>
> (i) In general.—Except as provided in subparagraph (C), the amount of any civil penalty imposed under subparagraph (A) shall not exceed $10,000.
>
> (ii) Reasonable cause exception.—No penalty shall be imposed under subparagraph (A) with respect to any violation if—
>
> (I) such violation was due to reasonable cause, and
>
> (II) the amount of the transaction or the balance in the account at the time of the transaction was properly reported.
>
> (C) Willful violations.—In the case of any person willfully violating, or willfully causing any violation of, any provision of section 5314—
>
> ***2** (i) the maximum penalty under subparagraph (B)(i) shall be increased to the greater of—
>
> (I) $100,000, or
>
> (II) 50 percent of the amount determined under subparagraph (D), and
>
> (ii) subparagraph (B)(ii) shall not apply.
>
> (D) Amount.—The amount determined under this subparagraph is—
>
> ...
>
> (ii) in the case of a violation involving a failure to report the existence of an account or any identifying information required to be provided with respect to an account, the balance in the account at the time of the violation.

31 U.S.C. § 5321(a)(5). Subsection (b)(2) of Section 5321 authorizes the Secretary to "commence a civil action to recover a civil penalty assessed under subsection (a) ...."

II. Discussion

A. Standard of Proof

As Congress did not specify the legal standard the Court should apply in a "civil action" brought by the Secretary under section 5321, I must determine what standard of proof applies. The starting point for this inquiry is the well-established principle that "[i]n a typical civil suit for money damages, plaintiffs must prove their case by a preponderance of the evidence." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983). *See also United States v. Regan*, 232 U.S. 37, 46–47, 34 S.Ct. 213, 58 L.Ed. 494 (1914) (holding that a civil action by the government to collect a monetary penalty "is to be conducted and determined according to the same rules and with the same incidents as are other civil actions").

The Supreme Court noted in *Huddleston* that where Congress has not specified a standard of proof, the Court has applied the clear and convincing evidence standard in civil matters only "where particularly important individual interests or rights are at stake," such as in cases involving termination of parental rights, involuntary commitment, and deportation. 459 U.S. at 389, 103 S.Ct. 683. Observing that "imposition of even severe civil sanctions that do not implicate such interests has been permitted after proof by a preponderance of the evidence," the Court held that the preponderance of the evidence standard applied to an action involving an alleged fraud in the sale or purchase of securities. *Id.* at 389–90, 103 S.Ct. 683. In doing so, the Court described the preponderance of the evidence standard as the one "generally applicable in civil actions." *Id.*

The Supreme Court has since rejected arguments that the higher standard of clear and convincing evidence applies to particular civil actions. *See Grogan v. Garner*, 498 U.S. 279, 288, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). In *Grogan*, the Court held that the preponderance of the evidence standard applies to exceptions to debt dischargeability for fraud in certain bankruptcy actions. The bankruptcy code was silent on the issue, and the

Court found that such silence weighed in favor of applying the preponderance standard: "[S]ilence is inconsistent with the view that Congress intended to require a special, heightened standard of proof." *Id.* at 286, 111 S.Ct. 654. The Court further treated the preponderance standard as the presumptive one in civil cases: "[B]ecause the preponderance-of-the-evidence standard results in a roughly equal allocation of the risk of error between litigants, we presume that this standard is applicable in civil actions between private litigants unless particularly important individual interests or rights are at stake." *Id.* (internal quotation marks omitted).

***3** Using these principles, every court that has answered the question before me has held that the preponderance of the evidence standard governs suits by the government to recover civil FBAR penalties. *See Bedrosian v. United States*, No. CV 15-5853, 2017 WL 3887520, at *1 (E.D. Pa. Sept. 5, 2017); *United States v. Bohanec*, 263 F.Supp.3d 881, 889 (C.D. Cal. 2016); *United States v. McBride*, 908 F.Supp.2d 1186, 1201–02 (D. Utah 2012); *United States v. Williams*, No. 1:09-cv-437, 2010 WL 3473311, at *1, *5 (E.D. Va. Sept. 1, 2010) (holding, as a matter of first impression, that preponderance of the evidence standard in a civil FBAR action), *rev'd on other grounds, United States v. Williams*, 489 Fed.Appx. 655 (4th Cir. 2012).

[1] **[2]** Defendants do not point to case law holding that the clear and convincing evidence standard applies to civil FBAR penalty cases. Rather, Defendants argue that the civil FBAR statute is analogous to the civil tax fraud statute, which requires proof by clear and convincing evidence. Defendants also argue that an internal memo by the Office of Chief Counsel of the IRS, written before any court appears to have considered this question, and opining that willfulness requires a higher standard of proof, should guide my ruling.[1] I find Defendants' arguments unpersuasive for the following reasons.

1. The civil FBAR penalty does not implicate "important individual interests or rights"

***4** Defendants argue that the clear and convincing evidence standard applies because the penalty for willful FBAR violations is "far more draconian" than the civil tax fraud penalty (ECF No. 106 at 3) and will involve proving allegations that could tarnish Mr. Garrity's reputation. (ECF No. 108 at 5.) Defendants thus suggest that the civil FBAR penalty implicates "important individual interests or rights" under *Huddleston*. I disagree.

That Defendants may be liable for a substantially larger sum of money for a willful FBAR violation than if the Government had pursued a civil tax fraud action does not warrant a higher standard of proof.[2] As *Huddleston* and *Grogan* indicate, it is the type of interest or right involved that triggers a higher standard of proof, not the amount in controversy; courts have not viewed cases involving "even severe civil sanctions" to implicate "important individual interests or rights" to warrant a higher standard of proof. *Huddleston*, 459 U.S. at 389–90, 103 S.Ct. 683. *See also Halo Electronics, Inc. v. Pulse Electronics, Inc.*, ––– U.S. ––––, 136 S.Ct. 1923, 1934, 195 L.Ed.2d 278 (2016) (rejecting requirement that willful patent infringement behavior warranting enhanced damages be proved by clear and convincing evidence); *Ramirez v. T & H Lemont, Inc.*, 845 F.3d 772, 777–81 (7th Cir. 2016) (holding that preponderance of the evidence standard applies to dismissal of a civil suit as a discovery sanction); *Fishman Transducers, Inc. v. Paul*, 684 F.3d 187, 193 (1st Cir. 2012) (holding that preponderance of the evidence standard applies to proof of willfulness for the purpose of obtaining more than single damages or profit disgorgement in trademark action).

Defendants also argue that the Government's proof of willfulness likely will involve allegations of fraud, which could tarnish Mr. Garrity, Sr.'s reputation, implicating a more important interest than those involved in typical civil cases. (*See* ECF No. 108 at 5.) But even allegations of fraud do not necessitate a higher standard of proof. In *Huddleston*, the Supreme Court held that the applicable standard of proof for a fraudulent misrepresentation claim was preponderance of the evidence, reversing the Court of Appeals's ruling that the clear and convincing evidence standard applied to allegations of fraud. 459 U.S. at 390, 103 S.Ct. 683. And in *Grogan*, the Supreme Court rejected the notion that the presence of a statutory fraud claim necessarily warranted a higher standard of proof, even though the common law of many states did apply such a standard: "Unlike a large number, and perhaps the majority, of the States, Congress has chosen the preponderance standard when it has created substantive causes of action for fraud." 498 U.S. at 288–89, 111 S.Ct. 654 (citing numerous examples). *See also McBride*, 908 F.Supp.2d at 1201 (discussing the applicability of *Huddleston* in the civil tax-penalty arena).[3]

***5** Moreover, the Chief Counsel's statement that "[c]ourts have traditionally applied the clear and convincing standard with respect to fraud cases in general" (ECF No. 106–1 at 3) does not account for differences in how courts treat fraud under federal statutes and the common law, respectively. *See Master–Halco, Inc. v. Scillia Dowling & Natarelli, LLC*, 739 F.Supp.2d 109, 122–23 (D. Conn. 2010) (discussing differences between standards of proof for statutory fraud and common law fraud, and holding that clear and convincing evidence was the appropriate standard of proof for civil conspiracy to commit fraud and aiding and abetting fraud under state common law). The cases Defendants cite in support of a higher standard involved allegations of a patent's invalidity, which the Supreme Court has explicitly held must be established by clear and convincing evidence, [4] or the Connecticut common law standard for proving fraud —clear and convincing evidence—which a federal action for a civil FBAR penalty does not implicate. Defendants also rely on civil tax fraud cases, which as discussed above, do not necessitate a higher standard of proof in civil FBAR penalty cases.

Further, the standard of proof in other civil enforcement actions is preponderance of the evidence, suggesting that a government enforcement action does not necessarily implicate important interests or rights. *See, e.g., Hi–Tech Pharm. v. Crawford*, 544 F.3d 1187, 1191 (11th Cir. 2008) (the government's standard of proof in an enforcement action under the Federal Food, Drug, and Cosmetic Act was preponderance of the evidence); *S.E.C. v. Moran*, 922 F.Supp. 867, 890 (S.D.N.Y. 1996) (holding that preponderance of the evidence governed civil securities fraud enforcement action in light of "well established law ... that the preponderance of the evidence standard is sufficient to govern a civil action unless the remedy sought would, *in fact*, deprive the defendant[ ] the ability to continue to pursue his livelihood such as disbarment or revocation of another such licen[s]e"). The sanction that Defendants may be exposed to, regardless of how "draconian" it may be, is monetary only. *See Bohanec*, 263 F.Supp.3d at 889. Despite characterizing their exposure to a monetary sanction as implicating a "property interest that require[s] protection" (ECF No. 108 at 3), Defendants have not demonstrated how the penalty the Government seeks would affect important individual interests or rights to warrant a higher standard of proof.

2. The element of intent does not support a higher standard of proof

Defendants also argue that the focus on Mr. Garrity Sr.'s intent in this case supports a higher standard of proof, as "[j]ust as it is difficult to show intent, it is also difficult to show a lack of intent." (ECF No. 106 at 6.) The Supreme Court has held, however, that, "[i]f anything, the difficulty of proving the defendant's state of mind supports a lower standard of proof," even where a party must prove intent largely through circumstantial evidence. *Huddleston*, 459 U.S. at 390 n.30, 103 S.Ct. 683. *See also Moran*, 922 F.Supp. at 890 (rejecting the argument that proof by circumstantial evidence in civil securities fraud action necessitates a higher standard of proof). Moreover, as Defendants themselves point out, regardless of the standard of proof, the burden of proof remains on the government. Therefore, the difficulty of showing *lack* of intent is irrelevant.

B. Willfulness

[3] Defendants also argue that the Government must prove that Mr. Garrity, Sr. intentionally violated a known legal duty in order to satisfy the element of willfulness, and that proof of reckless conduct is insufficient. I find Defendants' arguments unpersuasive, as they do not account for the well-established distinction between civil and criminal formulations of willfulness.

***6** In *Safeco Insurance Company of America v. Burr*, the Supreme Court held, in the context of the Fair Credit Reporting Act's requirement that insurers transmit adverse action notices reflecting negative credit reports to consumers, that a "willful failure" covered reckless conduct. 551 U.S. 47, 57, 127 S.Ct. 2201, 167 L.Ed.2d 1045 (2007). The starting point of the Court's inquiry was its observation that "where willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well ...." *Id. See also McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 132–33, 108 S.Ct. 1677, 100 L.Ed.2d 115 (1988) ("willful" under the Fair Labor Standards Act covers reckless violations); *Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 125–26, 105 S.Ct. 613, 83 L.Ed.2d 523 (1985) ("willful" in liquidated damages provision of the Age Discrimination in Employment Act covers reckless violations). The

Supreme Court explicitly acknowledged in *Safeco* that "[i]t is different in the criminal law. When the term 'willful' or 'willfully' has been used in a criminal statute, we have regularly read the modifier as limiting liability to knowing violations .... Civil use of the term, however, typically presents neither the textual nor the substantive reasons for pegging the threshold of liability at knowledge of wrongdoing." 551 U.S. at 57 n.9, 127 S.Ct. 2201.

Defendants concede that numerous courts have found that willfulness in the civil FBAR context includes reckless conduct. (ECF No. 106 at 11.) *See United States v. Williams*, 489 Fed.Appx. 655, 658 (4th Cir. 2012) (reversing the district court's ruling, as "at a minimum, Williams's undisputed actions establish reckless conduct, which satisfies the proof requirement under § 5314"); *United States v. Kelley–Hunter*, 281 F.Supp.3d 121, 124 (D.D.C. 2017); *United States v. Katwyk*, No. CV 17-3314-GW, 2017 WL 6021420, at *4 (C.D. Cal. Oct. 23, 2017); *Bedrosian v. United States*, Civ. No. 15-5853, 2017 WL 4946433, at *3 (E.D. Pa. Sept. 20, 2017); *United States v. Bohanec*, 263 F.Supp.3d 881, 888–89 (C.D. Cal. 2016); *United States v. Bussell*, No. CV 15-02034 SJO, 2015 WL 9957826, at *5 (C.D. Cal. Dec. 8, 2015); *United States v. McBride*, 908 F.Supp.2d 1186, 1204 (D. Utah 2012); *United States v. Williams*, No. 1:09-cv-437, 2010 WL 3473311, at *4 (E.D. Va. Sept. 1, 2010), *rev'd on other grounds, Williams*, 489 Fed.Appx. 655.[5]

Defendants cite no case in which a court has held to the contrary. Rather, despite the clear distinction the Supreme Court has drawn between willfulness in the civil and criminal contexts, the cases Defendants principally rely on are criminal cases. *See Ratzlaf v. United States*, 510 U.S. 135, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994) (holding that the government had to prove defendant acted with knowledge that his conduct was unlawful to sustain a criminal conviction for a willful violation of an antistructuring provision); *United States v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1991) (applying the standard for willfulness articulated in *Cheek v. United States*, 498 U.S. 192, 111 S.Ct. 604, 112 L.Ed.2d 617 (1991), "voluntary, intentional violation of a known legal duty," to criminal violations of 31 U.S.C. § 5314). As the Supreme Court has made clear, those criminal cases do not control this case. *See Safeco*, 551 U.S. at 57 n.9, 127 S.Ct. 2201. *See also Lefcourt v. United States*, 125 F.3d 79, 82–83 (2d Cir. 1997) (distinguishing *Cheek* in tax civil penalty case requiring showing of "conduct that is willful, a term which in this context requires only that a party act voluntarily in withholding requested information, rather than accidentally or unconsciously": "*Cheek* was a criminal case, and we are persuaded that its rationale does not apply in the context of the civil tax penalties at issue here."). *Cf. Farmer v. Brennan*, 511 U.S. 825, 836–37, 114 S.Ct. 1970, 128 L.Ed.2d 811 (1994) (contrasting the different uses of the term "recklessness" in civil and criminal contexts).

***7** Defendants point to no other authority that would warrant deviating from the Supreme Court's holdings that statutory willfulness in the civil context covers reckless conduct. I therefore conclude that the Government may prove the element of willfulness in this case with evidence that Mr. Garrity, Sr. acted recklessly.

III. Conclusion

For the reasons discussed above, I find that the Government must prove the elements of its claim for a judgment under 31 U.S.C. § 5321(a)(5) by a preponderance of the evidence and that proof of reckless conduct will satisfy the Government's burden on the element of willfulness.

IT IS SO ORDERED.

All Citations

--- F.Supp.3d ----, 2018 WL 1611387, 121 A.F.T.R.2d 2018-1342

Footnotes

[1] Chief Counsel Memorandum 200603026 (January 20, 2006) provides the following guidance on the standard of proof applicable to the section 5321(a)(5) penalty for willful violations:

> A second question in the November 23 memorandum, with respect to the willfulness issue, is whether the criteria for assertion of the civil FBAR penalty are the same as the burden of proof that the Service has when asserting the civil fraud penalty under IRC section 6663. Although there are no cases that address this issue with respect to the civil

> FBAR penalty, we expect the answer to be yes. This is because of the inherent difficulty of proving, or disproving, a state of mind (willfulness) at the time of a violation.
>
> The burden of proof for criminal cases for establishing willfulness is to provide proof "beyond a reasonable doubt." Although the same definition for willfulness applies [for civil cases] ("a voluntary intentional violation of a known legal duty"), the Service would have a lesser burden of proof to meet with respect to the civil FBAR penalty than the criminal penalty. We expect that a court will find the burden in civil FBAR cases to be that of providing "clear and convincing evidence," rather than merely a "preponderance of the evidence." The clear and convincing evidence standard is the same burden the Service must meet with respect to civil tax fraud cases where the Service also has to show the intent of the taxpayer at the time of the violation. Courts have traditionally applied the clear and convincing standard with respect to fraud cases in general, not just to tax fraud cases, because just as it is difficult to show intent, it is also difficult to show a lack of intent. The higher standard of clear and convincing evidence offers some protection for an individual who may be wrongly accused of fraud.

(ECF No. 106–1 at 3.) Defendants concede that the Chief Counsel Memorandum does not bind the Court. (ECF No. 106 at 5.) *See* 26 U.S.C. § 6110(k)(3) ("Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent."); *Bohanec*, 263 F.Supp.3d at 889 (holding that the Chief Counsel of the Internal Revenue Service's opinion on the willfulness standard was irrelevant) (internal citations omitted).

2 Defendants argue that they may be liable for at least $936,691.00 for a willful FBAR violation, compared to $621.00 if the Government had instead filed a civil tax fraud action. (ECF No. 106 at 3.)

3 In light of the presumption in favor of applying the preponderance standard in all civil actions, the few structural similarities that Defendants point out between the civil FBAR statute and the civil tax fraud statute are not sufficient to warrant applying a higher standard of proof. (*See* ECF No. 106 at 2–3.) It is also worth noting that the Second and Eighth Circuits have applied the preponderance of the evidence standard to the tax statute imposing civil penalties for aiding and abetting tax underpayments, i.e., 26 U.S.C. § 6701. *See Barr v. United States*, 67 F.3d 469 (2d Cir. 1995); *Mattingly v. United States*, 924 F.2d 785 (8th Cir. 1991). In doing so, the *Mattingly* decision, on which the *Barr* decision relied, suggested that the clear and convincing evidence standard is limited to civil tax fraud cases brought under 26 U.S.C. § 7454(a), which requires proof of "fraud with intent to evade tax." 26 U.S.C § 7454(a); *Mattingly*, 924 F.2d at 787 ("[A]bsent fraud with the intent to evade tax pursuant to § 7454(a), a preponderance standard is applicable in civil tax cases.").

4 Defendants cite *Lamoureux v. AnazaoHealth Corp.*, No. 3:03CV01382 (WIG), 2012 WL 12537933 (D. Conn. Sept. 24, 2012) (applying the clear and convincing evidence standard in a patent infringement case under 35 U.S.C. § 282). The Supreme Court explicitly held in *Microsoft Corp. v. i4i Ltd. Partnership*, 564 U.S. 91, 131 S.Ct. 2238, 180 L.Ed.2d 131 (2011), that the clear and convincing evidence standard governed proof of a patent's invalidity because of the specific language of 35 U.S.C. § 282, which includes a presumption of patent validity.

5 Defendants cite *United States v. Zwerner*, a non-precedential civil FBAR case in which the Southern District of Florida denied the government's summary judgment motion on the defendant's liability. But the *Zwerner* Court did not decide the issue, instead denying summary judgment because "[u]nder either intent standard, genuine issues of material fact remain[ed] in dispute." *United States v. Zwerner*, No. 13-22082-CIV, 2014 WL 11878430, at *3 (S.D. Fla. Apr. 29, 2014).

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134 Fed.Cl. 368
United States Court of Federal Claims.

Larry D. JARNAGIN and Linda Jarnagin, Plaintiffs,
v.
The UNITED STATES of America, Defendant.

No. 15–1534T
|
(Filed: November 30, 2017)

Synopsis
Background: Taxpayers, a dual United States–Canadian citizen and a United States citizen with Canadian residency status, brought action against United States, alleging that IRS wrongfully assessed and collected penalties based on taxpayers' failure to file IRS form entitled "Report of Foreign Bank and Financial Accounts" (FBAR) regarding taxpayers' Canadian bank account, as required by Bank Secrecy Act. Parties cross-moved for summary judgment.

Holdings: Upon transfer, the Court of Federal Claims, Kaplan, J., held that:

[1] Court of Federal Claims had subject matter jurisdiction over taxpayers' claim under the Tucker Act, and

[2] taxpayers' failure to file FBARs was not due to reasonable cause, and thus taxpayers were not entitled to refund of penalties assessed.

Plaintiffs' motion denied, and defendant's motion granted.

Attorneys and Law Firms

***369** Jason M. Silver, Scottsdale, AZ, for Plaintiffs.

Jason S. Selmont, U.S. Department of Justice, Tax Division, Court of Federal Claims Section, Washington, DC, with whom were Blaine G. Saito, Trial Attorney, David I. Pincus, Chief, Court of Federal Claims Section, and David A. Hubbert, Acting Assistant Attorney General, for Defendant.

Keywords: Tax Refund; Illegal Exaction; IRS; Bank Secrecy Act; Report of Foreign Bank and Financial Accounts; FBAR; Reasonable Cause; Ordinary Business Care and Prudence.

OPINION AND ORDER

KAPLAN, Judge.

In this case, plaintiffs Larry and Linda Jarnagin, husband and wife, assert that the IRS wrongfully assessed and collected penalties from them for the 2006, 2007, 2008, and 2009 tax years based on their failure to file certain reports regarding their foreign bank account as required by the Bank Secrecy Act. Mr. Jarnagin, a dual U.S.–Canadian citizen, and Mrs. Jarnagin, a U.S. citizen with Canadian residency status, do not dispute that they owned an account at the Canadian Imperial Bank of Commerce during each of the tax years at issue. They also do not dispute that they were required by law to file a report regarding that account with the IRS for each of those years and that they failed to do so. They assert instead that their failure to file the reports was due to reasonable cause and that the IRS was therefore barred from assessing and collecting the penalty by 31 U.S.C. § 5321(a)(5)(B)(ii).

For the reasons set forth below, the Court concludes that the Jarnagins did not exercise ordinary business care and prudence with respect to their obligation to file the reports at issue and thus cannot avail themselves of the reasonable cause defense. Accordingly, the government's motion for summary judgment is **GRANTED** and the Jarnagins' motion for summary judgment is **DENIED**.

BACKGROUND

I. The Statutory Framework

In 1970, Congress enacted the Bank Secrecy Act, Pub. L. No. 91–508, 84 Stat. 1114, in order to address its concerns over "the use by American residents of foreign financial facilities located in jurisdictions with various types of secrecy laws." H.R. Rep. No. 91–075 (1970), reprinted in 1970 U.S.C.C.A.N. 4394, 4395. "[C]onsiderable testimony" had been presented to Congress regarding "serious ***370** and widespread use of foreign financial facilities located in secrecy jurisdictions for the purpose of violating American law." Id. at

4397. In the Bank Secrecy Act, Congress responded by imposing on residents, citizens, or persons doing business in the United States a requirement that they keep records and make reports concerning certain foreign accounts and transactions. 31 U.S.C. § 5314(a) (2006)[1]; see also id. § 5311 (stating that the "purpose" of the Act is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism").

The statute thus provides, in pertinent part, that "the Secretary of the Treasury shall require a resident or citizen of the United States ... to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency." Id. § 5314(a). The Secretary of the Treasury has issued regulations implementing the statutory requirements. They state, in pertinent part, as follows:

> Each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner of Internal Revenue for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. 5314 to be filed by such persons.

31 C.F.R. § 1010.350(a) (2016).[2] The reporting form prescribed under 31 U.S.C. § 5314 and referenced in the regulation is Form TD–F 90–22.1 (entitled "Report of Foreign Bank and Financial Accounts"). Id.[3] Under the regulations, the form must be filed "on or before June 30 of each calendar year with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year." Id. § 1010.306(c) (previously codified at 31 C.F.R. § 103.27).

The statute authorizes the Secretary of the Treasury to impose a civil monetary penalty of not more than $10,000 for failure to file the Form TD–F 90–22.1. See 31 U.S.C. § 5321(a)(5) (providing that if "any person ... violates, or causes any violation of, any provision of section 5314," then "[t]he Secretary of the Treasury may impose a civil money penalty," not to exceed $10,000). "No penalty shall be imposed ... with respect to any violation," however, "if—(I) such violation was due to reasonable cause, and (II) the amount of the transaction or the balance in the account at the time of the transaction was properly reported." Id. § 5321(a)(5)(B)(ii).

II. Undisputed Facts

A. The Jarnagins' Educational and Business Backgrounds

Plaintiff Larry Jarnagin is a high school graduate. Def.'s Am. App. B Ex. 3 at 9, ECF No. 22–1. Although he does not have a college degree, he took courses at New Mexico Western University in approximately 1963 or 1964. See id. In addition, Mr. Jarnagin completed both barbering school and chiropractic school, and practiced professionally as a chiropractor for five years. Id. at 9–10. Mr. Jarnagin also owned and operated a number of barbershops in New Mexico. Id. at 13.

Linda Jarnagin attended multiple community colleges in Iowa and New Mexico in the 1960s and 1970s, taking classes in elementary education. Id. Ex. 4 at 8–9. She did not obtain a degree. Id. In the late 1970s, Mrs. Jarnagin took classes at a vocational technical school in order to obtain a real estate ***371** broker's license. Id. at 11. In approximately 1978, she passed her licensing exam. See id. at 9, 11–12. For about the next four years, Mrs. Jarnagin worked as a real estate broker. Id. at 14–15.

The Jarnagins were married in 1966. Id. at 8. They moved to Oklahoma around 1971, where Mr. Jarnagin, in addition to barbering, became a cattle farmer and began buying and selling farms. Id. Ex. 3 at 13. He also began buying, selling, and leasing oil and mineral rights. Id. at 16. Mr. Jarnagin has since continuously been involved in the real estate business. See id. at 16–17. He has set up and used corporations, limited liability companies, and "C Corps" for the purpose of buying and selling property. Id. at 17.

In the early- to mid–1980s, Mr. Jarnagin bought property in Canada and began operating his own ranch in British Columbia. Id. at 18–20. In 1986, the Jarnagins immigrated to Canada. Id. at 19. In 1989, Mr. Jarnagin became a Canadian citizen. Id. He currently resides in Canada approximately nine to ten months out of the year. Id. at 95. Mrs. Jarnagin spends more of her time in Oklahoma than in Canada. See id. at 95–96; see also id. Ex. 4 at 53; id. Ex. 5 at 30–31.

In the early 1990s, the Jarnagins purchased a number of apartment complexes in Oklahoma. Id. Ex. 3 at 20–21. At one point, they owned as many as six different properties. See id. Ex. 4 at 18. Mrs. Jarnagin "actively manage [d]" them. Id. Ex. 3 at 21. She served as the "property supervisor" and oversaw on-site managers, maintenance, and landscaping. Id. Ex. 4 at 18. In the 2000s, the Jarnagins sold or transferred the apartment complexes. Id. at 18–19. In particular, in 2006, the Jarnagins engaged in a property exchange known as a "1031," whereby they exchanged one of the apartment complexes for a shopping center in Oklahoma City, which they still own.[4] Id. at 19.

The Jarnagins also became owners of a nightclub in Phoenix, Arizona in the mid- or late–1990s, by virtue of their status as creditors in a bankruptcy proceeding. See id. Ex. 3 at 22; id. Ex 4 at 20. Ultimately, Mrs. Jarnagin went to Phoenix and took over the operations of the nightclub directly. See id. Ex. 3 at 22–23; id. Ex. 4 at 20–21. In 2006, the property was taken by the city of Phoenix through its power of eminent domain. Id. Ex. 4 at 22.

B. The Jarnagins' Canadian Bank Account and Their 2006–2009 Personal Income Tax Returns

In 1986, the Jarnagins opened a bank account in Canada at the Canadian Imperial Bank of Commerce. See id. Ex. 3 at 26–27. They continued to own and maintain this account throughout 2006, 2007, 2008, and 2009. Id. Ex 1 at 1–3, 6. At the end of 2006, the Jarnagins' account had a balance of $4,000,000. Id. at 1. At the end of 2007, the account had a balance of $3,500,000. Id. at 2. At the end of 2008, it had a balance of $3,850,000. Id. And in 2009, the account had a balance of at least $1,870,000. See id. at 2–3; see also id. Ex. 31 at 2, ECF No. 22–9.

For tax years 2006 through 2009, the Jarnagins filed joint Form 1040 Individual Income Tax Returns. Id. Ex. 7, ECF No 22–2; id. Ex. 8, ECF No. 22–4; id. Ex. 9, ECF No. 22–6; id. Ex. 10, ECF No. 22–7. Schedule B of each of those tax returns contained a section entitled "Part III Foreign Accounts and Trusts." See, e.g., id. Ex. 7 at 5. In that section, line 7a required a response to the following question:

> At any time during [the relevant tax year], did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?

Id. The form then contained checkboxes for answering the question either yes or no and directed filers to "[s]ee instructions for exceptions and filing requirements for Form TD F 90–22.1." Id.

***372** On their 2006, 2007, 2008, and 2009 tax returns, the Jarnagins' accountants (see below) checked the "no" box in response to line 7a, notwithstanding that the Jarnagins maintained a bank account in Canada during those years. Id.; id. Ex. 8 at 8; id. Ex 9 at 4; id. Ex. 10 at 4. In addition, the Jarnagins did not file an FBAR reporting their Canadian bank account during any of those years. Id. Ex. 1 at 3–6.

C. The Jarnagins' Bookkeeper

The Jarnagins employed the services of a bookkeeper—Misty Fairchild—to help manage the financial aspects of their businesses and to provide information to the accountants who prepared their tax returns (see below). Ms. Fairchild first began to perform bookkeeping services for the Jarnagins in January 1997 while she was still in college. Id. Ex. 3 at 34; id. Ex. 4 at 25; id. Ex. 5 at 12. The Jarnagins hired her because of the friendship between Mrs. Jarnagin and Ms. Fairchild's mother, and because Mrs. Jarnagin had learned that Ms. Fairchild was studying to be an accountant. Id. Ex. 4 at 25.

Ms. Fairchild initially helped manage the Jarnagins' apartments by keeping track of income and expenses at the properties. Id. Ex. 3 at 38. Her duties later expanded to include preparing annual financial statements for the Jarnagins and other daily financial management and bookkeeping tasks. See id. Ex. 4 at 27–28, 66–68; id. Ex. 5 at 13; see also id. Exs. 11–13. Ms. Fairchild was aware that the Jarnagins had a Canadian bank account. Id. Ex. 5 at 44–45. She did not, however, have any knowledge of or experience related to international tax matters. Id. Ex. 3 at 39; id. Ex. 4 at 26; id. Ex. 5 at 66. Nor did she know anything about filing tax returns for a person with foreign sources of income. Id. Ex. 5 at 67.

In 1998, Ms. Fairchild graduated from Southwestern Oklahoma State University with a bachelor's degree in accounting with a minor in finance. Id. Ex. 5 at 9. In 2000, she obtained her master's degree in business administration. Id. Ms. Fairchild then became a licensed certified public accountant (CPA) in 2002. Id. at 10. She continued to work for the Jarnagins during this period.

In August 2004, Ms. Fairchild took a position as a comptroller with a bank. Id. at 12, 14–15; id. Ex. 4 at 25–26. She nonetheless continued to perform bookkeeping and accounting-type work in a part-time, consulting role for the Jarnagins. Id. Ex. 5 at 15. While working in the banking industry, Ms. Fairchild did not have any responsibilities for or experience with international tax or cross-border issues. Id. at 19, 23. In 2010, Ms. Fairchild left the banking industry and opened an accounting firm with her brother, Kyle Zybach (discussed below). Id. at 23.

D. The Jarnagins' Accountants

The Jarnagins did not personally prepare their income tax returns for tax years 2006 through 2009. See id. Ex. 3 at 30–31. Instead, they employed the services of accountants in both Canada and the United States to prepare and file their Canadian and U.S. tax returns, respectively. See id. at 30–34.

Prior to the tax years at issue in this case, the Jarnagins' U.S. tax returns were prepared by James Crook, an accountant and former IRS employee. Id. at 33, 43. After Mr. Crook passed away in 2005, his firm continued to prepare the Jarnagins' tax returns, starting with their return for 2005, which was prepared by Mike Gordon. See id. at 33–34, 49–50; id. Ex. 4 at 33–34; id. Ex. 16 ¶ 15. The Jarnagins testified that Mr. Gordon was a CPA but that they otherwise had "no idea" what his qualifications were and did not know whether or not he had any knowledge about, or experience with, issues of international taxation. Id. Ex. 4 at 34–35; see also id. Ex. 3 at 50.

Shortly thereafter, Mr. Gordon passed away and Mr. Crook's widow took over the preparation of the Jarnagins' tax returns for tax years 2006 and 2007. Id. Ex. 3 at 50; see also id. Ex. 7 at 3 (the Jarnagins' 2006 tax return reflecting Marie Crook as tax preparer); id. Ex. 8 at 3 (the Jarnagins' 2007 tax return showing the same). Mr. Jarnagin was unsure of Mrs. Crook's qualifications and did not know whether or not she was a CPA. Id. Ex. 3 at 52–53.

For tax years 2008 and 2009, the Jarnagins turned to a new accountant, Kyle Zybach, the ***373** brother of Ms. Fairchild, their bookkeeper. See id. at 34; id. Ex. 9 at 2; id. Ex. 10 at 2. The Jarnagins knew that Mr. Zybach was a CPA but did not know or inquire whether he had any knowledge about or experience with international tax matters. Id. Ex. 3 at 55. Mr. Zybach testified that he had no such prior experience. Id. Ex. 6 at 10–11.

The Jarnagins never expressly informed Mr. Gordon, Mrs. Crook, or Mr. Zybach that they maintained a bank account in Canada. See id. Ex. 3 at 45–46, 56; id. Ex. 4 at 37–38; see also id. Ex. 6 at 23. Nor did the Jarnagins provide any statements from the Canadian account to any of their U.S. accountants. See id. Ex. 3 at 45–46, 51–52, 54–56; see also id. Ex. 4 at 37.

Both Mr. and Mrs. Jarnagin testified that they believed their accountants would have been aware that they maintained a bank account in Canada because their Canadian businesses and residence were common knowledge. See id. Ex. 3 at 44–46, 50–51, 56; id. Ex. 4 at 37–38, 68–69, 71–72. In addition, the Jarnagins' annual financial statements (which they supplied to their U.S. accountants) contained references to a Canadian bank account. Id. Ex. 11 at 2; id. Ex. 12 at 2; id. Ex. 13 at 2 (financial statements provided by the Jarnagins to their U.S. accountants for 2006, 2007, and 2008 listing a personal "CD/Savings" account at "CIBC" in Canadian dollars); see also id. Ex. 3 at 44–46, 50–51, 56; id. Ex. 4 at 37–38, 68–69, 71–72. The Jarnagins also believed that their U.S. accountants would have inferred the existence of a Canadian bank account given that they were required to send the Jarnagins' U.S. tax information to Canadian accountants each year so that those accountants could file the Jarnagins' Canadian tax returns. See id. Ex. 3 at 44–45; id. Ex. 4 at 36–38; see also id. Ex. 5 at 45–46.

The record supports the Jarnagins' expectation that their U.S. accountants would have known of their Canadian bank account notwithstanding the Jarnagins' failure to directly draw their U.S. accountants' attention to its existence. Thus, Mr. Zybach testified that while he did not recall ever being directly told about the Canadian account, he was aware of it "from [his] prior experience and from looking at the financial statements that were provided." Id. Ex. 6 at 23.

E. The Jarnagins' Role in Preparing Their Tax Returns

The Jarnagins had little involvement in the preparation of their tax returns for tax years 2006 through 2009. Mr. Jarnagin explained that "[b]asically, we handed everything over to the accountants, [said] '[h]ere, take care of it and tell us how much we owe,' and that's about it." Id. Ex. 3 at 44; see also id. at 57–58. Similarly, Mrs. Jarnagin testified that they "just turned everything over to [Mr. Gordon] that needed to be done." Id. Ex. 4 at 44–45. She also recalled that the Jarnagins played a similarly passive role when Mr. Zybach prepared their returns; she did not remember any discussions regarding tax planning, only rare meetings to provide records. Id. at 45–46.

Mr. and Mrs. Jarnagin both signed their names under the declaration contained at the end of the Forms 1040 that they filed for each of the years at issue in this case. Id. Ex. 7 at 3; id. Ex. 8 at 3; id. Ex. 9 at 2; id. Ex. 10 at 2; see also id. Ex. 4 at 50–51, 57, 62–63. Those declarations read as follows:

> Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.

E.g., id. Ex. 10 at 2.

Notwithstanding this declaration, however, Mr. Jarnagin testified that he did not review his 2006 tax return prior to filing it. Id. Ex. 3 at 59–60. Nor did he ask any questions of Mrs. Crook or anyone else at her firm regarding the return. Id. Mr. Jarnagin also did not review the tax returns his U.S. accountants filed in tax years 2007, 2008, and 2009. Id. at 64–66, 68–69, 71–72.

Mrs. Jarnagin testified that she did not "usually have time to review [the returns], but [she did] look to see how much [they] owe[d]." Id. Ex. 4 at 48. She thus did not review the 2006, 2007, 2008, or 2009 tax returns other than to learn the amount of tax owed. See id. at 48, 52–53, 56–58, 62–63; see also id. Ex. 6 at 22 (Kyle Zybach testifying ***374** that the Jarnagins "normally didn't really want to look over the whole return, just kind of the 1040, total income, how much tax do [they] owe or what are [they] getting a refund for" and that he did not sit down with the Jarnagins to go over their returns).

F. Penalties Imposed by the IRS

On June 28, 2012, the IRS sent separate letters to Mr. and Mrs. Jarnagin "proposing a penalty for violating the reporting or record keeping requirements relating to accounts [they] maintain with financial institutions overseas." Id. Ex. 28 at 1; id. Ex. 29 at 1. Specifically, the IRS informed the Jarnagins that it was "proposing the assessment of a penalty under 31 U.S.C. § 5321(a)(5) for failing to meet the filing requirements of 31 U.S.C. § 5314." Id. Ex. 28 at 1; id. Ex. 29 at 1. The total proposed penalty was $100,000, representing $10,000 each for Mr. and Mrs. Jarnagin for each tax year 2006 through 2010, inclusive, based upon their failure to report their bank account at the Canadian Imperial Bank of Commerce. Id. Ex. 28 at 5; id. Ex. 29 at 5.

The Jarnagins disputed the proposed penalties with the IRS in August 2012. Compl. Ex. C, ECF No. 1. Ultimately, in late 2015, the IRS agreed to withdraw its proposed penalty for 2010, but asserted that the Jarnagins were liable for the "Report of Foreign Bank and Financial Accounts (FBAR) penalty" for 2006, 2007, 2008, and 2009, and demanded payment of $40,000 each from Mr. and Mrs. Jarnagin. See Compl. Exs. A–B; Def.'s Am. App. B Exs. 30–31.

On November 10, 2015, Mr. and Mrs. Jarnagin each paid a $40,000 FBAR penalty. Compl. Ex. B. On November 13, 2015, the Jarnagins filed a Form 843, seeking an abatement and refund of the penalty amounts paid. Compl. Ex. C. The Jarnagins allege that the IRS denied that request. Compl. ¶ 11.

III. This Action

On December 16, 2015, the Jarnagins filed the present suit. ECF No. 1. In their complaint they assert one count, which is entitled "Wrongful Assessment and Collection of Penalties." Id. at 3. The Jarnagins allege that their "failure to file a[n] FBAR for tax years 2006, 2007, 2008 and 2009, was due to reasonable cause," and that "[t]he IRS illegally or unlawfully failed to grant [the] Jarnagin[ ]s['] claims for refund of the FBAR penalties paid for tax years 2006, 2007, 2008 and 2009." Id. ¶¶ 14, 16. They seek judgment in the amount of $80,000, plus interest, attorneys' fees, and costs. Id. at 4.

This case was initially assigned to Senior Judge James F. Merow, but was transferred to the undersigned on January 11, 2017. See ECF No. 16. On March 24, 2017, the government filed a motion for summary judgment. ECF No. 19. On May 10, 2017, the Jarnagins filed their response and cross-motion for summary judgment. ECF No. 25. The parties finished briefing the cross-motions on June 30, 2017, but on August 9, 2017, the government sought leave to file a surreply. ECF No. 30. The Court granted leave the next day. ECF No. 31. The Jarnagins then filed their own surreply on August 23, 2017. ECF No. 33. On November 20, 2017, the Court held oral argument on the parties' cross-motions. See Order, ECF No. 35.

DISCUSSION

I. Subject Matter Jurisdiction

[1] Neither party has substantively addressed in its briefs the Court's subject matter jurisdiction over this case. Subject matter jurisdiction, however, is a threshold matter, Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 94–95, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998), and the Court has "an independent obligation to determine whether subject matter jurisdiction exists, even in the absence of a challenge from any party," Arbaugh v. Y & H Corp., 546 U.S. 500, 514, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006).

[2] The Tucker Act grants the Court of Federal Claims jurisdiction "to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." ***375** 28 U.S.C. § 1491(a) (2012). Under this grant, the court may assert jurisdiction over a complaint (such as this one) alleging an illegal exaction if the plaintiff alleges that "money ... was 'improperly paid, exacted, or taken from the claimant in contravention of the Constitution, a statute or a regulation.' " Norman v. United States, 429 F.3d 1081, 1095 (Fed. Cir. 2005) (quoting Eastport S.S. Corp. v. United States, 178 Ct. Cl. 599, 605, 372 F.2d 1002 (1967)); see also Aerolineas Argentinas v. United States, 77 F.3d 1564, 1572–73 (Fed. Cir. 1996) (observing that "Tucker Act claims may be made for recovery of monies that the government has required to be paid contrary to law"); S. P.R. Sugar Co. Trading Corp. v. United States, 167 Ct. Cl. 236, 244–45, 334 F.2d 622 (1964) (finding that "[u]nder [the Tucker Act], suit can be brought in this court to recover exactions said to have been illegally imposed by federal officials (except where Congress has expressly placed jurisdiction elsewhere)"); Clapp v. United States, 127 Ct. Cl. 505, 513, 117 F.Supp. 576 (1954) (stating that "a claim to recover an illegal exaction made by officials of the Government, which exaction is based upon a power supposedly conferred by a statute, is a claim founded upon any Act of Congress").

[3] Here, the Jarnagins assert that the government's assessment and collection of FBAR penalties was unlawful because 31 U.S.C. § 5321(a)(5) contains a prohibition on penalties where, inter alia, the taxpayer has reasonable cause for failing to file an FBAR. Thus, because the government based its exaction upon an asserted statutory power and because the Jarnagins claim that the penalty was exacted in contravention of that statute, the Jarnagins' claim is one for an illegal exaction and the Court has subject matter jurisdiction over it.

II. Summary Judgment Standards

The standards for granting summary judgment are well established. Summary judgment may be granted where there is no genuine issue of material fact and the movant is entitled to judgment as a matter of law. Rule 56(a) of the Rules of the Court of Federal Claims; Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). A fact is material if it "might affect the outcome of the suit under the governing law." Anderson, 477 U.S. at 248, 106 S.Ct. 2505. An issue is genuine if it "may reasonably be resolved in favor of either party." Id. at 250, 106 S.Ct. 2505.

The moving party bears the burden of demonstrating the absence of any genuine issue of material fact. Conroy v. Reebok Int'l, Ltd., 14 F.3d 1570, 1575 (Fed. Cir. 1994); see also Celotex Corp. v. Catrett, 477 U.S. 317, 322–23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). All significant doubts regarding factual issues must be resolved in favor of the party opposing summary judgment. Mingus Constructors, Inc. v. United States, 812 F.2d 1387, 1390 (Fed. Cir. 1987). "[T]he party opposing summary judgment must show an evidentiary conflict on the record; mere denials or conclusory statements are not sufficient." Id. at 1390–91. "[E]ntry of summary judgment is appropriate against a [party] 'who fails to make a showing sufficient to establish the existence of an essential element to [its] case, and on which [it] will bear the burden of proof at trial.' " Zafer Taahhut Insaat ve Ticaret A.S. v. United States, 833 F.3d 1356, 1362–63 (Fed. Cir. 2016) (quoting Celotex Corp., 477 U.S. at 322, 106 S.Ct. 2548) (third and fourth alterations in original).

III. The Parties' Cross–Motions for Summary Judgment

In this case, there is no genuine dispute as to any material fact or as to whether the Jarnagins violated the law when they failed to file FBARs for tax years 2006–2009. The disagreement between the parties is whether, as a matter of law, the Jarnagins qualify for an exception to the statutory penalty because "the violation[s were] due to reasonable cause, and ... the amount of the transaction or the balance in the account at the time of the transaction was properly reported." 31 U.S.C. § 5321(a)(5)(B)(ii); see also Br. in Opp'n to Def.'s Mot. for Summ. J & in Supp. of Pls.' Cross–Mot for Summ. J. (Pls.' Br.) at 14, ECF No. 25 (stating that "Plaintiffs are liable for the non-willful FBAR penalty, except that reasonable cause exists and such is ***376** a defense to the imposition of the non-willful FBAR penalty").

The Jarnagins argue that they have established reasonable cause for failing to file FBARs for 2006, 2007, 2008, and 2009. Pls.' Br. at 6. They assert that: 1) "they hired a competent CPA to prepare all required forms"; 2) "the CPA was aware of the CIBC account in Canada through the financial statements provided to him by Plaintiffs before he filed the returns"; and 3) "Plaintiffs actually relied in good faith on the CPA." Id. In short, the Jarnagins argue, "they relied upon their CPA[s] as it related to their tax returns, which is all that is required." Id. at 20.

For the reasons set forth below, the Court concludes that, as a matter of law, the Jarnagins have not established reasonable cause for their violations of the reporting requirement. Accordingly, they do not qualify for an exception from the statutory penalty provision and their request for reimbursement of the penalties paid lacks merit. [5]

A. Reasonable Cause Standard

Neither the statute nor its corresponding regulations define "reasonable cause," and there is little case law regarding the meaning and application of the reasonable cause standard under 31 U.S.C. § 5321(a)(5)(B)(ii). See id. § 5312; see also 31 C.F.R. § 1010.100. Sections 6651(a) and 6664(c)(1) of the Internal Revenue Code and their implementing regulations, however, use and define the phrase in the tax compliance context. Accordingly, the Court finds those provisions instructive in construing the reasonable cause standard applicable here. See Bragdon v. Abbott, 524 U.S. 624, 631, 118 S.Ct. 2196, 141 L.Ed.2d 540 (1998) (stating that "Congress' repetition of a well-established term carries the implication that Congress intended the term to be construed in accordance with pre-existing regulatory interpretations"); see also Moore v. United States, No. C13-2063RAJ, 2015 WL 1510007, at *4 (W.D. Wash. Apr. 1, 2015) (concluding that "[t]here is no reason to think that Congress intended the meaning of 'reasonable cause' in the Bank Secrecy Act to differ from the meaning ascribed to it in tax statutes").

The first of those provisions, 26 U.S.C. § 6651(a), prescribes penalties for failing to timely file certain returns or to pay particular taxes "unless it is shown that such failure is due to reasonable cause and not due to willful neglect." The regulations implementing § 6651 equate the reasonable cause standard with a standard of ordinary business care and prudence. See 26 C.F.R. § 301.6651–1(c)(1) (stating that "[i]f the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause" and that "[a] failure to pay will be considered to be due to reasonable cause to the extent the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship ... if he paid on the due date"); see also United States v. Boyle, 469 U.S. 241, 246 n.4, 105 S.Ct. 687, 83 L.Ed.2d 622 (1985) (holding that IRS's "correlation [in its regulation] of 'reasonable cause' with 'ordinary business care and prudence' is consistent with Congress' intent, and over 40 years of case law" and "merits deference").

Similarly, 26 U.S.C. § 6664(c)(1) states that "[n]o penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion." [6] IRS regulations, in turn, state that with respect to § 6662 underpayments, "[t]he determination of whether a taxpayer acted with reasonable ***377** cause ... is made on a case-by-case basis, taking into account all pertinent facts and circumstances." 26 C.F.R. § 1.6664–4(b)(1). They provide that "[g]enerally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability." Id. The regulations further state that "[c]ircumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer." Id. They advise that "[r]eliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reasonable cause and good faith." Id. "Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith." Id.

The regulations contain examples that illustrate "reasonable cause," and include circumstances in which the taxpayer engages a "professional tax advisor," provides him or her with "full details," and relies upon his or her "advice." Id. § 1.6664–4(b)(2). The regulation defines the word "advice" as "any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly." Id. § 1.6664–4(c)(2).

On the other hand, if the taxpayer "sought advice from someone that [he] knew, or should have known, lacked knowledge in the relevant aspects of Federal tax law, or if other facts demonstrate that [he] failed to act reasonably or in good faith, [he] would not be considered to have shown reasonable cause." Id. § 1.6664–4(b)(2). Additionally, the taxpayer's education, sophistication, and business experience must be considered, "the advice must be based upon all pertinent facts and circumstances," and the advice must not be based on unreasonable factual or legal assumptions. Id.

B. Whether the Jarnagins Have Reasonable Cause for Failing to File the FBARs

[4] In light of the foregoing, the Court concludes that in order to show reasonable cause under 31 U.S.C. § 5321(a)(5)(B)(ii), the Jarnagins must establish that they exercised "ordinary business care and prudence" with respect to their obligation to file FBARs for tax years 2006 through 2009. As noted, they assert that they have met their burden of proving their entitlement to the defense by showing that 1) "they hired a competent CPA to prepare all required forms"; 2) "the CPA was aware of the CIBC account in Canada through the financial statements provided to him by Plaintiffs before he filed the returns"; and 3) "Plaintiffs actually relied in good faith on the CPA." Pls.' Br. at 6.

For purposes of ruling on the cross-motions for summary judgment, the Court assumes that the accountants the Jarnagins hired were "competent ... to prepare all required forms" and were aware that the Jarnagins had a bank account in Canada. Nonetheless, the Court concludes that, as a matter of law, the Jarnagins did not exercise ordinary business care and prudence in the handling of their reporting obligations.

First, as noted above, IRS regulations specify that in determining reasonable cause, "the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability." 26 C.F.R. § 1.6664–4(b)(1). The Jarnagins have owned multiple businesses in multiple states and in two countries, yet they apparently did not have any substantive discussions with any of their American accountants about their taxes, did not review their tax returns, and did not specifically identify their Canadian bank account to their American accountants or ask for any advice with respect to that account. Further, while the Jarnagins relied upon their accountants to fill out their tax returns, the record contains no evidence that they otherwise sought advice (legal or otherwise) concerning any obligations that they might have had to file reports or make disclosures concerning their foreign assets or businesses.

Second, ordinary business care and prudence would require that the Jarnagins personally ***378** read and review their completed tax returns carefully. Each year the Jarnagins "declare[d]," "[u]nder penalties of perjury," that they "examined th[e] return and accompanying schedules and statements, and [that] to the best of [their] knowledge and belief, it [was] true, correct, and complete." Def.'s Am. App. B Exs. 7–10. Yet it is undisputed that the Jarnagins did not, in fact, read any of their tax returns before signing or filing them. Id. Ex. 3 at 59–60, 64–66, 68–69, 71–72; id. Ex. 4 at 48, 52–53, 56–58, 62–63; see also id. Ex. 6 at 22.

[5] "A taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents." United States v. Williams, 489 Fed.Appx. 655, 659 (4th Cir. 2012) (quoting Greer v. Comm'r of Internal Revenue, 595 F.3d 338, 347 n.4 (6th Cir. 2010)) (finding that taxpayer willfully violated the FBAR reporting requirement). Further, the Jarnagins had a particular obligation—given Mr. Jarnagin's dual citizenship, his business activities in Canada, and their maintenance of a Canadian bank account with millions of dollars on deposit—to attend to Part III of Schedule B, which is entitled, after all, "Foreign Accounts and Trusts." See United States v. Sturman, 951 F.2d 1466, 1476–77 (6th Cir. 1991) (finding that "[i]t is reasonable to assume that a person who has foreign bank accounts would read the information specified by the government in tax forms"); see also Williams, 489 Fed.Appx. at 659 (observing that not reading line 7a and not paying attention to tax returns "constitute[d] willful blindness to the FBAR requirement" and that line 7a "put [the taxpayer] on inquiry notice of the FBAR requirement").

Had the Jarnagins read the text of Part III, Foreign Accounts and Trusts, they would have seen the obvious error their accountants committed when they answered "no" to the question of whether the Jarnagins had "an interest in ... a financial account in a foreign country ...." Def.'s Am. App. B Ex. 7 at 5; id. Ex. 8 at 8; id. Ex. 9 at 4; id. Ex. 10 at 4. They also would have seen the admonition in that Part to "[s]ee instructions for exceptions and filing requirements for Form TD F 90–22.1." [7]

Further, any individual exercising ordinary business care and prudence would have made inquiry of their accountant about the FBAR filing requirements after having identified the clear error in the response provided to question 7a. In that regard, the Court notes again that the Jarnagins are not unsophisticated in matters of business and finance. They have been involved in multiple real estate transactions, property management, oil and gas leasing, and the management of a nightclub. See id. Exs. 3–4. They have property interests and financial accounts in two countries, and the account at issue in this case reflects substantial wealth. See id.; see also id. Ex. 1. A reasonable person, particularly one with the sophistication, investments, and wealth of the Jarnagins, would not have signed their income tax returns without reading them, would have identified the clear error committed by their accountants, and would have sought advice regarding their obligation to file a Form TD F 90–22.1.

Finally, the Court finds that the mere fact that the Jarnagins' returns were prepared by tax professionals does not excuse their failure to file FBARs. To be sure, IRS regulations provide that a taxpayer's reliance upon the advice of tax professionals may establish reasonable cause for a violation of the tax laws in appropriate circumstances. See 26 C.F.R. § 1.6664–4(c)(2) (stating that advice consists of "any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly"). But the Jarnagins neither requested nor received any advice one way or the other from their ***379** accountants regarding whether they were required to file FBARs—that is, their accountants conducted no analysis and drew no conclusions concerning the obligation, nor did they communicate any such conclusion to the Jarnagins. In fact, Mr. Zybach's testimony shows that he himself was unaware of the FBAR requirement and so could not have provided the Jarnagins any advice at all regarding their obligations to file one. The Jarnagins, in other words, cannot use as a shield reliance upon advice that they neither solicited nor received. See Russian Recovery Fund Ltd. v. United States, 122 Fed.Cl. 600, 623 (2015) (stating that "the only record plaintiff offers of 'advice' given to [it] concerning the propriety of taking the losses is the returns themselves" and that the court was thus being "asked to accept that, by signing off on the returns ... [the accounting firm] was giving its considered advice on whether it was appropriate to take the loss deduction," and rejecting the same), aff'd, 851 F.3d 1253 (Fed. Cir. 2017); see also Richardson v. Comm'r of Internal Revenue, 125 F.3d 551, 558–59 (7th Cir. 1997) ("The record shows only that her returns were signed by a tax preparer. There is no evidence that a professional, after being informed of the circumstances, advised her that she did not have taxable income in the relevant years."); Neonatology Assocs., P.A. v. Comm'r of Internal Revenue, 115 T.C. 43, 100 (2000) ("We also are unpersuaded by petitioners' assertion that they relied reasonably on the correctness of the contents of their returns simply because their returns were prepared by certified public accountants. The mere fact that a certified public accountant has prepared a tax return does not mean that he or she has opined on any or all of the items reported therein.”), aff'd, 299 F.3d 221 (3d Cir. 2002).

In fact, in Boyle, the Supreme Court rejected a similar argument by an estate that it had reasonable cause for the untimely filing of its tax return because it had relied upon the estate's tax attorney to prepare and file the return. 469 U.S. at 249–52, 105 S.Ct. 687. The Court reasoned that the duty to promptly file is “fixed and clear” and placed directly on the taxpayer, “not on some agent or employee of the [taxpayer].” Id. at 249, 105 S.Ct. 687; see also Baccei v. United States, 632 F.3d 1140, 1148 (9th Cir. 2011) (noting that “a taxpayer cannot rely on its employee or agent to escape responsibility for the nonperformance of nondelegable tax duties” and that “reliance upon [a professional advisor] to competently file a payment extension request does not constitute reasonable cause excusing [the taxpayer's] failure to timely pay the estate taxes owed” (quotation omitted)). The Court acknowledged that “[w]hen an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice.” Boyle, 469 U.S. at 251, 105 S.Ct. 687 (emphasis in original). Such “reliance” however, “cannot function as a substitute for compliance with an unambiguous statute.” Id. The Court thus held that “failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not ‘reasonable cause.’ ” Id. at 252, 105 S.Ct. 687.

In short, the Court concludes that the Jarnagins did not exercise ordinary business care and prudence and that their failure to file FBARs for the years at issue was not due to reasonable cause. Accordingly, they are not entitled to a refund of the penalties assessed against them.

CONCLUSION

For the reasons set forth above, the government's motion for summary judgment is **GRANTED** and Plaintiffs' motion for summary judgment is **DENIED**. The Clerk is directed to enter judgment accordingly. Each side shall bear its own costs.

IT IS SO ORDERED.

All Citations

134 Fed.Cl. 368, 120 A.F.T.R.2d 2017-6683, 2017-2 USTC P 50,426

Footnotes

[1] Because the penalties collected by the IRS in this matter were based on violations relating to the 2006, 2007, 2008, and 2009 tax years, the Court's citations to the United States Code are to the 2006 codification, unless otherwise noted.

[2] During the years at issue in this case, this regulation was located at 31 C.F.R. § 103.24, but was relocated without substantive change in 2011. See Transfer and Reorganization of Bank Secrecy Act Regulations, 75 Fed. Reg. 65806–01 (Oct. 26, 2010).

[3] The form is also referred to as an “FBAR.” United States v. Simon, 727 F.3d 682, 685 (7th Cir. 2013); see also 31 C.F.R. § 1010.350(g)(4).

[4] The characterization of this exchange as a “1031” is based on 26 U.S.C. § 1031. That section states in pertinent part that “[n]o gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.” Id. § 1031(a)(1).

[5] In light of the Court's conclusion that the Jarnagins' failure to file FBARs was not due to reasonable cause, it does not address the question of whether the Jarnagins have satisfied the additional criteria for the exception to the FBAR penalty—i.e., that “the amount of the transaction or the balance in the account at the time of the transaction was properly reported.” See 31 U.S.C. § 5321(a)(5)(B)(ii).

[6] Section 6662 of Title 26 concerns penalties for “accuracy-related” underpayments. Section 6663 concerns the underpayment of taxes “due to fraud.”

[7] In their defense, the Jarnagins assert that the question at line 7a on Schedule B is “in very small font.” Pls.' Br. at 4. But the caption of the section, “Part III Foreign Accounts and Trusts,” is in bold print and in the same font size as the captions for Parts I and II of Schedule B. See, e.g., Def.'s Am. App. B Ex. 7 at 5. And both the question at line 7a and the admonition regarding the FBAR filing requirement are in the exact same font size as the other lines on Schedule B and the main Form 1040. See id.

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94 S.Ct. 1494
Supreme Court of the United States

The CALIFORNIA BANKERS ASSOCIATION, Appellant,
v.
George P. SHULTZ, Secretary of the Treasury, et al.
George P. SHULTZ, Secretary of the Treasury, et al., Appellants,
v.
The CALIFORNIA BANKERS ASSOCIATION et al.
Fortney H. STARK, Jr., et al., Appellants,
v.
George P. SHULTZ et al.

Nos. 72—985, 72—1073 and 72—1196.
|
Argued Jan. 16, 1974.
|
Decided April 1, 1974.

Synopsis
Bank customers, bank, bankers' association and organization suing on behalf of itself and its bank customer members brought action to enjoin Secretary of Treasury and head of other federal agencies from enforcing provisions of the Bank Secrecy Act. A three-judge District Court for the Northern District of California, 347 F.Supp. 1242, upheld the record keeping and reporting provisions but held that the domestic reporting provisions were repugnant to the Fourth Amendment and appeals were taken. The Supreme Court, Mr. Justice Rehnquist, held that record-keeping requirements imposed by Secretary's regulations did not deprive banks of due process by imposing unreasonable burdens upon them; that the mere maintenance of records by the banks under compulsion of the regulations does not constitute a seizure; that association's claim that record-keeping requirements violated its members' First Amendment rights was premature where government had not sought disclosure of association's membership and contributors; and that depositors who did not allege engaging in the type of $10,000 domestic currency transaction requiring reporting lacked standing to challenge the domestic reporting regulations.

Affirmed in part, reversed in part and remanded.

Mr. Justice Powell joined by Mr. Justice Blackmun, filed concurring opinion.

Mr. Justice Douglas Mr. Justice Brennan and Mr. Justice Marshall filed dissenting opinions.

****1497** ***21** Syllabus *

The Bank Secrecy Act of 1970, which was enacted following extensive hearings concerning the unavailability of foreign and domestic bank records of customers thought to be engaged in illegal activities, authorizes the Secretary of the Treasury to prescribe by regulation certain bank recordkeeping and reporting requirements, the Act's penalties attaching only upon violation of the regulations thus prescribed. (Unless otherwise indicated, references below to the Act also include the accompanying regulations.) The Act is designed to obtain financial information having ‘a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.’ Title I of the Act requires financial institutions to maintain records of their customers' identities, to make microfilm copies of checks and similar instruments, and to keep records of certain other items. Title II requires the reporting to the Federal Government of certain foreign and domestic financial transactions. Title II, s 231, requires reports of the transportation of currency and specified instruments exceeding $5,000 into or out of the country, exception being made, inter alia, for banks and security dealers. Section 241 requires individuals with bank accounts or other relationships with foreign banks to provide specified information on a tax return form. Section 221 delegates to the Secretary of the Treasury ****1498** the authority to require reports of transactions ‘if they involve the payment, receipt, or transfer of United States currency, or such other monetary instruments as the Secretary may specify . . .,’ s 222 providing that he may require such reports from the domestic financial institution involved, the parties to the transaction, or both, and s 223 providing that he may designate financial institutions ***22** to receive the reports. Under the implementing regulations only financial institutions must file reports with the Internal Revenue Service (IRS), and then only where the transaction involves the deposit, withdrawal, exchange, or other payment of currency exceeding $10,000. The regulations provide that the Secretary may grant exemptions from the requirements of the regulations. Suits were brought by various plaintiffs challenging the constitutionality of the Act, principally on the ground that it violated the Fourth Amendment, because when the bank makes and keeps records under compulsion of the Secretary's regulations it acts as a Government agent and thereby engages in a 'seizure' of its customer's records. A three-judge District Court, though upholding the recordkeeping requirements of Title I of the Act and the foreign transaction reporting requirements of Title II, concluded that the domestic reporting provisions of Title II, ss 221—223, contravened the Fourth Amendment, and enjoined their enforcement. Three separate appeals were taken. In No. 72—958, the California Bankers Association, a plaintiff below, asserts that Title I's recordkeeping provisions violate (1) due process, because there is no rational relationship between the Act's objectives and the required recordkeeping and because the Act is unduly burdensome, and (2) rights of privacy. In No. 72—1196, a bank plaintiff, certain plaintiff depositors, and the American Civil Liberties Union (ACLU) also a plaintiff, as a depositor in a bank subject to the recordkeeping requirements and as a representative of its bank customer members, attack both the Title I recordkeeping requirements and the Title II foreign financial transaction reporting requirements on Fourth Amendment grounds; on Fifth Amendment grounds, as violating the privilege against compulsory self-incrimination; and on First Amendment grounds, as violating free speech and free association rights. In No. 72—1073, the Secretary asserts that the District Court erred in holding Title II's domestic financial transaction reporting requirements facially invalid without considering the actual implementation of the statute by the regulations. Held:

1. Title I's recordkeeping requirements, which are a proper exercise of Congress' power to deal with the problem of crime in interstate and foreign commerce, do not deprive the bank plaintiffs of due process of law. Pp. 1509—1513.

(a) There is a sufficient nexus between the evil Congress sought to address and the recordkeeping procedure to meet the requirements of the Due Process Clause of the Fifth Amendment, ***23** and the fact that banks are not mere bystanders in transactions involving negotiable instruments but have a substantial stake in their availability and acceptance and are the most easily identifiable party to the instruments, makes it appropriate for the banks rather than others to do the recordkeeping. United States v. Darby, 312 U.S. 100, 61 S.Ct. 451, 85 L.Ed. 609; Shapiro v. United States, 335 U.S. 1, 68 S.Ct. 1375, 92 L.Ed. 1787. Pp. 1509—1511.

(b) The cost burdens on the banks of the recordkeeping requirements are not unreasonable. P. 1512.

(c) The bank plaintiffs' claim that the recordkeeping requirements undermine the right of a depositor effectively to challenge an IRS third-party summons is premature, absent the issuance of such process involving a depositor's transactions. Pp. 1512—1513.

2. Title I's recordkeeping provisions do not violate the Fourth Amendment ****1499** rights of either the bank or depositor plaintiffs, the mere maintenance by the bank of records without any requirement that they be disclosed to the Government (which can secure access only by existing legal process) constituting no illegal search and seizure. Pp. 1513—1514.

3. Title I's recordkeeping provisions do not violate the Fifth Amendment rights of either the bank or depositor plaintiffs. P. 1514.

(a) The bank plaintiffs, being corporations, have no constitutional privilege against compulsory self-incrimination by virtue of the Fifth Amendment. Hale v. Henkel, 201 U.S. 43, 74—75, 26 S.Ct. 370, 378—379, 50 L.Ed. 652. P. 1514.

(b) A depositor plaintiff incriminated by evidence produced by a third party sustains no violation of his own Fifth Amendment rights. Johnson v. United States, 228 U.S. 457, 458, 33 S.Ct. 572, 57 L.Ed. 919; Couch v. United States, 409 U.S. 322, 328, 93 S.Ct. 611, 615, 34 L.Ed.2d 548. P. 1514.

4. The ACLU's claim that Title I's recordkeeping requirements violate its members' First Amendment rights since the challenged provisions could possibly be used to identify its members and contributors (cf. NAACP v. Alabama, 357 U.S. 449, 78 S.Ct. 1163, 2 L.Ed.2d 1488), is premature, the Government having sought no such disclosure here. Pp. 1514—1515.

5. The reporting requirements in Title II applicable to foreign financial dealings, which single out transactions with the greatest potential for avoiding enforcement of federal laws and which involve substantial sums, do not

abridge plaintiffs' Fourth Amendment rights and are well within Congress' powers to legislate with respect to foreign commerce. Carroll v. United States, 267 U.S. 132, 154, 45 S.Ct. 280, 285, 69 L.Ed. 543; Almeida-Sanchez v. United States, 413 U.S. 266, 272, 93 S.Ct. 2535, 2539, 37 L.Ed.2d 596. Pp. 1516—1518.

***24** 6. The regulations for the reporting by financial institutions of domestic financial transactions are reasonable and abridge no Fourth Amendment rights of such institutions, which are themselves parties to the transactions involved, since neither ‘incorporated nor unincorporated associations (have) an unqualified right to conduct their affairs in secret.’ United States v. Morton Salt Co., 338 U.S. 632, 652, 70 S.Ct. 357, 368, 94 L.Ed. 401. Pp. 1518—1520.

7. The depositor plaintiffs, who do not allege engaging in the type of $10,000 domestic currency transaction requiring reporting, lack standing to challenge the domestic reporting regulations. It is therefore unnecessary to consider contentions made by the bank and depositor plaintiffs that the regulations are constitutionally defective because they do not require the financial institution to notify the customer that a report will be filed concerning the domestic currency transaction. Pp. 1520—1522.

8. The depositor plaintiffs who are parties in this litigation are premature in challenging the foreign and domestic reporting provisions under the Fifth Amendment. Pp. 1522—1524.

(a) Since those plaintiffs merely allege that they intend to engage in foreign currency transactions with foreign banks and make no additional allegation that any of the information required by the Secretary will tend to incriminate them, their challenge to the foreign reporting requirements cannot be considered at this time. Communist Party v. SACB, 367 U.S. 1, 105—110, 81 S.Ct. 1357, 1415—1418, 6 L.Ed.2d 625, followed; Albertson v. SACB, 382 U.S. 70, 86 S.Ct. 194, 15 L.Ed.2d 165, distinguished. Pp. 1522—1524.

(b) The depositor plaintiffs' challenge to the domestic reporting requirements are similarly premature, since there is no allegation that any depositor engaged in a $10,000 domestic transaction with a bank that the latter was required to report and no allegation that ****1500** any bank report would contain information incriminating any depositor. Marchetti v. United States, 390 U.S. 39, 88 S.Ct. 697, 19 L.Ed.2d 889; Grosso v. United States, 390 U.S. 62, 88 S.Ct. 709, 19 L.Ed.2d 906, and Haynes v. United States, 390 U.S. 85, 88 S.Ct. 722, 19 L.Ed.2d 923, distinguished. P. 1524.

9. The bank plaintiffs cannot vicariously assert Fifth Amendment claims on behalf of their depositors under the circumstances present here, since the depositors cannot assert those claims themselves at this time. See par. 8, supra. Pp. 1522—1523.

10. The contentions of the ACLU that the reporting requirements with respect to foreign and domestic transactions invade its First Amendment associational interests are too speculative and hypothetical to warrant consideration, in view of the fact that the ACLU alleged only that it maintains accounts at a San ***25** Francisco bank but not that it regularly engages in abnormally large domestic currency transactions, transports or receives monetary instruments from foreign commercial channels, or maintains foreign bank accounts. Pp. 1524—1525.

347 F.Supp. 1242, affirmed in part, reversed in part, and remanded.

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Opinion

Mr. Justice REHNQUIST delivered the opinion of the Court.

These appeals present questions concerning the constitutionality of the socalled Bank Secrecy Act of 1970 (Act), and the implementing regulations promulgated thereunder by the Secretary of the Treasury. The Act, Pub.L. 91—508, 84 Stat. 1114, 12 U.S.C. ss 1730d, 1829b, ***26** 1951—1959, and 31 U.S.C. ss 1051—1062, 1081—1083, 1101—1105, 1121—1122, was enacted by

Congress in 1970 following extensive hearings concerning the unavailability of foreign and domestic bank records of customers thought to be engaged in activities entailing criminal or civil liability. Under the Act, the Secretary of the Treasury is authorized to prescribe by regulation certain recordkeeping and reporting requirements for banks and other financial insituations in this country. Because it has a bearing on our treatment of some of the issues raised by the parties, we think it important to note that the Act's civil and criminal penalties attach only upon violation of regulations promulgated by the Secretary; if the Secretary were to do nothing, the Act itself would impose no penalties on anyone.

The express purpose of the Act is to require the maintenance of records, and the making of certain reports, which 'have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.' 12 U.S.C. ss 1829b(a)(2), 1951; 31 U.S.C. s 1051. Congress was apparently concerned with two major problems in connection with the enforcement of the regulatory, tax, and criminal laws of the United States. [1]

First, there was a need to insure that domestic banks and financial institutions continue to maintain adequate records of their financial transactions with their customers. Congress found that the recent growth of financial institutions in the United States had been paralleled by an increase in criminal activity which made use of ***27** these institutions. While many of the records which the Secretary by regulation ultimately ****1501** required to be kept had been traditionally maintained by the voluntary action of many domestic financial institutions, Congress noted that in recent years some larger banks had abolished or limited the practice of photocopying checks, drafts, and similar instruments drawn on them and presented for payment. The absence of such records, whether through failure to make them in the first instance or through failure to retain them, was thought to seriously impair the ability of the Federal Government to enforce the myriad criminal, tax, and regulatory provisions of laws which Congress had enacted. At the same time, it was recognized by Congress that such required records would 'not be made automatically available for law enforcement purposes (but could) only be obtained through existing legal process.' H.R.Rep.No. 91—975, p. 10 (1970); see S.Rep.No. 91—1139, p. 5 (1970).

In addition, Congress felt that there were situations where the deposit and withdrawal of large amounts of currency or of monetary instruments which were the equivalent of currency should be actually reported to the Government. While reports of this nature had been required by previous regulations issued by the Treasury Department, it was felt that more precise and detailed reporting requirements were needed. The Secretary was therefore authorized to require the reporting of what may be described as large domestic financial transactions in currency or its equivalent.

Second, Congress was concerned about a serious and widespread use of foreign financial institutions, located in jurisdictions with strict laws of secrecy as to bank activity, for the purpose of violating or evading domestic criminal, tax, and regulatory enactments. The House ***28** Report on the bill, No. 91—975, supra, at 12—13, described the situation in these words:

'Considerable testimony was received by the Committee from the Justice Department, the United States Attorney for the Southern District of New York, the Treasury Department, the Internal Revenue Service, the Securities and Exchange Commission, the Defense Department and the Agency for International Development about serious and widespread use of foreign financial facilities located in secrecy jurisdictions for the purpose of violating American law. Secret foreign bank accounts and secret foreign financial institutions have permitted proliferation of 'white collar' crime; have served as the financial underpinning of organized criminal operations in the United States; have been utilized by Americans to evade income taxes, conceal assets illegally and purchase gold; have allowed Americans and others to avoid the law and regulations governing securities and exchanges; have served as essential ingredients in frauds including schemes to defraud the United States; have served as the ultimate depository of black market proceeds from Vietnam; have served as a source of questionable financing for conglomerate and other corporate stock acquisitions, mergers and takeovers; have covered conspiracies to steal from the U.S. defense and foreign aid funds; and have served as the cleansing agent for 'hot' or illegally obtained monies.

'The debilitating effects of the use of these secret institutions on Americans and the American economy are vast. It has been estimated that hundreds of millions in tax revenues have been lost. Unwarranted and unwanted credit is being pumped into ***29** our markets. There have been some cases of corporation directors, officers and employees who, through deceit and violation of law, enriched themselves or endangered the financial soundness of their companies to the detriment of their stockholders. Criminals engaged in illegal gambling, skimming, and narcotics traffic are operating their financial affairs with an impunity that approaches statutory exemption.

****1502** 'When law enforcement personnel are confronted with the secret foreign bank account or the secret financial institution they are placed in an impossible position. In order to receive evidence and testimony regarding activities in the secrecy jurisdiction they must subject themselves to a time consuming and ofttimes fruitless foreign legal process. Even when procedural obstacles are overcome, the foreign jurisdictions rigidly enforce their secrecy laws against their own domestic institutions and employees.

'One of the most damaging effects of an American's use of secret foreign financial facilities is its undermining of the fairness of our tax laws. Secret foreign financial facilities, particularly in Switzerland, are available only to the wealthy. To open a secret Swiss account normally requires a substantial deposit, but such an account offers a convenient means of evading U.S. taxes. In these days when the citizens of this country are crying out for tax reform and relief, it is grossly unfair to leave the secret foreign bank account open as a convenient avenue of tax evasion. The former U. S. Attorney for the Southern District of New York has characterized the secret foreign bank account as the largest single tax loophole permitted by American law.' U.S.Code Cong. & Admin.News 1970, p. 4397.

While most of the recordkeeping requirements imposed ***30** by the Secretary under the Act merely require the banks to keep records which most of them had in the past voluntarily kept and retained, and while much of the required reporting of domestic transactions had been required by earlier Treasury regulations in effect for nearly 30 years,[2] there is no denying the impressive sweep of the authority conferred upon the Secretary by the Bank Secrecy Act of 1970. While an Act conferring such broad authority over transactions such as these might well surprise or even shock those who lived in an earlier era, the latter did not live to see the time when bank accounts would join chocolate, cheese, and watches as a symbol of the Swiss economy. Nor did they live to see the heavy utilization of our domestic banking system by the minions of organized crime as well as by millions of legitimate businessmen. The challenges made here to the Bank Secrecy Act are directed not to any want of legislative authority in Congress to treat the subject, but instead to the Act's asserted violation of specific constitutional prohibitions.

I

Title I of the Act, and the implementing regulations promulgated thereunder by the Secretary of the Treasury, require financial institutions to maintain records of the identities of their customers, to make microfilm copies of certain checks drawn on them, and to keep records of certain other items. Title II of the Act and its implementing regulations require reports of certain domestic and foreign currency transactions.

A. TITLE I—THE RECORDKEEPING REQUIREMENTS

Title I of the Act contains the general recordkeeping requirements for banks and other financial ***31** institutions, as provided by the Secretary by regulation. Section 101 of the Act, 12 U.S.C. s 1829b, applies by its terms only to federally insured banks. It contains congressional findings 'that adequate records maintained by insured banks have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings.' The major requirements of the section are that insured banks record the identities of persons having accounts with them and of persons having signature authority thereover, in such form as the Secretary may require. To the extent that the Secretary determines by regulation that ****1503** such records would have the requisite 'high degree of usefulness,' the banks must make and maintain microfilm or other reproductions of each check, draft, or other instrument drawn on it and presented to it for payment, and must maintain a record of each check, draft, or other instrument received by it for deposit or collection, together with an identification of the party for whose account it is to be deposited or collected. Section 101 further authorizes the Secretary to require insured banks to maintain a record of the identity of all individuals who engage in transactions which are reportable by the bank under Title II of the Act, and authorizes the Secretary to prescribe the required retention period for such records. Section 102, 12 U.S.C. s 1730d, amends the National Housing Act to authorize the Secretary to apply similar recordkeeping requirements to institutions insured thereunder. Sections 122—123 of the Act, 12 U.S.C. ss 1952—1953, authorize the Secretary to issue regulations applying similar recordkeeping requirements to additional domestic financial institutions.[3]

***32** Although an initial draft of Title I, see H.R. 15073, 91st Cong., 1st Sess., would have compelled the Secretary to promulgate regulations requiring banks to maintain copies of all items received for collection or presented for payment, the Act as finally passed required the maintenance only of such records and microfilm copies as the Secretary determined to have a 'high degree of usefulness.'[4] Upon passage of the Act, the Treasury Department established a task force which consulted with representatives from financial institutions, trade associations, and governmental agencies to determine the type of records which should be maintained. Whereas the original regulations promulgated by the Secretary had required the copying of all checks, the task force decided, and the regulations were accordingly amended, to require check copying only as to checks in excess of $100.[5] The regulations also require the copying of ***33** only 'on us' checks: checks drawn on the bank or issued and payable by it. 31 CFR s 103.34(b)(3). The regulations exempt from the copying requirements certain 'on us' checks such as dividend, payroll, and employee benefit checks, provided they are drawn on an account expected to average at least one hundred checks per ****1504** month.[6] The regulations also require banks to maintain records of the identity and taxpayer identification number of each person maintaining a financial interest in each deposit or share account opened after June 30, 1972, and to microfilm various other financial documents. 31 CFR s 103.34.[7] In addition, the ***34** Secretary's regulations require all financial institutions to maintain a microfilm or other copy of each extension of credit in an amount exceeding $5,000 except those secured by interest in real property, and to microfilm each advice, request, or instruction given or received regarding the transfer of funds, currency, or other money or credit in amounts exceeding $10,000 to a person, account, or place outside the United States. 31 CFR s 103.33.

Reiterating the stated intent of the Congress, see, e.g., H.R.Rep.No. 91—975, supra, at 10; S.Rep.No. 91—1139, supra, at 5, the regulations provide that inspection, review, or access to the records required by the Act to be maintained is governed by existing legal process. 31 CFR s 103.51.[8] Finally, ss 125—127 of the Act provide ***35** for civil and criminal penalties for willful violations of the recordkeeping requirements. 12 U.S.C. ss 1955—1957.

B. TITLE II—FOREIGN FINANCIAL TRANSACTION REPORTING REQUIREMENTS

Chapter 3 of Title II of the Act and the regulations promulgated thereunder generally require persons to report the transportation of monetary instruments into or out of the United States, or receipts of such instruments in the United States from places outside the United States, if the transportation or receipt involves instruments of a value greater than $5,000. Chapter 4 of Title II of the Act and the implementing regulations generally require United States citizens, residents, and businessmen to file reports of their relationships with ****1505** foreign financial institutions. The legislative history of the foreign-transaction reporting provisions indicates that the Congress was concerned with the circumvention of United States regulatory, tax, and criminal laws which United States citizens and residents were accomplishing through the medium of secret foreign bank transactions. S.Rep.No. 91—1139, supra, at 7; H.R.Rep.No. 91—975, supra, at 13.

Section 231 of the Act, 31 U.S.C. s 1101, requires anyone connected with the transaction to report, in the manner prescribed by the Secretary, the transportation into or out of the country of monetary instruments[9] exceeding $5,000 on any one occasion. As ***36** provided by the Secretary's regulations, the report must include information as to the amount of the instrument, the date of receipt, the form of instrument, and the person from whom it was received. See 31 CFR ss 103.23, 103.25.[10] The regulations exempt various classes of persons from this reporting requirement, including banks, brokers or other dealers in securities, common carriers, and others engaged in the business of transporting currency for banks, 31 CFR s 103.23(c). Monetary instruments which are transported without the filing of a required report, or with a materially erroneous report, are subject to forfeiture under s 232 of the Act, 31 U.S.C. s 1102; a person who has failed to file the required report or who has filed a false report is subject to civil penalties under ss 207 and 233, 31 U.S.C. ss 1056 and 1103, as well as criminal penalties under s 209 and 210, 31 U.S.C. ss 1058 and 1059.

Section 241 of the Act, 31 U.S.C. s 1121, authorizes the Secretary to prescribe regulations requiring residents and citizens of the United States, as well as nonresidents in the United States and doing business therein, to maintain records and file reports with respect to their transactions ***37** and relationships with foreign financial agencies. Pursuant to this authority, the regulations require each person subject to the jurisdiction of the United States to make a report on yearly tax returns of any 'financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country.' 31 CFR s 103.24. Violations of the reporting requirement of s 241 as implemented by the regulations are also subject to civil and criminal penalties under s 207, 209, and 210 of the Act, 31 U.S.C. ss 1056, 1058, and 1059.

C. TITLE II—DOMESTIC FINANCIAL TRANSACTION REPORTING REQUIREMENTS

[1] In addition to the foreign transaction reporting requirements discussed above, Title II of the Act provides for certain reports of domestic transactions where such reports have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. Prior to the enactment of the Act, financial institutions had been providing reports of their customers' large currency transactions pursuant to regulations ****1506** promulgated by the Secretary of Treasury[11] which had required reports of all currency transactions that, in the judgment of the institution, exceeded those 'commensurate with the customary conduct of the business, industry or profession of the person or organization concerned.'[12] In passing the ***38** Act, Congress recognized that the use of financial institutions, both domestic and foreign, in furtherance of activities designed to evade the regulatory mechanisms of the United States, had markedly increased. H.R.Rep.No. 91—975, supra, at 10; S.Rep.No. 91—1139, supra, at 2—3. Congress recognized the importance of reports of large and unusual currency transactions in ferreting out criminal activity and desired to strengthen the statutory basis for requiring such reports. H.R.Rep.No. 91—975, supra, at 11—12. In particular, Congress intended to authorize more definite standards for determining what constitutes the type of unusual transaction that should be reported. S.Rep.No. 91—1139, supra, at 6.

Section 221 of the Act, 31 U.S.C. s 1081, therefore delegates to the Secretary the authority for specifying the currency transactions which should be reported, 'if they involve the payment, receipt, or transfer of United States currency, or such other monetary instruments as the Secretary may specify.' Section 222 of the Act, 31 U.S.C. s 1082, provides that the Secretary may require such reports from the domestic financial institution involved or the parties to the transactions or both.[13] Section 223 of the Act, 31 U.S.C. s 1083, authorizes the Secretary to designate financial institutions to receive such reports.

***39** In the implementing regulations promulgated under this authority, the Secretary has required only that financial institutions file certain reports with the Commissioner of Internal Revenue. The regulations require that a report be made for each deposit, withdrawal, exchange of currency,[14] or other payment or transfer 'which involves a transaction in currency of more than $10,000.' 31 CFR s 103.22.[15] The regulations exempt from the reporting requirement certain intrabank transactions and 'transactions with an established customer ****1507** maintaining a deposit relationship (in amounts) commensurate with the customary conduct of the business, industry, or profession of the customer concerned.' ***40** Ibid.[16] Provision is also made in the regulations whereby information obtained by the Secretary may in some instances and in confidence be available to other departments or agencies of the United States. 31 CFR s 103.43; see 31 U.S.C. s 1061.[17] There is also provision made in the regulations whereby the Secretary may in his sole discretion make exceptions to or grant exemptions from the requirements of the regulation. 31 CFR s 103.45(a).[18] Failure to file the required ***41** report or the filing of a false report subjects the banks to criminal and civil penalties. 31 U.S.C. ss 1056, 1058, 1059.

II

This litigation began in June 1972 in the United States District Court for the Northern District of California. Various plaintiffs applied for a temporary restraining order prohibiting the defendants, including the Secretary of the Treasury and heads of other federal agencies, from enforcing the provisions of the Bank Secrecy Act, enacted by Congress on October 26, 1970, and thereafter implemented by the Treasury regulations. The plaintiffs below included several named individual bank customers, the Security National Bank, the California Bankers Association, and the American Civil Liberties Union (ACLU), suing on behalf of itself and its various bank customer members.

The plaintiffs' principal contention in the District Court was that the Act and the regulations were violative of the Fourth Amendment's guarantee against unreasonable search and seizure. The complaints also alleged that the Act violated the First, Fifth, Ninth, Tenth, and Fourteenth Amendments. The District ****1508** Court issued a temporary restraining order enjoining the enforcement of the foreign and domestic reporting provisions of Title II of the Act, and requested the convening of a three-judge court pursuant to 28 U.S.C. s 2284 to entertain the myriad of constitutional challenges to the Act.

***42** The three-judge District Court unanimously upheld the constitutionality of the recordkeeping requirements of Title I of the Act and the accompanying regulations, and the requirements of Title II of the Act and the regulations for reports concerning the import and export of currency and monetary instruments and relationships with foreign financial institutions. The District Court concluded, however, with one judge dissenting, that the domestic reporting provisions of ss 221—223 of Title II of the Act, 31 U.S.C. ss 1081—1083, were repugnant to the Fourth Amendment of the Constitution. 347 F.Supp. 1242 (1972). The court held that since the domestic reporting provisions of the Act permitted the Secretary of the Treasury to require detailed reports of virtually all domestic financial transactions, including those involving personal checks and drafts, and since the Act could conceivably be administered in such a manner as to compel disclosure of all details of a customer's financial affairsT he domestic reporting provisions must fall as facially violative of the Fourth Amendment. Their enforcement was enjoined.

Both the plaintiffs and the Government defendants filed timely notices of appeal from the portions of the District Court judgment adverse to them. We noted probable jurisdiction over three separate appeals from the decision below pursuant to 28 U.S.C. ss 1252 and 1253. 414 U.S. 816, 94 S.Ct. 34, 38 L.Ed.2d 48 (1973):

No. 72—985. The appellant in this appeal is the California Bankers Association, an association of all state and national banks doing business in California. The Association challenges the constitutionality of the recordkeeping provisions of Title I, as implemented by the regulations, on two grounds. First, the Association contends that the Act violates the Due Process Clause of the Fifth Amendment because there is no rational relationship ***43** between the objectives of the Act and the recordkeeping required, and because the Act places an unreasonable burden on the Association's member banks. Second, the Association contends that the recordkeeping requirements of Title I violate the First Amendment right of privacy and anonymity of the member banks' customers.

No. 72—1196. This appeal was filed on behalf of a number of plaintiffs in the original suit in the District Court: on behalf of the Security National Bank, on behalf of the American Civil Liberties Union as a depositor in a bank subject to the recordkeeping requirements, and as a representative of its bank customer members, and on behalf of certain bank customers. The appeal first challenges the constitutionality of the recordkeeping requirements of Title I of the Act and the implementing regulations, as does the appeal in No. 72—985, supra. Second, the appeal challenges the constitutionality of the foreign financial transaction reporting requirements of Title II of the Act and the implementing regulations. These recordkeeping and foreign reporting requirements are challenged on three grounds: first, that the requirements constitute an unreasonable search and seizure in violation of the Fourth Amendment; second, that the requirements constitute a coerced creation and retention of documents in violation of the Fifth Amendment privilege against compulsory self-incrimination; and third, that the requirements violate the First Amendment rights of free speech and free association.

No. 72—1073. In this appeal, the Secretary of the Treasury, as appellant, challenges that portion of the District Court's order holding the domestic financial transaction reporting requirements of Title II to violate the Fourth Amendment. The Government contends ****1509** that the District Court erred in holding these provisions of Title II to ***44** be unconstitutional on their face, without considering the actual implementation of the statute by the Treasury regulations. The Government urges that since only those who violate these regulations may incur civil or criminal penalties, it is the actual regulations issued by the Secretary of the Treasury, and not the broad authorizing language of the statute, which are to be tested against the standards of the Fourth Amendment; and that when so tested they are valid.

For convenience, we will refer throught the remainder of this opinion to the District Court plaintiffs as plaintiffs, since they are both appellants and appellees in the appeals filed in this Court.

III

We entertain serious doubt as to the standing of the plaintiff California Bankers Association to litigate the claims which it asserts here. Its complaint alleged that it is an unincorporated association consisting of 158 state and national banks doing busines in California. So far as appears from the complaint, the Association is not in any way engaged in the banking business, and is not even subject to the Secretary's regulations which it challenges. While the District Court found that the Association sued on behalf of its member banks, the Association's complaint contains no such allegation. The Association seeks to litigate, not only claims on behalf of its member banks, but also claims of injury to the depositors of its member banks. Since the Government has not questioned the standing of the Association to litigate the claims peculiar to banks, and more importantly since plaintiff Security National Bank has standing as an affected bank, and therefore determination of the Association's standing would in no way avoid resolution of any constitutional issues, we assume without deciding that ***45** the Association does have standing. See Doe v. Bolton, 410 U.S. 179, 189, 93 S.Ct. 739, 746, 35 L.Ed.2d 201 (1973); Sierra Club v. Morton, 405 U.S. 727, 739, 92 S.Ct. 1361, 1368, 31 L.Ed.2d 636 (1972); NAACP v. Button, 371 U.S. 415, 428, 83 S.Ct. 328, 335, 9 L.Ed.2d 405 (1963).

We proceed then to consider the initial contention of the bank plaintiffs that the recordkeeping requirements imposed by the Secretary's regulations under the authority of Title I deprive the banks of due process by imposing unreasonable burdens upon them, and by seeking to make the banks the agents of the Government in surveillance of its citizens. Such recordkeeping requirements are scarcely a novelty. The Internal Revenue Code, for example, contains a general authorization to the Secretary of the Treasury to prescribe by regulation records to be kept by both business and individual taxpayers, 26 U.S.C. s 6001, which has been implemented by the Secretary in various regulations.[19] And this ****1510** Court has been ***46** faced with numerous cases involving similar recordkeeping requirements. Similar requirements imposed on the countless businesses subject to the Emergency Price Control Act during the Second World War were upheld in Shapiro v. United States, 335 U.S. 1, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948), the Court observing that there was 'a sufficient relation between the activity sought to be regulated and the public concern so that the government can constitutionally regulate or forbid the basic activity concerned, and can constitutionally require the keeping of particular records, subject to inspection . . ..' Id., at 32, 68 S.Ct., at 1392. In United States v. Darby, 312 U.S. 100, 61 S.Ct. 451, 85 L.Ed. 609 (1941), the Court held that employers subject to the Fair Labor Standards Act could be required to keep records of wages paid and hours worked:

'Since, as we have held, Congress may require production for interstate commerce to conform to (wage and hour) conditions, it may require the employer, as a means of enforcing the valid law, to keep a record showing whether he has in fact complied with it.' Id., at 125, 61 S.Ct., at 462.

[2] **[3]** We see no reason to reach a different result here. The plenary authority of Congress over both interstate and foreign commerce is not open to dispute, and that body was not limited to any one particular approach to effectuate its concern that negotiable instruments moving in the channels of that commerce were significantly aiding criminal enterprise. The Secretary of the Treasury, authorized by Congress, concluded that copying and retention of certain negotiable instruments by the bank upon which they were drawn would facilitate the detection and apprehension of participants in such criminal ***47** enterprises. Congress could have closed the channels of commerce entirely to negotiable instruments, had it thought that so drastic a solution were warranted; it could have made the transmission of the proceeds of any criminal activity by negotiable instruments in interstate or foreign commerce a separate criminal offense. Had it chosen to do the latter, under the precise authority of Darby or Shapiro, supra, it could have required that each individual engaging in the sending of negotiable instruments through the channels of commerce maintain a record of such action; the bank plaintiffs concede as much.[20]

[4] The bank plaintiffs contend, however, that the Act does not have as its primary purpose regulation of the banks themselves, and therefore the requirement that the banks keep the records is an unreasonable burden on the banks. Shapiro and Darby, which involved legislation imposing recordkeeping requirements in aid of substantive regulation, are therefore said not to control. But provisions requiring reporting or recordkeeping by the paying institution, rather than the individual who receives the payment, are by no means unique. The Internal Revenue Code and its regulations, for example, contain provisions which require businesses to report income payments to third parties (26 U.S.C. s 6041(a)), employers to keep records of certain payments made to employees (Treas.Reg. s 31.6001 et seq.), corporations to report dividend payments made to third parties (26 U.S.C. s 6042), cooperatives to report patronage dividend payments (26 U.S.C. s 6044), brokers to report customers' gains and losses (26 U.S.C. s 6045), and banks to report payments of interest made to depositors (26 U.S.C. s 6049).

***48** In Darby an identifiable class of employer was made subject to the Fair Labor Standards Act, and in Shapiro an identifiable class of business had been ****1511** placed under the Price Control Act; in each of those instances, Congress found that the purpose of its regulation was adequately secured by requiring records to be kept by the persons subject to the substantive commands of the legislation. In this case, however, Congress determined that recordkeeping alone would suffice for its purposes, and that no correlative substantive legislation was required. Neither this fact, nor the fact that the principal congressional concern is with the activities of the banks' customers, rather than with the activities of the banks themselves, serves to invalidate the legislation on due process grounds.

[5] **[6]** **[7]** The bank plaintiffs proceed from the premise that they are complete bystanders with respect to transactions involving drawers and drawees of their negotiable instruments. But such is hardly the case. A voluminous body of law has grown up defining the rights of the drawer, the payee, and the drawee bank with respect to various kinds of negotiable instruments. The recognition of such rights, both in the various States of this country and in other countries, is itself a part of the reason why the banking business has flourished and played so prominent a part in commercial transactions. The bank is a party to any negotiable instrument drawn upon it by a depositor, and upon acceptance or payment of an instrument incurs obligations to the payee. While it obviously is not privy to the background of a transaction in which a negotiable instrument is used, the existing wide acceptance and availability of negotiable instruments is of inestimable benefit to the banking industry as well as to commerce in general.

Banks are therefore not conscripted neutrals in transactions ***49** involving negotiable instruments, but parties to the instruments with a substantial stake in their continued availability and acceptance. Congress not illogically decided that if records of transactions of negotiable instruments were to be kept and maintained, in order to be available as evidence under customary legal process if the occasion warranted, the bank was the most easily identifiable party to the instrument and therefore should do the recordkeeping. We believe this conclusion is consistent with Darby and Shapiro, and that there is a sufficient connection between the evil Congress sought to address and the recordkeeping procedure it required to pass muster under the Due Process Clause of the Fifth Amendment.[21]

****1512** **[8]** ***50** The bank plaintiffs somewhat halfheartedly argue, on the basis of the costs which they estimate will be incurred by the banking industry in complying with the Secretary's recordkeeping requirements, that this cost burden alone deprives them of due process of law. They cite no cases for this proposition, and it does not warrant extended treatment. In its complaint filed in the District Court, plaintiff Security National Bank asserted that it was an ‘insured’ national bank; to the extent that Congress has acted to require records on the part of banks insured by the Federal Deposit Insurance Corporation, or of financial institutions insured under the National Housing Act, Congress is simply imposing a condition on the spending of public funds. See, e.g., Steward Machine Co. v. Davis, 301 U.S. 548, 57 S.Ct. 883, 81 L.Ed. 1279 (1937); Helvering v. Davis, 301 U.S. 619, 57 S.Ct. 904, 81 L.Ed. 1307 (1937). Since there was no allegation in the complaints filed in the District Court, and since it is not contended here that any bank plaintiff is not covered by FDIC or Housing Act insurance, it is unnecessary to consider what questions would arise had Congress relied solely upon its power over interstate commerce to impose the recordkeeping requirements. The cost burdens imposed on the banks by the recordkeeping requirements are far from unreasonable, and we hold that such burdens do not deny the banks due process of law. [22]

[9] ***51** The bank plaintiffs also contend that the recordkeeping requirements imposed by the Secretary pursuant to the Act undercut a depositor's right to effectively challenge a third-party summons issued by the Internal Revenue Service. See Reisman v. Caplin, 375 U.S. 440, 84 S.Ct. 508, 11 L.Ed.2d 459 (1964); Donaldson v. United States, 400 U.S. 517, 91 S.Ct. 534, 27 L.Ed.2d 580 (1971); Couch v. United States, 409 U.S. 322, 93 S.Ct. 611, 34 L.Ed.2d 548 (1973). Whatever wrong such a result might work on a depositor, it works no injury on his bank. It is true that in a limited class of cases this Court has permitted a party who suffered injury as a result of the operation of a law to assert his rights even though the sanction of the law was borne by another, Pierce v. Society of Sisters, 268 U.S. 510, 45 S.Ct. 571, 69 L.Ed. 1070 (1925), and conversely, the Court has allowed a party upon whom the sanction falls to rely on the wrong done to a third party in obtaining relief, Barrows v. Jackson, 346 U.S. 249, 73 S.Ct. 1031, 97 L.Ed. 1586 (1953); Eisenstadt v. Baird, 405 U.S. 438, 92 S.Ct. 1029, 31 L.Ed.2d 349 (1972). Whether the bank might in other circumstances rely on an injury to its depositors, or whether, instead, this case is governed by the general rule that one has standing only to vindicate his own rights, e.g., Moose Lodge v. Irvis, 407 U.S. 163, 166, 92 S.Ct. 1965, 1968, 32 L.Ed.2d 627 (1972), need not now be decided, since, in any event, the claim is premature. Claims of depositors against the compulsion ***52** by lawful process of bank records involving the depositors' own transactions must wait until such process issues.

****1513** Certain of the plaintiffs below, appellants in No. 72—1196, including the American Civil Liberties Union, the Security National Bank, and various individual plaintiff depositors, argue that if 'the dominant purpose of the Bank Secrecy Act is the creation, preservation, and collection of evidence of crime . . . (i)t is against the standards applicable to the criminal law, then, that its constitutionality must be measured.' They contend that the recordkeeping requirements violate the provisions of the Fourth, Fifth, and First Amendments to the Constitution. At this point, we deal only with such constitutional challenges as they relate to the recordkeeping provisions of Title I of the Act.

[10] We see nothing in the Act which violates the Fourth Amendment rights of any of these plaintiffs. Neither the provisions of Title I nor the implementing regulations require that any information contained in the records be disclosed to the Government; both the legislative history and the regulations make specific reference to the fact that access to the records is to be controlled by existing legal process.

Plaintiffs urge that when the bank makes and keeps records under the compulsion of the Secretary's regulations it acts as an agent of the Government, and thereby engages in a 'seizure' of the records of its customers. But all of the records which the Secretary requires to be kept pertain to transactions to which the bank was itself a party. See United States v. Biswell, 406 U.S. 311, 316, 92 S.Ct. 1593, 32 L.Ed.2d 87 (1972). The fact that a large number of banks voluntarily kept records of this sort before they were required to do so by regulation is an indication that the records were thought useful to the bank in the conduct of its ***53** own business, as well as in reflecting transactions of its customers. We decided long ago that an Internal Revenue summons directed to a third-party bank was not a violation of the Fourth Amendment rights of either the bank or the person under investigation by the taxing authorities. See First National Bank v. United States, 267 U.S. 576, 45 S.Ct. 231, 69 L.Ed. 796 (1925), aff'g 295 F. 142 (SD Ala.1924); Donaldson v. United States, supra, 400 U.S., at 522, 91 S.Ct., at 538. '(I)t is difficult to see how the summoning of a third party, and the records of a third party, can violate the rights of the taxpayer, even if a criminal prosecution is contemplated or in progress.' Id., at 537, 91 S.Ct., at 545 (Douglas, J., concurring).

[11] Plaintiffs nevertheless contend that the broad authorization given by the Act to the Secretary to require the maintenance of records, coupled with the broad authority to require certain reports of financial transactions, amounts to the power to commit an unlawful search of the banks and the customers. This argument is based on the fact that 31 CFR s 103.45, as it existed when the District Court ruled in the case, permitted the Secretary to impose additional recordkeeping or reporting requirements by written order or authorization; this authority has now been deleted from the regulation; [23] plaintiffs thus argue that the Secretary could order the immediate reporting of any records made or kept under the compulsion of the Act. We, of course, must examine the statute and the regulations as they now exist. Hall v. Beals, 396 U.S. 45, 48, 90 S.Ct. 200, 201, 24 L.Ed.2d 214 (1969) (per curiam); Thorpe v. Housing Authority, 393 U.S. 268, 281 n. 38, 89 S.Ct. 518, 526, 21 L.Ed.2d 474 (1969). Even if plaintiffs were correct in urging that we decide the case on the basis of the regulation as it existed at the time the District Court ruled, their contention would be without merit. Whatever the Secretary might have authorized ***54** under the regulation, he did not in fact require the reporting of any records made or kept under the compulsion of the Act. Indeed, ****1514** since the legislative history of the Act clearly indicates that records which it authorized the Secretary to require were to be available only by normal legal process, it is doubtful that the Secretary would have the authority ascribed to him by plaintiffs even under the earlier form of the regulation. But in any event, whether or not he had the authority, he did not exercise it, and in fact none of the records were required to be reported. Since we hold that the mere maintenance of the records by the banks under the compulsion of the regulations invaded no Fourth Amendment right of any depositor, plaintiffs' attack on the recordkeeping requirements under that Amendment fails.[24] That the bank in making the records required by the Secretary acts under the compulsion of the regulation is clear, but it is equally clear that in doing so it neither searches nor seizes records in which the depositor has a Fourth Amendment right.

[12] **[13]** **[14]** ***55** Plaintiffs have briefed their contentions in such a way that we cannot be entirely certain whether their Fifth Amendment attack is directed only to the reporting provisions of the regulations, or to the recordkeeping provisions as well. To the extent that it is directed to the regulations requiring the banks to keep records, it is without merit. Incorporated banks, like other organizations, have no privilege against compulsory self-incrimination, e.g., Hale v. Henkel, 201 U.S. 43, 74—75, 26 S.Ct. 370, 378—379, 50 L.Ed. 652 (1906); Wilson v. United States, 221 U.S. 361, 382—384, 31 S.Ct. 538, 545—546, 55 L.Ed. 771 (1911); United States v. White, 322 U.S. 694, 699, 64 S.Ct. 1248, 1251, 88 L.Ed. 1542 (1944). Since a party incriminated by evidence produced by a third party sustains no violation of his own Fifth Amendment rights, Johnson v. United States, 228 U.S. 457, 458, 33 S.Ct. 572, 57 L.Ed. 919 (1913); Couch v. United States, 409 U.S., at 328, 93 S.Ct., at 615, the depositor plaintiffs here present no meritorious Fifth Amendment challenge to the recordkeeping requirements.

Plaintiff ACLU makes an additional challenge to the recordkeeping requirements of Title I. It argues that those provisions, and the implementing regulations, violate its members' First Amendment rights, since the provisions could possibly be used to obtain the identities of its members and contributors through the examination of the organization's bank records. This Court has recognized that an organization may have standing to assert that constitutional rights of its members be protected from governmentally compelled disclosure of their membership in the organization, and that absent a countervailing governmental interest, such information may not be compelled. NAACP v. Alabama, 357 U.S. 449, 78 S.Ct. 1163, 2 L.Ed.2d 1488 (1958). See Pollard v. Roberts, 283 F.Supp. 248 (ED Ark.), aff'd per curiam, 393 U.S. 14, 89 S.Ct. 47, 21 L.Ed.2d 14 (1968).

[15] Those cases, however, do not elicit a per se rule that would forbid such disclosure in a situation where the governmental interest would override ****1515** the associational ***56** interest in maintaining such confidentiality. Each of them was litigated after a subpoena or summons had already been served for the records of the organization, and an action brought by the organization to prevent the actual disclosure of the records.[25] No such disclosure has been sought by the Government here, and the ACLU's challenge is therefore premature. This Court, in the absence of a concrete fact situation in which competing associational and governmental interests can be weighed, is simply not in a position to determine whether an effort to compel disclosure of such records would or would not be barred by cases such as NAACP v. Alabama, supra.[26] The threat to any First Amendment rights of the ACLU or its members from the mere existence of the records in the hands of the bank is a good deal more ***57** remote than the threat assertedly posed by the Army's system of compilation and distribution of information which we declined to adjudicate in Laird v. Tatum, 408 U.S. 1, 92 S.Ct. 2318, 33 L.Ed.2d 154 (1972).

IV

We proceed now to address the constitutional challenges directed at the reporting requirements of the regulations authorized in Title II of the Act. Title II authorizes the Secretary to require reporting of two general categories of banking transactions: foreign and domestic. The District Court upheld the constitutionality of the foreign transaction reporting requirements of regulations issued under Title II; certain of the plaintiffs below, appellants in No. 72—1196, have appealed from the portion of the District Court's judgment, and here renew their contentions of constitutional infirmity in the foreign reporting regulations based upon the First, Fourth, and Fifth Amendments. The District Court invalidated the Act insofar as it authorized the Secretary to promulgate regulations requiring banks to report domestic transactions involving their customers, and the Government in No. 72—1073 appeals from that portion of the District Court's judgment.

As noted above, the regulations issued by the Secretary under the authority of Title II contain two essential reporting requirements with respect to foreign financial transactions. Chapter 3 of Title II of the Act, 31 U.S.C. ss 1101—1105, and the corresponding regulation, 31 CFR s 103.23, require individuals to report transportation of monetary instruments into or out of the United States, or receipts of such instruments in the United States from places outside the ****1516** United States, if the instrument transported or received has a value in excess of $5,000. Chapter 4 of Title II of the Act, 31 U.S.C. ss 1121, 1122, and the corresponding regulation, 31 CFR s 103.24, generally ***58** require United States citizens, residents, and businessmen to file reports of their relationships with foreign financial institutions.

The domestic reporting provisions of the Act as implemented by the regulations, in contrast to the foreign reporting requirements, apply only to banks and financial institutions. In enacting the statute, Congress provided in s 221, 31 U.S.C. s 1081, that the Secretary might specify the types of currency transactions which should be reported:

> ‘Transactions involving any domestic financial institution shall be reported to the Secretary at such time, in such manner, and in such detail as the Secretary may require if they involve the payment, receipt, or tansfer of United States currency, or such other monetary instruments as the Secretary may specify, in such amounts, denominations, or both, or under such circumstances, as the Secretary shall by regulation prescribe.’

Section 222 of the Act, 31 U.S.C. s 1082, authorizes the Secretary to require such reports from the domestic financial institution involved, from the parties to the transactions, or from both. In exercising his authority under these sections, the Secretary has promulgated regulations which require only that the financial institutions make the report to the Internal Revenue Service; he has not required any report from the individual parties to domestic financial transactions.[27] The applicable regulation, 31 CFR s 103.22, requires the financial institution to ‘file a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to such financial institution, which involves a transaction in currency of more than $10,000.’ The regulation exempts several types of currency transactions ***59** from this reporting requirement, including transactions ‘with an established customer maintaining a deposit relationship with the bank, in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry or profession of the customer concerned.’ Ibid.

A. FOURTH AMENDMENT CHALLENGE TO THE FOREIGN REPORTING REQUIREMENTS

The District Court, in differentiating for constitutional purposes between the foreign reporting requirements and the domestic reporting requirements imposed by the Secretary, relied upon our opinion in United States v. United States District Court, 407 U.S. 297, 92 S.Ct. 2125, 32 L.Ed.2d 752 (1972), for the proposition that Government surveillance in the area of foreign relations is in some instances subject to less constitutional restraint than would be similar activity in domestic affairs. Our analysis does not take us over this ground.

[16] The plenary authority of Congress to regulate foreign commerce, and to delegate significant portions of this power to the Executive, is well established. C. & S. Air Lines v. Waterman S.S. Corp., 333 U.S. 103, 109, 68 S.Ct. 431, 435, 92 L.Ed. 568 (1948); Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294, 53 S.Ct. 350, 77 L.Ed. 796 (1933). Plaintiffs contend that in exercising that authority to require reporting of previously described foreign financial transactions, Congress and the Secretary have abridged their Fourth Amendment rights.

The familiar language of the Fourth Amendment protects '(t)he right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures . . ..' Since a statute requiring the filing and subsequent publication of a corporate tax return has been upheld against a Fourth Amendment challenge, ****1517** Flint v. Stone Tracy Co., 220 U.S. 107, 174—176, 31 S.Ct. 342, 358—359, 55 L.Ed. 389 (1911), reporting requirements are by no means ***60** per se violations of the Fourth Amendment. Indeed, a contrary holding might well fly in the face of the settled sixty-year history of self-assessment of individual and corporate income taxes in the United States. This Court has on numerous occasions recognized the importance of the self-regulatory aspects of that system, and interests of the Congress in enforcing it:

'In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. This disclosure it requires him of make in his annual return. To ensure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil.' Helvering v. Mitchell, 303 U.S. 391, 399, 58 S.Ct. 630, 633, 82 L.Ed. 917 (1938).

To the extent that the reporting requirements of the Act and the settled practices of the tax collection process are similar, this history must be overcome by those who argue that the reporting requirements are a violation of the Fourth Amendment. Plaintiffs contend, however, that Boyd v. United States, 116 U.S. 616, 6 S.Ct. 524, 29 L.Ed. 746 (1886), establishes the invalidity of the foreign reporting requirement under the Fourth Amendment, and that the particular requirements imposed are so indiscriminate in their nature that the regulations must be deemed to be the equivalent of a general warrant of the kind condemned as obnoxious to the Fourth Amendment in cases such as Stanford v. Texas, 379 U.S. 476, 85 S.Ct. 506, 13 L.Ed.2d 431 (1965). We do not think these cases would support plaintiffs even if their contentions were directed at the domestic reporting requirements; in light of the fact that the foreign reporting requirements deal with matters in foreign commerce, we think plaintiffs' reliance on the cases to challenge those requirements must fail.

***61** Boyd v. United States, supra, is a case which has been the subject of repeated citation, discussion, and explanation since the time of its decision 88 years ago. In Communist Party v. SACB, 367 U.S. 1, 81 S.Ct. 1357, 6 L.Ed.2d 625 (1961), the Court described the Boyd holding as follows:

'The Boyd case involved a statute providing that in proceedings other than criminal arising under the revenue laws, the Government could secure an order of the court requiring the production by an opposing claimant or defendant of any documents under his control which, the Government asserted, might tend to prove any of the Government's allegations. If production were not made, the allegations were to be taken as confessed. On the Government's motion, the District Court had entered such an order, requiring the claimants in a forfeiture proceeding to produce a specified invoice. Although the claimants objected that the order was improper and the statute unconstitutional in coercing self-incriminatory disclosures and permitting unreasonable searches and seizures, they did, under protest, produce the invoice, which was, again over their constitutional objection, admitted into evidence. This Court held that on such a record a judgment for the United States could not stand, and that the statute was invalid as repugnant to the Fourth and Fifth Amendments.' Id., at 110, 81 S.Ct., at 1417.

But the Boyd Court recognized that the Fourth Amendment does not prohibit all requirements that information be made available to the Government:

'(T)he supervision authorized to be exercised by officers of the revenue over the manufacture or custody of excisable articles, and the entries thereof in books required by law to be kept for their inspection, are necessarily excepted out of the category of ***62** unreasonable searches and seizures.' 116 U.S., at 623—624, 6 S.Ct. at 528.

****1518** Stanford v. Texas, supra, involved a warrant issued by a state judge which described petitioner's home and authorized the search and seizure of 'books, records, pamphlets, cards, receipts, lists, memoranda, pictures, recordings and other written instruments concerning the Communist Party of Texas.' This Court found the warrant to be an unconstitutional general warrant, and invalidated the search and seizure conducted pursuant to it. Unlike the situation in Stanford, the Secretary's regulations do not authorize indiscriminate rummaging among the records of the plaintiffs, nor do the reports they require deal with literary material as in Stanford; the information sought is about commerce, not literature. The reports of foreign financial transactions required by the regulations must contain information as to a relatively limited group of financial transactions in foreign commerce, and are reasonably related to the statutory purpose of assisting in the enforcement of the laws of the United States.

[17] Of primary importance, in addition, is the fact that the information required by the foreign reporting requirements pertains only to commercial transactions which take place across national boundaries. Mr. Chief Justice Taft, in his opinion for the Court in Carroll v. United States, 267 U.S. 132, 45 S.Ct. 280, 69 L.Ed. 543 (1925), observed:

'Travellers may be so stopped in crossing an international boundary because of national self protection reasonably requiring one entering the country to identify himself as entitled to come in, and his belongings as effects which may be lawfully brought in.' Id., at 154, 45 S.Ct., at 285.

This settled proposition has been reaffirmed as recently ***63** as last Term in Almeida-Sanchez v. United States, 413 U.S. 266, 272, 93 S.Ct. 2535, 2539, 37 L.Ed.2d 596 (1973). If reporting of income may be required as an aid to enforcement of the federal revenue statutes, and if those entering and leaving the country may be examined as to their belongings and effects, all without violating the Fourth Amendment, we see no reason to invalidate the Secretary's regulations here. The statutory authorization for the regulations was based upon a conclusion by Congress that international currency transactions and foreign financial institutions were being used by residents of the United States to circumvent the enforcement of the laws of the United States. The regulations are sufficiently tailored so as to single out transactions found to have the greatest potential for such circumvention and which involve substantial amounts of money. They are therefore reasonable in the light of that statutory purpose, and consistent with the Fourth Amendment.

B. FOURTH AMENDMENT CHALLENGE TO THE DOMESTIC REPORTING REQUIREMENTS

The District Court examined the domestic reporting requirements imposed on plaintiffs by looking to the broad authorization of the Act itself, without specific reference to the regulations promulgated under its authority. The District Court observed:

'(A)lthough to date the Secretary has required reporting only by the financial institutions and then only of currency transactions over $10,000, he is empowered by the Act, as indicated above, to require, if he so decides, reporting not only by the financial institution, but also by other parties to or participants in transactions with the institutions and, further, that the Secretary may require reports, not only of currency transactions but of any transaction ***64** involving any monetary instrument—and in any amount —large or small.' 347 F.Supp., at 1246.

The District Court went on to pose, as the question to be resolved, whether 'these provisions, broadly authorizing an executive agency of government to require financial institutions and parties (thereto) . . . to routinely report . . . the detail of almost every conceivable financial transaction . . . ****1519** (are) such an invasion of a citizen's right of privacy as amounts to an unreasonable search within the meaning of the Fourth Amendment.' Ibid.

[18] Since, as we have observed earlier in this opinion, the statute is not self-executing, and were the Secretary to take no action whatever under his authority there would be no possibility of criminal or civil sanctions being imposed on anyone, the District Court was wrong in framing the question in this manner. The question is not what sort of reporting requirements might have been imposed by the Secretary under the broad authority given him in the Act, but rather what sort of reporting requirements he did in fact impose under that authority.

'Even where some of the provisions of a comprehensive legislative enactment are ripe for adjudication, portions of the enactment not immediately involved are not thereby thrown open for a judicial determination of constitutionality. 'Passing upon the possible significance of the manifold provisions of a broad statute in advance of efforts to apply the separate provisions is analogous to rendering an advisory opinion upon a statute or a declaratory judgment upon a hypothetical case.' Watson v. Buck, 313 U.S. 387, 402, 61 S.Ct. 962, 967, 85 L.Ed. 1416.' Communist Party v. SACB, 367 U.S., at 71, 81 S.Ct., at 1397.

The question for decision, therefore, is whether the regulations relating to the reporting of domestic transactions, ***65** violations of which could subject those required to report to civil or criminal penalties, invade any Fourth Amendment right of those required to report. To that question we now turn.

The regulations issued by the Secretary require the reporting of domestic financial transactions only by financial institutions. United States v. Morton Salt Co., 338 U.S. 632, 70 S.Ct. 357, 94 L.Ed. 401 (1950), held that organizations engaged in commerce could be required by the Government to file reports dealing with particular phases of their activities. The language used by the Court in that case is instructive:

'It is unnecessary here to examine the question of whether a corporation is entitled to the protection of the Fourth Amendment. Cf. Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 66 S.Ct. 494, 90 L.Ed. 614. Although the 'right to be let alone—the most comprehensive of rights and the right most valued by civilized men,' Brandeis, J., dissenting in Olmstead v. United States, 277 U.S. 438, 471, at page 478, 48 S.Ct. 564, 570, 572, 72 L.Ed. 944, is not confined literally to searches and seizures as such, but extends as well to the orderly taking under compulsion of process, Boyd v. United States, 116 U.S. 616, 6 S.Ct. 524, 29 L.Ed. 746; Hale v. Henkel, 201 U.S. 43, 70, 26 S.Ct. 370, 377, 50 L.Ed. 652, neither incorporated nor unincorporated associations can plead an unqualified right to conduct their affairs in secret. Hale v. Henkel, supra; United States v. White, 322 U.S. 694, 64 S.Ct. 1248, 88 L.Ed. 1542.

'While they may and should have protection from unlawful demands made in the name of public investigation, cf. Federal Trade Comm'n v. American Tobacco Co., 264 U.S. 298, 44 S.Ct. 336, 68 L.Ed. 696, corporations can claim no equality with individuals in the enjoyment of a right to privacy. Cf. United States v. White, supra. They are endowed with public attributes. They have a collective impact upon society, from ***66** which they derive the privilege of acting as artificial entities. The Federal Government allows them the privilege of engaging in interstate commerce. Favors from government often carry with them an enhanced measure of regulation. (Citations omitted.) Even if one were to regard the request for information in this case as caused by nothing more than official curiosity, nevertheless law-enforcing agencies have a legitimate ****1520** right to satisfy themselves that corporate behavior is consistent with the law and the public interest.' 338 U.S., at 651—652, 70 S.Ct., at 368.

[19] We have no difficulty then in determining that the Secretary's requirements for the reporting of domestic financial transactions abridge no Fourth Amendment right of the banks themselves. The bank is not a mere stranger or bystander with respect to the transactions which it is required to record or report. The bank is itself a party to each of these transactions, earns portions of its income from conducting such transactions, and in the past may have kept records of similar transactions on a voluntary basis for its own purposes. See United States v. Biswell, 406 U.S., at 316, 92 S.Ct., at 1596. The regulations presently in effect governing the reporting of domestic currency transactions require information as to the personal and business identity of the person conducting the transaction and of the person or organization for whom it was conducted, as well as a summary description of the nature of the transaction. It is conceivable, and perhaps likely, that the bank might not of its own volition compile this amount of detail for its own purposes, and therefore to that extent the regulations put the bank in the position of seeking information from the customer in order to eventually report it to the Government. But as we have noted above, 'neither ***67** incorporated nor unincorporated associations can plead an unqualified right to conduct their affairs in secret.' United States v. Morton Salt Co., supra, 338 U.S., at 652, 70 S.Ct., at 368.

[20] The regulations do not impose unreasonable reporting requirements on the banks. The regulations require the reporting of information with respect to abnormally large transactions in currency, much of which information the bank as a party to the transaction already possesses or would acquire in its own interest. To the extent that the regulations in connection with such transactions require the bank to obtain information from a customer simply because the Government wants it, the information is sufficiently described and limited in nature, and sufficiently related to a tenable congressional determination as to improper use of transactions of that type in interstate commerce, so as to withstand the Fourth Amendment challenge made by the bank plaintiffs. '(T)he inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant. 'The gist of the protection is in the requirement, expressed in terms, that the disclosure sought shall not be unreasonable.'' United States v. Morton Salt Co., supra, at 652—653, 70 S.Ct., at 369; see Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 208, 66 S.Ct. 494, 505, 90 L.Ed. 614 (1946).

In addition to the Fourth Amendment challenge to the domestic reporting requirements made by the bank plaintiffs, we are faced with a similar challenge by the depositor plaintiffs, who contend that since the reports of domestic transactions which the bank is required to make will include transactions to which the depositors were parties, the requirement that the bank make a report of the transaction violates the Fourth Amendment rights of the depositor. The complaint filed in the District Court by the ACLU and the depositors contains ***68** no allegation by any of the individual depositors that they were engaged in the type of $10,000 domestic currency transaction which would necessitate that their bank report it to the Government. This is not a situation where there might have been a mere oversight in the specificity of the pleadings and where this Court could properly infer that participation in such a transaction was necessarily inferred from the fact that the individual plaintiffs allege that they are in fact ‘depositors.’ Such an inference can be made, for example, as to the recordkeeping provisions of Title I, which require the banks to keep various records of certain ****1521** transactions by check; as our discussion of the challenges by the individual depositors to the recordkeeping provisions, supra, implicitly recognizes, the allegation that one is a depositor is sufficient to permit consideration of the challenges to the recordkeeping provisions, since any depositor would to some degree be affected by them. Here, however, we simply cannot assume that the mere fact that one is a depositor in a bank means that he has engaged or will engage in a transaction involving more than $10,000 in currency, which is the only type of domestic transaction which the Secretary's regulations require that the banks report. That being so, the depositor plaintiffs lack standing to challenge the domestic reporting regulations, since they do not show that their transactions are required to be reported.[28]

‘Plaintiffs in the federal courts ‘must allege some threatened or actual injury resulting from the putatively ***69** illegal action before a federal court may assume jurisdiction.’ Linda R. S. v. Richard D., 410 U.S. 614, 617, 93 S.Ct. 1146, 1148, 35 L.Ed.2d 536 (1973). There must be a ‘personal stake in the outcome’ such as to ‘assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions.’ Baker v. Carr, 369 U.S. 186, 204, 82 S.Ct. 691, 703, 7 L.Ed.2d 663 (1962). . . . Abstract injury is not enough. It must be alleged that the plaintiff ‘has sustained or is immediately in danger of sustaining some direct injury’ as the result of the challenged statute or official conduct. Massachusetts v. Mellon, 262 U.S. 447, 488, 43 S.Ct. 597, 601, 67 L.Ed. 1078 (1923). The injury or threat of injury must be both ‘real and immediate,’ not ‘conjectural’ or ‘hypothetical.’ Golden v. Zwickler, 394 U.S. 103, 109—110, 89 S.Ct. 956, 960, 22 L.Ed.2d 113 (1969); Maryland Casualty Co. v. Pacific Coal & Oil Co., 312 U.S. 270, 273, 61 S.Ct. 510, 512, 85 L.Ed. 826 (1941); United Public Workers v. Mitchell, 330 U.S. 75, 89—91, 67 S.Ct. 556, 564—565, 91 L.Ed. 754 (1947).' O'Shea v. Littleton, 414 U.S. 488, 493—494, 94 S.Ct. 669, 695, 38 L.Ed.2d 674 (1974) (footnote omitted).

We therefore hold that the Fourth Amendment claims of the depositor plaintiffs may not be considered on the record before us. Nor do we think that the California Bankers Association or the Security National Bank can vicariously assert such Fourth Amendment claims on behalf of bank customers in general.

[21] **[22]** The regulations promulgated by the Secretary require that a report concerning a domestic currency transaction involving more than $10,000 be filed only by the financial institution which is a party to the transaction; the regulations do not require a report from the customer. 31 CFR s 103.22; see 31 U.S.C. s 1082. Both the bank and depositor plaintiffs here argue that the regulations are constitutionally defective because they do not require ***70** the financial institution to notify the customer that a report will be filed concerning the domestic currency transaction. Since we have held that the depositor plaintiffs have not made a sufficient showing of injury to make a constitutional challenge to the domestic reporting requirements, we do not address ourselves to the necessity of notice to those bank customers whose transactions must be reported. The fact that the regulations do not require the banks to notify the customer of the report violates no constitutional right of the banks, and the banks in any event are left free to adopt whatever ****1522** customer notification procedures they desire.[29]

***71** C. FIFTH AMENDMENT CHALLENGE TO THE FOREIGN AND DOMESTIC REPORTING REQUIREMENTS

[23] The District Court rejected the depositor plaintiffs' claim that the foreign reporting requirements violated the depositors' Fifth Amendment privilege against compulsory self-incrimination, and found it unnecessary to consider the similarly based challenge to the domestic reporting requirements since the latter were found to be in violation of the Fourth Amendment. The appeal of the depositor plaintiffs in No. 72—1196 challenges the foreign reporting requirements under the Fifth Amendment, and their brief likewise challenges the domestic reporting requirements as violative of that Amendment. Since they are free to urge in this Court reasons for affirming the judgment of the District Court which may not have been relied upon by the District Court, we consider here the Fifth Amendment objections to both the foreign and the domestic reporting requirements.

[24] As we noted above, the bank plaintiffs, being corporations, have no constitutional privilege against compulsory self-incrimination by virtue of the Fifth Amendment. Hale v. Henkel, 201 U.S. 43, 26 S.Ct. 370, 50 L.Ed. 652 (1906). Their brief urges that they may vicariously assert Fifth Amendment claims on behalf of their depositors. But since we hold infra that those depositor plaintiffs who are actually parties in this litigation are premature in asserting any Fifth Amendment claims, we do not believe that the banks ***72** under these circumstances have standing to assert Fifth Amendment claims on behalf of customers in general.

The individual depositor plaintiffs below made various allegations in the complaint and affidavits filed in the District Court. Plaintiff Stark alleged that he was, in addition to being president of plaintiff Security National Bank, a customer of and depositor in the bank. Plaintiff Marson alleged that he was a customer of and depositor in the Bank of America. Plaintiff Lieberman alleged that he had repeatedly in the recent past transported or shipped one or more monetary instruments exceeding $5,000 in value from the United States to places outside the United States, and ****1523** expected to do likewise in the near future. Plaintiffs Lieberman, Harwood, Bruer, and Durell each alleged that they maintained a financial interest in and signature authority over one or more bank accounts in foreign countries. This, so far as we can assertain from the record, is the sum and substance of the depositors' allegations of fact upon which they seek to mount an attack on the reporting requirements of regulations as violative of the privilege against compulsory self-incrimination granted to each of them by the Fifth Amendment.

Considering first the challenge of the depositor plaintiffs to the foreign reporting requirements, we hold that such claims are premature. In United States v. Sullivan, 274 U.S. 259, 47 S.Ct. 607, 71 L.Ed. 1037 (1927), this Court reviewed a judgment of the Court of Appeals for the Fourth Circuit, 15 F.2d 809 (1926), which had held that the Fifth Amendment protected the respondent from being punished for failure to file an income tax return. This Court reversed the decision below, stating:

‘As the defendant's income was taxed, the statute of course required a return. See United States v. Sischo, 262 U.S. 165, 43 S.Ct. 511, 67 L.Ed. 925. In the decision that this was contrary to the Constitution we are of opinion that ***73** the protection of the Fifth Amendment was pressed too far. If the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all. We are not called on to decide what, if anything, he might have withheld. Most of the items warranted no complaint. It would be an extreme if not an extravagant application of the Fifth Amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime. But if the defendant desired to test that or any other point he should have tested it in the return so that it could be passed upon. He could not draw a conjuror's circle around the whole matter by his own declaration that to write any word upon the government blank would bring him into danger of the law.’ 274 U.S., at 263—264, 47 S.Ct., at 607—608.

[25] Here the depositor plaintiffs allege that they intend to engage in foreign currency transactions or dealings with foreign banks which the Secretary's regulations will require them to report, but they make no additional allegation that any of the information required by the Secretary will tend to incriminate them. It will be time enough for us to determine what, if any, relief from the reporting requirement they may obtain in a judicial proceeding when they have properly and specifically raised a claim of privilege with respect to particular items of information required by the Secretary, and the Secretary has overruled their claim of privilege. The posture of plaintiffs' Fifth Amendment rights here is strikingly similar to those asserted in Communist Party v. SACB, 367 U.S., at 105—110, 81 S.Ct., at 1415—1418. The Communist Party there sought to assert the Fifth Amendment claims of its officers as a ***74** defense to the registration requirement of the Subversive Activities Control Act, although the officers were not at that stage of the proceeding required by the Act to register, and had neither registered nor refused to register on the ground that registration might incriminate them. The Court said:

'If a claim of privilege is made, it may or may not be honored by the Attorney General. We cannot, on the basis of supposition that privilege will be claimed and not honored, proceed now to adjudicate the constitutionality under the Fifth Amendment of the registration provisions. Whatever proceeding may be taken after and if the privilege is claimed will provide ****1524** an adequate forum for litigation of that issue.' Id., at 107, 81 S.Ct., at 1416.

Plaintiffs argue that cases such as Albertson v. SACB, 382 U.S. 70, 86 S.Ct. 194, 15 L.Ed.2d 165 (1965), have relaxed the requirements of earlier cases, but we do not find that contention supported by the language or holding of that case. There the Attorney General had petitioned for and obtained an order from the Subversive Activities Control Board compelling certain named members of the Communist Party to register their affiliation. In response to the Attorney General's petitions, both before the Board and in subsequent judicial proceedings, the Communist Party members had asserted the privilege against self-incrimination, and their claims had been rejected by the Attorney General. A previous decision of this Court had held that an affirmative answer to the inquiry as to membership in the Communist Party was an incriminating admission protected under the Fifth Amendment. Blau v. United States, 340 U.S. 159, 71 S.Ct. 223, 95 L.Ed. 170 (1950). The differences then between the posture of the depositor plaintiffs in this case and that of petitioner in Albertson v. SACB, supra, are evident.

***75** We similarly think that the depositor plaintiffs' challenges to the domestic reporting requirements are premature. As we noted above, it is not apparent from the allegations of the complaints in these actions that any of the depositor plaintiffs would be engaged in $10,000 domestic transactions with the bank which the latter would be required to report under the Secretary's regulations pertaining to such domestic transactions. Not only is there no allegation that any depositor engaged in such transactions, but there is no allegation in the complaint that any report which such a bank was required to make would contain information incriminating any depositor. To what extent, if any, depositors may claim a privilege arising from the Fifth Amendment by reason of the obligation of the bank to report such a transaction may be left for resolution when the claim of privilege is properly asserted.

Depositor plaintiffs rely on Marchetti v. United States, 390 U.S. 39, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968), Grosso v. United States, 390 U.S. 62, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968), and Haynes v. United States. 390 U.S. 85, 88 S.Ct. 722, 19 L.Ed.2d 923 (1968), as supporting the merits of their Fifth Amendment claim. In each of those cases, however, a claim of privilege was asserted as a defense to the requirement of reporting particular information required by the law under challenge, and those decisions therefore in no way militate against our conclusion that depositor plaintiffs' efforts to litigate the Fifth Amendment issue at this time are premature.

D. PLAINTIFF ACLU's FIRST AMENDMENT CHALLENGE TO THE FOREIGN AND DOMESTIC REPORTING REQUIREMENTS

[26] The ACLU claims that the reporting requirements with respect to foreign and domestic transactions invade its associational interests protected by the First Amendment. ***76** We have earlier held a similar claim by this organization to be speculative and hypothetical when addressed to the recordkeeping requirements imposed by the Secretary. Supra, at 1514—1515. The requirement that particular transactions be reported to the Government, rather than that records of them be available through normal legal process, removes part of the speculative quality of the claim. But the only allegation found in the complaints with respect to the financial activities of the ACLU states that it maintains accounts at one of the San Francisco offices of the Wells Fargo Bank & Trust Company. There is no allegation that the ACLU engages with any regularity in abnormally large domestic currency transactions, transports or receives monetary instruments from channels of foreign commerce, or maintains accounts in financial institutions in foreign countries. Until there is some showing that the reporting requirements ****1525** contained in the Secretary's regulations would require the reporting of information with respect to the organization's financial activities, no concrete controversy is presented to this Court for adjudication. O'Shea v. Littleton, 414 U.S., at 493—494, 94 S.Ct., at 675.

V

[27] **[28]** **[29]** All of the bank and depositor plaintiffs have stressed in their presentations to the District Court and to this Court that the recordkeeping and reporting requirements of the Bank Secrecy Act are focused in large part on the acquisition of information to assist in the enforcement of the criminal laws. While, as we have noted, Congress seems to have been equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported, concern for the enforcement of the criminal law was undoubtedly prominant in the minds of the legislators who considered ***77** the Act. We do not think it is strange or irrational that Congress, having its attention called to what appeared to be serious and organized efforts to avoid detection of criminal activity, should have legislated to rectify the situation. We have no doubt that Congress, in the sphere of its legislative authority, may just as properly address itself to the effective enforcement of criminal laws which it has previously enacted as to the enactment of those laws in the first instance. In so doing, it is of course subject to the strictures of the Bill of Rights, and may not transgress those strictures.[30] But the fact that a legislative enactment manifests a concern for the enforcement of the criminal law does not cast any generalized pall of constitutional suspicion over it. Having concluded that on the record in these appeals, plaintiffs have failed to state a claim for relief under the First, Fourth, and Fifth Amendments, and having concluded that the enactment in question was within the legislative authority of Congress, our inquiry is at an end.

On the appeal of the California Bankers Association in No. 72—985 from that portion of the judgment of the District Court upholding the recordkeeping requirements imposed by the Secretary pursuant to Title I, the judgment is affirmed. On the appeal of the bank and depositor plaintiffs in No. 72—1196 from that portion of the District Court's judgment upholding the recordkeeping requirements and regulations of Title I and the foreign reporting requirements imposed under the authority of Title II, the judgment is likewise affirmed. On the Government's ***78** appeal in No. 72—1073 from that portion of the District Court's judgment which held that the domestic reporting requirements imposed under Title II of the Act violated the Constitution, the judgment is reversed. The cause is remanded to the District Court for disposition consistent with this opinion.

So ordered.

Affirmed in part, reversed in part, and remanded.

Mr. Justice POWELL, with whom Mr. Justice BLACKMUN joins, concurring.

I join the Court's opinion, but add a word concerning the Act's domestic reporting requirements.

The Act confers broad authority on the Secretary to require reports of domestic monetary transactions from the financial institutions and parties involved. 31 U.S.C. ss 1081 and 1082. The implementing regulations, however, require only that the financial institution 'file a report on each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or ****1526** to such financial institution, which involves a transaction in currency of more than $10,000.' 31 CFR s 103.22 (italics added). As the Court properly recognizes, we must analyze plaintiffs' contentions in the context of the Act as narrowed by the regulations. Ante, at 1519. From this perspective, I agree that the regulations do not constitute an impermissible infringement of any constitutional right.

A significant extension of the regulations' reporting requirements, however, would pose substantial and difficult constitutional questions for me. In their full reach, the reports apparently authorized by the open-ended language of the Act touch upon intimate areas of an individual's personal affairs. Financial transactions can reveal much about a person's activities, associations, ***79** and beliefs. At some point, governmental intrusion upon these areas would implicate legitimate expectations of privacy. Moreover, the potential for abuse is particularly acute where, as here, the legislative scheme permits access to this information without invocation of the judicial process. In such instances, the important responsibility for balancing societal and individual interests is left to unreviewed executive discretion, rather than the scrutiny of a neutral magistrate. United States v. United States District Court, 407 U.S. 297, 316—317, 92 S.Ct. 2125, 2136—2137, 32 L.Ed. 2d 752 (1972). As the issues are presently framed, however, I am in accord with the Court's disposition of the matter.

Mr. Justice DOUGLAS, dissenting.

I

The Court expresses a doubt that the California Bankers Association has standing to litigate the claims it asserts.

That doubt, however, should be dissipated by our decisions.

Sierra Club v. Morton, 405 U.S. 727, 739, 92 S.Ct. 1361, 1368, 31 L.Ed.2d 636, stated unequivocally that 'an organization whose members are injured may represent those members in a proceeding for judicial review.'

Appellants in No. 72—1196 are a national bank, a bank customer and depositor, a membership organization which is a customer of banks and receives money through banks for its members, a businessman who has engaged in and expects to engage in foreign financial transactions, and individuals having interests in or authority over foreign bank accounts. There can hardly be any doubt that these persons—at least the individuals and the membership organization—having standing. I think the same is true of the national bank in No. 72—1196 and the California Bankers Association in No. 72—985.

***80** The claims the associations litigate in these cases are not only those of its members but also those of the depositors of those member banks. This will cost the banks, it is estimated, over $6 million a year. Certainly that is enough to give the banks standing. Moreover, they must spy on their customers. The Bank Secrecy Act requires banks to record and retain the details of their customers' financial lives. In Pierce v. Society of Sisters, 268 U.S. 510, 45 S.Ct. 571, 69 L.Ed. 1070, the Court upheld the right of a representative litigant, a parochial school, to have standing to raise questions pertaining to the rights of parents, guardians, and children. See Barrows v. Jackson, 346 U.S. 249, 257, 73 S.Ct. 1031, 1035, 97 L.Ed. 1586. In Eisenstadt v. Baird, 405 U.S. 438, 92 S.Ct. 1029, 31 L.Ed.2d 349, we upheld that the standing of a distributor of contraceptives to assert rights of unmarried persons, since they were denied 'a forum in which to assert their own rights.' Id., at 446, 92 S.Ct., at 1034. The question of standing has been variously described. But the 'gist' of the question, we said in Baker v. Carr, 369 U.S. 186, 204, 82 S.Ct., 691, 703, 7 L.Ed.2d 663, was whether the party has 'such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues.' There is that 'concrete ****1527** adverseness' here; and that doubtless is the reason the Solicitor General does not raise the question which the Court now stirs.

II

The Act has as its primary goal the enforcement of the criminal law.[1] The recordkeeping requirements originated ***81** according to Congressman Patman, author of the measure, with the Department of Justice and the Internal Revenue Service in response to two problems: (1) 'A trend was developing in the larger banks away from their traditional practices of microfilming all checks drawn on them.' 116 Cong.Rec. 16953. (2) As respects the identification of depositors, '(a) typical example might involve a situation where a person with a criminal reputation holds an account but does not personally make deposits or withdrawals.' Ibid.

The purpose of the Act was to give the Secretary of the Treasury 'primary responsibility' under Title II 'to see to it that criminals do not take undue advantage ***82** of international trade and go undetected and unpunished.' Id., at 16954. He added 'I would be the first to admit that this legislation does not provide perfect crime prevention. However, it is felt that the legislation will substantially increase the risk of discovery of any criminal who undertakes to hide his activity behind foreign secrecy.' Id., at 16955.

The same purpose was reflected in the Senate. Senator Proxmire, the author of the Senate version of the bill, stated: '(T)he purpose of the bill is to provide law enforcement authorities with greater evidence of financial transactions in order to reduce the incidence of whitecollar crime.'[2] Id., at 32627.

Customers have a constitutionally justifiable expectation of privacy in the documentary details of the financial transactions reflected in their bank accounts. That wall is not impregnable. Our Constitution provides the procedures whereby the confidentiality of one's financial affairs may be disclosed.

A

First, as to the recordkeeping requirements,[3] their announced purpose ****1528** is that they will have 'a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings,' 12 U.S.C. ss 1829b(a)(2), 1953(a). The duty of the bank or institution is to microfilm or otherwise copy every check, draft, or similar instrument drawn on it or presented to it for payment and to keep ***83** a record of each one 'received by it for deposit or collection,' 12 U.S.C. ss 1829b(d)(1) and (2). The retention is for up to six years unless the Secretary determines that 'a longer period is necessary,' 12 U.S.C. s 1829b(g). The regulations[4] issued by the Secretary ***84** show the depth and extent of the quicksand in which our financial institutions must now operate.[5]

It is estimated that a minimum of 20 billion checks—and perhaps 30 billion—will have to be photocopied and that the weight of these little pieces of paper will approximate 166 million pounds a year.[6]

****1529** It would be highly useful to governmental espionage to have like reports from all our bookstores, all our hardware ***85** and retail stores, all our drugstores. These records too might be 'useful' in criminal investigations.

One's reading habits furnish telltale clues to those who are bent on bending us to one point of view. What one buys at the hardware and retail stores may furnish clues to potential uses of wires, soap powders, and the like used by criminals. A mandatory recording of all telephone conversations would be better than the recording of checks under the Bank Secrecy Act, if Big Brother is to have his way. The records of checks—now available to the investigators—are highly useful. In a sense a person is defined by the checks he writes. By examining them the agents get to know his doctors, lawyers, creditors, political allies, social connections, religious affiliation, educational interests, the papers and magazines he reads, and so on ad infinitum. These are all tied to one's social security number; and now that we have the data banks, these other items will enrich that storehouse and make it possible for a bureaucrat—by pushing one button—to get in an instant the names of the 190 million Americans who are subversives or potential and likely candidates.

It is, I submit, sheer nonsense to agree with the Secretary that all bank records of every citizen 'have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.' That is unadulterated nonsense unless we are to assume that every citizen is a crook, an assumption I cannot make.

Since the banking transactions of an individual give a fairly accurate account of his religion, ideology, opinions, and interests, a regulation impounding them and making them automatically available to all federal investigative agencies is a sledge-hammer approach to a problem that only a delicate scalpel can manage. Where fundamental personal rights are involved—as is true when as here the ***86** Government gets large access to one's beliefs, ideas, politics, religion, cultural concerns, and the like—the Act should be 'narrowly drawn' (Cantwell v. Connecticut, 310 U.S. 296, 307, 60 S.Ct. 900, 905, 84 L.Ed. 1213) to meet the precise evil.[7] Bank accounts at times harbor criminal plans. But we only rush with the crowd when we vent on our banks and their customers the devastating and leveling requirements of the present Act. I am not yet ready to agree that America is so possessed with evil that we must level all constitutional barriers to give our civil authorities the tools to catch criminals.

Heretofore this Nation has confined compulsory recordkeeping to that required to monitor either (1) the recordkeeper, or (2) his business. Marchetti v. United States, 390 U.S. 39, 88 S.Ct. 697, 19 L.Ed.2d 889 and United States v. Darby, 312 U.S. 100, 61 S.Ct. 451, 85 L.Ed. 609, are illustrative. Even then, as Mr. Justice Harlan writing for the Court said, they must be records that would 'customarily' be kept, have a 'public' rather than a private purpose, and arise out of an "essentially noncriminal and regulatory area of inquiry." ****1530** Marchetti v. United States, supra, 390 U.S., at 57, 88 S.Ct., at 707.

Those requirements are in no way satisfied here, and yet there is saddled upon the banks of this Nation an estimated bill of over $6 million a year to spy on their customers.

***87** B

Second, as to the reporting provisions of the Act, they require disclosure of two types of foreign financial transactions and relationships. One provision requires a report of transportation into or out of the country of monetary instruments exceeding $5,000.[8] Another requires parties to any transaction or relationship with 'a foreign financial agency' to make such reports or make and keep such records as the Secretary may require.[9] Civil[10] and criminal[11] penalties are sanctions behind these reporting provisions.

The Act also requires the Secretary to make the reported information concerning transactions 'available for a purpose consistent with the provisions of this chapter to any other department or agency of the Federal

Government' upon request.[12] And to overcome any claims of self-incrimination it requires the grant of use immunity.[13]

***88** As respects domestic transactions the Secretary established two reporting requirements. (1) Routine reports are, with some exceptions, required concerning any transaction of more than $10,000 in currency from each financial institution involved.[14] The signature of at least one principal party to the transaction is required.[15] (2) The Secretary at the time of the trial reserved the right to grant exemptions from the requirements, impose additional recordkeeping or reporting requirements authorized by statute, or otherwise modify, the requirements of this part.[16]

We said in Katz v. United States, 389 U.S. 347, 351—352, 88 S.Ct. 507, 511, 19 L.Ed.2d 576: 'What a person knowingly ****1531** exposes to the public, even in his own home or office, is not a subject of Fourth Amendment protection. . . . But what he seeks to preserve ***89** as private, even in an area accessible to the public, may be constitutionally protected.' As stated in United States v. White, 401 U.S. 745, 752, 91 S.Ct. 1122, 1126, 28 L.Ed.2d 453, the question is 'what expectations of privacy' will be protected by the Fourth Amendment 'in the absence of a warrant.' A search and seizure conducted without a warrant is per se unreasonable, subject to 'jealously and carefully drawn' exceptions, Jones v. United States, 357 U.S. 493, 499, 78 S.Ct. 1253, 1257, 2 L.Ed.2d 1514. One's bank accounts are within the 'expectations of privacy' category. For they mirror not only one's finances but his interests, his debts, his way of life, his family, and his civic commitments. There are administrative summonses for documents, cf. Camara v. Municipal Court, 387 U.S. 523, 87 S.Ct. 1727, 18 L.Ed.2d 930; See v. City of Seattle, 387 U.S. 541, 87 S.Ct. 1737, 18 L.Ed.2d 943. But there is a requirement that their enforcement receive judicial scrutiny and a judicial order, United States v. United States District Court, 407 U.S. 297, 313—318, 92 S.Ct. 2125, 2134—2137, 32 L.Ed.2d 752. As we said in that case, 'The Fourth Amendment does not contemplate the executive officers of Government as neutral and disinterested magistrates. Their duty and responsibility are to enforce the laws, to investigate, and to prosecute. . . . But those charged with this investigative and prosecutorial duty should not be the sole judges of when to utilize constitutionally sensitive means in pursuing their tasks. The historical judgment, which the Fourth Amendment accepts, is that unreviewed executive discretion may yield too readily to pressures to obtain incriminating evidence and overlook potential invasions of privacy and protected speech.' Id., at 317, 92 S.Ct., at 2136.

Suppose Congress passed a law requiring telephone companies to record and retain all telephone calls and make them available to any federal agency on request. Would we hesitate even a moment before striking it down? I think not, for we condemned in United States v. United States District Court 'the broad and unsuspected governmental ***90** incursions into conversational privacy which electronic surveillance entails.' Id., at 313, 92 S.Ct., at 2135.

A checking account, as I have said, may well record a citizen's activities, opinion, and beliefs as fully as transcripts of his telephone conversations.

The Fourth Amendment warrant requirements may be removed by constitutional amendment but they certainly cannot be replaced by the Secretary of the Treasury's finding that certain information will be highly useful in 'criminal, tax, or regulatory investigations or proceedings.' 12 U.S.C. s 1951(b).

We cannot avoid the question of the constitutionality of the reporting provisions of the Act and of the regulations by saying they have not yet been applied to a customer in any criminal case. Under the Act and regulations the reports go forward to the investigative or prosecuting agency on written request without notice to the customer. Delivery of the records without the requisite hearing of probable cause[17] breaches the Fourth Amendment.

****1532** I also agree in substance with my Brother BRENNAN's view that the grant of authority by Congress to the Secretary of the Treasury is too broad to pass constitutional muster. This legislation is symptomatic of the ***91** slow eclipse of Congress by the mounting Executive power. The phenomenon is not brand new. It was reflected in Schechter Poultry Corp. v. United States, 295 U.S. 495, 55 S.Ct. 837, 79 L.Ed. 1570. United States v. Robel, 389 U.S. 258, 88 S.Ct. 419, 19 L.Ed.2d 508, is a more recent example. National Cable Television Assn. v. United States, 415 U.S. 336, 94 S.Ct. 1146, 39 L.Ed.2d 370, and FPC v. New England Power Co., 415 U.S. 345, 94 S.Ct. 1151, 39 L.Ed.2d 383, are even more recent. These omnibus grants of power allow the Executive Branch to make the law as it chooses in violation of the teachings of Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 72 S.Ct. 863, 96 L.Ed. 1153, as well as Schechter, that lawmaking is a congressional, not an Executive, function.

Mr. Justice BRENNAN, dissenting.

I concur in Parts I and II—A of Mr. Justice DOUGLAS' opinion. As to the Act's foreign and domestic reporting requirements, however, I see no need to address the independent constitutional objections the plaintiffs below attempt to raise. The reporting requirements are inseparable from—and in some cases considerably broader than—the recordkeeping requirements. Thus, since in my view the recordkeeping provisions unconstitutionally vest impermissibly broad authority in the Secretary of the Treasury, see United States v. Robel, 389 U.S. 258, 269, 88 S.Ct. 419, 426, 19 L.Ed.2d 508 (1967) (Brennan, J., concurring in result), the reporting provisions, too, are invalid.

The symbiotic nature of the recordkeeping and reporting requirements is clearly manifested in the expressions of congressional purpose found in 12 U.S.C. s 1951(b) and 31 U.S.C. s 1051, which lay down blanket commands that 'records' and 'reports' be required where they 'have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings.'

One example of this interdependence may be found in 12 U.S.C. ss 1951—1953, which apply to 'any uninsured ***92** bank or uninsured institution,' terms which are themselves not defined in the Act. Section 1953 authorizes the Secretary to require the keeping of 'any records or evidence of any type' so long as he may require them of insured banks. Section 1952 authorizes him to require 'the making of appropriate reports by uninsured banks or uninsured institutions of any type with respect to their ownership, control, and managements and any changes therein.' As appears from the legislative history, these provisions work in tandem, permitting the Secretary to detect instances of the use of sham or illegal transactions in which the institutional party is merely an alter ego of the customer it purportedly services. See S.Rep.No.91—1139, p. 3 (1970); Hearings on Foreign Bank Secrecy and Bank Records (H.R. 15073) before the House Committee on Banking and Currency, 91st Cong., 1st and 2d Sess., 10—14 (1969—1970). Neither provision would usefully aid the detection of such practices without the other.

Not only are the reporting and recordkeeping requirements functionally inseparable, but the reporting requirements impose additional requirements, thus adding to the power of the Secretary to invade individual rights. For instance, the reporting provisions for all transactions involving domestic financial institutions, 31 U.S.C. s 1081, authorizes the Secretary to require reports at any time and in any manner and detail, of any transaction that involves the 'payment, receipt, or transfer of United States currency, or such other monetary instruments as the Secretary may specify.' Although the Secretary has by regulation limited the meaning of 'monetary instruments,' 31 CFR s 103.11, and invoked the section only where the transaction involves more than $10,000, ****1533** see 31 CFR s 103.22, this in no way alters the fundamental vice of the statute.

***93** That vice, see concurring opinion in United States v. Robel, supra, is the delegation of power to the Secretary in broad and indefinite terms under a statute that lays down criminal sanctions and potentially affects fundamental rights. See Bantam Books, Inc. v. Sullivan, 372 U.S. 58, 83 S.Ct. 631, 9 L.Ed.2d 584 (1963); Cantwell v. Connecticut, 310 U.S. 296, 304—307, 60 S.Ct. 900, 903—905, 84 L.Ed. 1213 (1940). My view in Robel applies here:
'Formulation of policy is a legislature's primary responsibility, entrusted to it by the electorate, and to the extent Congress delegates authority under indefinite standards, this policy-making function is passed on to other agencies, often not answerable or responsive in the same degree to the people. '(S)tandards of permissible statutory vagueness are strict . . .' in protected areas. NAACP v. Button, 371 U.S., at 432, 83 S.Ct., at 337. 'Without explicit action by lawmakers, decisions of great constitutional import and effect would be relegated by default to administrators who, under our system of government, are not endowed with authority to decide them.' Greene v. McElroy, 360 U.S. 474, 507, 79 S.Ct. 1400, 1419, 3 L.Ed.2d 1377.' 389 U.S., at 276, 88 S.Ct., at 430.

In the case of the Bank Secrecy Act, also potentially involving First, Fourth, and Fifth Amendment rights of the vast majority of our citizenry, it exceeds Congress' constitutional power of delegation to empower the Secretary of the Treasury to require whatever reports and records he believes to be possessed of a 'high degree of usefulness' where the purpose is to further 'criminal, tax, or regulatory investigations or proceedings.'

Mr. Justice MARSHALL, dissenting.

Although I am in general agreement with the opinions of my Brothers DOUGLAS and BRENNAN, I believe it important to set forth what I view as the essential issue in these cases.

***94** The purposes of the recordkeeping requirements of the Bank Secrecy Act are clear from the language of the legislation itself—to require the maintenance of records which will later be available for examination by the Government in 'criminal, tax, or regulatory investigations or proceedings.' See 12 U.S.C. ss 1829b(a)(2) and 1951(b). The maintenance of the records is thus but the initial step in a process whereby the Government seeks to acquire the private financial papers of the millions of individuals, businesses, and organizations that maintain accounts in banks and use negotiable instruments such as checks to carry out the financial side of their day-by-day transactions. In my view, this attempt to acquire private papers constitutes a search and seizure under the Fourth Amendment.

As this Court settled long ago in Boyd v. United States, 116 U.S. 616, 622, 6 S.Ct. 524, 528, 29 L.Ed. 746 (1886), 'a compulsory production of a man's private papers to establish a criminal charge against him . . . is within the scope of the fourth amendment to the constitution . . ..' The acquisition of records in this case, as we said of the order to produce an invoice in Boyd, may lack the 'aggravating incidents of actual search and seizure, such as forcible entry into a man's house and searching amongst his papers . . .,' Id., at 622, 6 S.Ct., at 527, but this cannot change its intrinsic character as a search and seizure. We do well to recall the admonishment in Boyd, id., at 635, 6 S.Ct., at 535:

> 'It may be that it is the obnoxious thing in its mildest and least repulsive form; but illegitimate and unconstitutional practices get their first footing in that way, namely, by silent approaches and slight deviations from legal modes of procedure.'

By compelling an otherwise unwilling bank to photocopy the checks of its customers, ****1534** the Government has as much of a hand in seizing those checks as if it had forced ***95** a private person to break into the customer's home or office and photocopy the checks there. See Byars v. United States, 273 U.S. 28, 47 S.Ct. 248, 71 L.Ed. 520 (1927). Compare Burdeau v. McDowell, 256 U.S. 465, 41 S.Ct. 574, 65 L.Ed. 1048 (1921), with Lustig v. United States, 338 U.S. 74, 78—79, 69 S.Ct. 1372, 1373—1374, 93 L.Ed. 1819 (Frankfurter, J.). See also, Corngold v. United States, 367 F.2d 1 (CA9 1966). Our Fourth Amendment jurisprudence should not be so wooden as to ignore the fact that through micro-filming and other techniques of this electronic age, illegal searches and seizures can take place without the brute force characteristic of the general warrants which raised the ire of the Founding Fathers. See Entick v. Carrington, 19 How.St.Tr. 1029 (1765); Stanford v. Texas, 379 U.S. 476, 483—484, 85 S.Ct. 506, 510—511, 13 L.Ed.2d 431 (1965). As we emphasized in Katz v. United States, 389 U.S. 347, 88 S.Ct. 507, 19 L.Ed.2d 576 (1967), the absence of any physical seizure of tangible property does not foreclose Fourth Amendment inquiry. Id., at 352—353, 88 S.Ct., at 511—512. The Fourth Amendment 'governs not only the seizure of tangible items, but extends as well to the recording of oral statements . . ..' Id., at 353, 88 S.Ct., at 512. By the same logic, the Fourth Amendment should apply to the recording of checks mandated by the Act here. And such a massive and indiscriminate search and seizure, not only without a warrant but also without probable cause to believe that any evidence to be obtained is relevant to any investigation, is plainly inconsistent with the principles behind the Amendment. See Stanford v. Texas, supra, 379 U.S., at 485—486, 85 S.Ct., at 511—512; Katz v. United States, supra, 389 U.S., at 356—359, 88 S.Ct., at 514—515.

It is suggested that there is no seizure under the Fourth Amendment because the bank, which is required to create and maintain the record, is already a party to the transaction. See ante, at 1513. Surely this is irrelevant to the question of whether a Government search or seizure is involved. The fact that one has disclosed private papers to the bank, for a limited purpose, within the context of ***96** a confidential customerbank relationship, does not mean that one has waived all right to the privacy of the papers. Like the user of the pay phone in Katz v. United States, who, having paid the toll, was 'entitled to assume that the words he utters into the mouthpiece will not be broadcast to the world,' 389 U.S., at 352, 88 S.Ct., at 512, so the customer of a bank, having written or deposited a check, has a reasonable expectation that his check will be examined for bank purposes only—to credit, debit or balance his account—and not recorded and kept on file for several years by Government decree so that it can be available for Government scrutiny. See United States v. First Nat. Bank of Mobile, 67 F.Supp. 616 (SD Ala.1946).

The majority argues that any Fourth Amendment claim is premature, since the Act itself only affects the keeping of records and in no way changes the law regarding acquisition of the records by the Government. I cannot agree. This attempt to bifurcate the acquisition of information into two independent and unrelated steps is wholly unrealistic. As the Government itself concedes, 'banks have in the past voluntarily allowed law enforcement officials to inspect bank records without requiring the issuance of a summons.' Brief for Appellees in Nos. 72—985 and 72—1196, p. 38 n. 19. Indeed, the Chief of the Organized Crime and Racketeering Section of the Criminal Division of the Justice Department told a Senate Subcommittee in 1972 that access by the FBI to bank records without process occurs 'with some degree of frequency.' Hearings to amend the Bank Secrecy Act (S. 3814 and S. 3828) before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban ****1535** Affairs, 92d Cong., 2d Sess., 114—115 (1972).

The plain fact of the matter is that the Act's recordkeeping requirement feeds into a system of widespread ***97** informal access to bank records by Government agencies and law enforcement personnel. If these customers' Fourth Amendment claims cannot be raised now, they cannot be raised at all, for once recorded, their checks will be readily accessible, without judicial process and without any showing of probable cause, to any of the several agencies that presently have informal access to bank records.

The Government suggests that the Act does not in any way preclude banks from refusing to allow informal access and insisting on the issuance of legal process before turning over a customer's financial records. Such a refusal, however, even if accompanied by notice to the customer with an opportunity for him to assert his constitutional claims, comes too late, for the seizure has already taken place. By virtue of the Act's recordkeeping requirement, copies of the customer's checks are already in the bank's files and amenable to process. The seizure has already occurred, and all that remains is the transfer of the documents from the agent forced by the Government to accomplish the seizure to the Government itself. Indeed, it is ironic that although the majority deems the bank customers' Fourth Amendment claims premature, it also intimates that once the bank has made copies of a customer's checks, the customer no longer has standing to invoke his Fourth Amendment rights when a demand is made on the bank by the Government for the records. See ante, at 1513. By accepting the Government's bifurcated approach to the recordkeeping requirement and the acquisition of the records, the majority engages in a hollow charade whereby Fourth Amendment claims are to be labeled premature until such time as they can be deemed too late.

Nor can I accept the majority's analysis of the First Amendment associational claims raised by the American ***98** Civil Liberties Union on behalf of its members who seek to preserve the anonymity of their financial support of the organization. The First Amendment gives organizations such as the ACLU the right to maintain in confidence the names of those who belong or contribute to the organization, absent a compelling governmental interest requiring disclosure. See NAACP v. Alabama, 357 U.S. 449, 78 S.Ct. 1163, 2 L.Ed.2d 1488 (1958). See also Lamont v. Postmaster General, 381 U.S. 301, 85 S.Ct. 1493, 14 L.Ed.2d 398 (1965); Gibson v. Florida Legislative Investigation Comm'n, 372 U.S. 539, 83 S.Ct. 889, 9 L.Ed.2d 929 (1963); Louisiana ex rel. Gremillion v. NAACP, 366 U.S. 293, 81 S.Ct. 1333, 6 L.Ed.2d 301 (1961); Shelton v. Tucker, 364 U.S. 479, 81 S.Ct. 247, 5 L.Ed.2d 231 (1960); Bates v. City of Little Rock, 361 U.S. 516, 80 S.Ct. 412, 4 L.Ed.2d 480 (1960); United States v. Rumely, 345 U.S. 41, 73 S.Ct. 543, 97 L.Ed. 770 (1953). It is certainly inconsistent with this long line of cases for the Government, absent any showing of need whatsoever, to require the bank with which the ACLU maintains an account to make and keep a microfilm record of all checks received by the ACLU and deposited to its account. The net result of this requirement, obviously, is an easily accessible list of all of the ACLU's contributors. And, given the widespread informal access to bank records by Government agencies, see supra, at 1534—1535, the existence of such a list surely will chill the exercise of First Amendment rights of association on the part of those who wish to have their contributions remain anonymous. The technique of examining bank accounts to investigate political organizations is, unfortunately, not rare. See, e.g., Pollard v. Roberts, 283 F.Supp. 248 (E.D.Ark.), aff'd per curiam, 393 U.S. 14, 89 S.Ct. 47, 21 L.Ed.2d 14 (1968); United States Servicemen's Fund v. Eastland, 159 U.S.App.D.C. 352, 488 F.2d 1252 (1973).

First Amendment freedoms are 'delicate and vulnerable' They need breathing ****1536** space to survive. NAACP v. Button, 371 U.S. 415, 433, 83 S.Ct. 328, 338, 9

L.Ed.2d 405 (1963). The threat of disclosure entailed in the existence of an easily accessible ***99** list of contributors may deter the exercise of First Amendment rights as potently as disclosure itself. Cf. ibid. See also United States Servicemen's Fund v. Eastland, supra, 159 U.S.App.D.C., at 365—368, 488 F.2d, at 1265—1268. More importantly, however slight may be the inhibition of First Amendment rights caused by the bank's maintenance of the list of contributors, the crucial factor is that the Government has shown no need, compelling or otherwise, for the maintenance of such records. Surely the fact that some may use negotiable instruments for illegal purposes cannot justify the Government's running roughshod over the First Amendment rights of the hundreds of lawful yet controversial organizations like the ACLU. Congress may well have been correct in concluding that law enforcement would be facilitated by the dragnet requirements of this Act. Those who wrote our Constitution, however, recognized more important values.

I respectfully dissent.

All Citations

416 U.S. 21, 94 S.Ct. 1494, 39 L.Ed.2d 812, 33 A.F.T.R.2d 74-1041, 74-1 USTC P 9318, 1974-1 C.B. 393

Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Timber & Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

[1] See generally S.Rep.No.91—1139 (1970); H.R.Rep.No.91—975 (1970), U.S.Code Cong. & Admin.News 1970, p. 4394; Hearings on Foreign Bank Secrecy and Bank Records (H.R. 15073) before the House Committee on Banking and Currency, 91st Cong., 1st and 2d Sess. (1969—1970); Hearings on Foreign Bank Secrecy (S. 3678 and H.R. 15073) before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency, 91st Cong., 2d Sess. (1970).

[2] See n. 11, infra.

[3] Under s 123(b), 12 U.S.C. s 1953(b), the authority of the Secretary extends to any person engaging in the business of:
‘(1) Issuing or redeeming checks, money orders, travelers' checks, or similar instruments, except as an incident to the conduct of its own nonfinancial business.
‘(2) Transferring funds or credits domestically or internationally.
‘(3) Operating a currency exchange or otherwise dealing in foreign currencies or credits.
‘(4) Operating a credit card system.
‘(5) Performing such similar, related, or substitute functions for any of the foregoing or for banking as may be specified by the Secretary in regulations.’
Section 122 of the Act, 12 U.S.C. s 1952, authorizes theSecretary to require reports with respect to the ownership, control, and management of uninsured domestic financial institutions.

[4] See House Hearings, supra, n. 1, at 60—61, 80, 146, 162, 314, 316, 321, 333; S.Rep.No. 91—1139, supra, at 18—19 (Supplemental views).

[5] For a summary of the task force study, see Hearings to amend the Bank Secrecy Act (S. 3814 and S. 3828) before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., 60—64 (1972). The Secretary initially issued regulations on April 5, 1972 implementing the provisions of the Act. See 31 CFR pt. 103 (37 Fed.Reg. 6912). The Treasury Department task force found that law enforcement would not be greatly impaired by limiting the check-copying requirement to checks in excess of $100. In Assistant Secretary of the Treasury estimated that this exclusion would eliminate 90% of all personal checks from the microfilming requirements. Senate Hearings on S. 3814, supra, at 42, 44, 57—58. The regulations were thus amended shortly after their promulgation to exclude the copying of checks drawn for $100 or less. 31 CFR s 103.34(b)(3), as amended, 37 Fed.Reg. 23114 (1972), 38 Fed.Reg. 2174 (1973), effective Jan. 17, 1973.

[6] Exempted by 31 CFR s 103.34(b)(3) are dividend checks, payroll checks, employee benefit checks, insurance claim checks, medical benefit checks, checks drawn on governmental agency accounts, checks drawn by brokers or dealers in securities, checks drawn on fiduciary accounts, checks drawn on other financial institutions, and pension or annuity checks, provided they are drawn on an account expected to average at least one hundred checks per month.

[7] Title 31 CFR s 103.34(b) requires that each bank retain either the original or a microfilm or other copy or reproduction of (1) documents granting signature authority over accounts; (2) statements or ledger cards showing transactions in each

account; (3) each item involving more than $10,000 remitted or transferred to a person, account, or place outside the United States; (4) a record of each remittance or transaction of funds, currency, monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account, or place outside the United States; (5) each check or draft in an amount exceeding $10,000 drawn on or issued by a foreign bank which the domestic bank has paid or presented to a nonbank drawee for payment; (6) each item of more than $10,000 received directly from a bank, broker, or dealer in foreign exchange outside the United States; (7) a record of each receipt of currency, monetary instruments, checks, or investment securities, and each transfer of funds or credit in amounts exceeding $10,000 received directly from a bank, broker, or dealer in foreign exchange outside the United States; (8) records needed to reconstruct a demand deposit account and to trace checks in excess of $100 deposited in such account.

Title 31 CFR s 103.35 requires brokers and dealers in securities to maintain similar information with respect to their brokerage accounts.

The prescribed retention period for all records under the regulations is five years, except for the records required for reconstructing a demand deposit account, which must be retained for only two years. 31 CFR s 103.36(c).

[8] Title 31 CFR s 103.51 provides:

'Except as provided in ss 103.34(a)(1) and 103.35(a)(1), and except for the purpose of assuring compliance with the recordkeeping and reporting requirements of this part, this part does not authorize the Secretary or any other person to inspect or review the records required to be maintained by subpart C of this part. Other inspection, review or access to such records is governed by other appliable law.'

This regulation became effective January 17, 1973. 37 Fed.Reg. 23114 (1972); 38 Fed.Reg. 2174 (1973).

[9] 'Monetary instrument' is defined by s 203(l) of the Act as 'coin and currency of the United States, and in addition, such foreign coin and currencies, and such types of travelers' checks, bearer negotiable instruments, bearer investment securities, bearer securities, and stock with title passing upon delivery, or the equivalent thereof, as the Secretary may by regulation specify for the purposes of the provision of this title to which the regulation relates.' 31 U.S.C. s 1052(l).

[10] The form provided by the Treasury Department for the reporting of these transactions is Form 4790 (Report of International Transportation of Currency or Monetary Instruments). See Motion to Affirm on behalf of the United States in No 72—985, App. C, pp. 29—30. The report must identify the person required to file the report, his capacity, and the identity of persons for whom he acts, and must specify the amounts and types of monetary instruments, the method of transportation, and, if applicable, the name of the person from whom the shipment was received.

[11] In issuing these regulations, the Secretary relied upon the authority of two statutory provisions: (1) the Trading with the Enemy Act, 40 Stat. 411, as amended by s 2, Act of Mar. 9, 1933, 48 Stat. 1, and by s 301, First War Powers Act, 1941, 55 Stat. 839, see 12 U.S.C. s 95a (1940 ed., Supp. V); and (2) s 251 of the Revised Statutes, 31 U.S.C. s 427.

[12] The previous regulations promulgated by the Secretary, see 31 CFR s 102.1 (1949), 10 Fed.Reg. 6556, originally mentioned transactions involving $1,000 or more in denominations of $50 or more, or $10,000 or more in any denominations. In 1952, the former amount was raised to $2,500 in denominations of $100 or more. See 17 Fed.Reg. 1822, 2306. When these regulations were revised in 1959 to simplify the reporting form, the Secretary noted the great value of the reports to law enforcement. See Treasury Release No. A—590, Aug. 3, 1959, included in the Jurisdictional Statement for the United States in No. 72—1073, App. E, pp. 127—130.

[13] The proper interpretation of this section is a source of dispute in these appeals. See n. 29, infra.

[14] 'Currency' is defined in the Secretary's regulations as the 'coin and currency of the United States or of any other country, which circulate in and are customarily used and accepted as money in the country in which issued. It includes U.S. silver certificates, U.S. notes and, Federal Reserve notes, but does not not include bank checks or other negotiable instruments not customarily accepted as money.' 31 CFR s 103.11.

[15] The form prescribed by the Secretary, see 31 CFR s 103.25(a), for the reporting of the domestic currency transactions is Treasury Form 4789 (Currency Transaction Report). See Jurisdictional Statement for the United States in No. 72—1073, App. D, p. 121. Form 4789 requires information similar to that required by the previous Treasury reporting form, see n. 12, supra, including (1) the name, address, business or profession and social security number of the person conducting the transaction; (2) similar information as to the person or organization for whom it was conducted; (3) a summary description of the nature of the transaction, the type, amount, and denomination of the currency involved and a description of any check involved in the transaction; (4) the type of identification presented; and (5) the identity of the reporting financial institution.

The regulations also provide that the names of all customers whose currency transactions in excess of $10,000 are not reported on Form 4789 must be reported to the Secretary on demand. 31 CFR s 103.22.

16 Transactions with Federal Reserve Banks or Federal Home Loan Banks, or solely with or originated by financial institutions or foreign banks, are also excluded from these reporting requirements. 31 CFR s 103.22.

17 Section 212 of the Act, 31 U.S.C. s 1061, authorizes the Secretary to provide by regulation for the availability of information provided in the reports required by the Act to other departments and agencies of the Federal Government. Pursuant to this authority, the Secretary has promulgated 31 CFR s 103.43, which provides:

'The Secretary may make any information set forth in any report received pursuant to this part available to any other department or agency of the United States upon the request of the head of such department or agency, made in writing and stating the particular information desired, the criminal, tax or regulatory investigation or proceeding in connection with which the information is sought and the official need therefor. Any information made available under this section to other departments or agencies of the United States shall be received by them in confidence, and shall not be disclosed to any person except for official purposes relating to the investigation or proceeding in connection with which the information is sought.'

The last sentence of this regulation was added by an amendment, see 37 Fed.Reg. 23114 (1972); 38 Fed.Reg. 2174 (1973), effective Jan. 17, 1973.

18 Title 31 CFR s 103.45(a) provides:

'The Secretary, in his sole discretion, may by written order or authorization make exceptions to or grant exemptions from the requirements of this part. Such exceptions or exemptions may be conditional or unconditional, may apply to particular persons or to classes of persons, and may apply to particular transactions or classes of transactions. They shall, however, be applicable only as expressly stated in the order of authorization, and they shall be revocable in the sole discretion of the Secretary.'

When originally promulgated, this regulation additionally gave the Secretary the authority to 'impose additional recordkeeping or reporting requirements authorized by statute, or otheriwise modify, the requirements of' the Act. 37 Fed.Reg. 6915 (1972). The amendment to the present form became effective January 17, 1973. 37 Fed.Reg. 23114 (1972); 38 Fed.Reg. 2174 (1973).

19 See, e.g., Treas.Reg. s 1.368—3 (records to be kept by taxpayers who participate in tax-free exchanges in connection with a corporate reorganization); s 1.374—3 (records to be kept by a railroad corporation engaging in a tax-free exchange in connection with a railroad reorganization); s 1.857—6 (real estate investment trusts must keep records of stock ownership); s 1.964—3 (shareholders must keep records of their interest in a controlled foreign corporation); s 1,1101—4 (records to be kept by a stock or security holder who receives stock or securities or other property upon a distribution made by a qualified bank holding corporation); s 1.1247—5 (foreign investment company must keep records sufficient to verify what taxable income it may have); s 1.6001—1 (all persons liable to tax under subtitle A of the Internal Revenue Code shall keep records sufficient to establish gross income, deductions, and credits); s 31.6001 et seq. (requirements that various employers keep records of withholding under the Railroad Retirement Tax Act and the Federal Unemployment Tax Act); ss 45.6001—2 to 45.6001—4 (records to be kept by manufacturers of butter and cheese); ss 46.6001—2 (records to be kept by manufacturers of sugar); s 46.6001—4 (records to be kept by persons paying premiums on policies issued by foreign insurers). Treas.Reg. s 301.7207—1 provides for criminal penalties for willful delivery or disclosure to the Internal Revenue Service of a document known by the person disclosing it to be false as to any material matter.

20 Brief for Appellant California Bankers Association in No. 72—985, p. 25.

21 Congress had before it ample testimony that the requirement that banks reproduce checks and maintain other records would significantly aid in the enforcement of federal tax, regulatory, and criminal laws. See House Hearings, supra, n. 1, at 151, 322, 359; Senate Hearings, supra, n. 1, at 61—68, 175, 230, 250—255, 282. While a substantial portion of the checks drawn on banks in the United States may never be of any utility for law enforcement, tax or regulatory purposes, the regulations do limit the check-copying requirement to checks in excess of $100. 31 CFR ss 103.34(b)(3) and (4). This $100 exception was added to the regulations since this litigation was instituted, see n. 5, supra; in reviewing the judgment of the District Court in this case, we look to the statute and the regulations as they now stand, not as they once did. Hall v. Beals, 396 U.S. 45, 48, 90 S.Ct. 200, 201, 24 L.Ed.2d 214 (1969) (per curiam); Thorpe v. Housing Authority, 393 U.S. 268, 281 n. 38, 89 S.Ct. 518, 526, 21 L.Ed.2d 474 (1969).

The California Bankers Association contends that the $100 exception is meaningless since microfilm cameras cannot discriminate between checks in different amounts. There was, however, testimony during the House Hearings that an additional step could be added to the check-handling procedures to sort out those checks not required to be copied, and that many banks have equipment that can sort checks on a dollar-amount basis. House Hearings, supra, n. 1, at 322, 359. In any event, it is clear that the Act and regulations do not require banks to microfilm all checks, which some banks have traditionally done, but instead leave the decision to the banks. Given the fact that the cost burden placed on the banks in implementing the recordkeeping requirements of the statute and regulations is also a reasonable one, see n. 22, infra, we do not think that the recordkeeping requirements are unreasonable.

[22] The only figures in the record as to the cost burden placed on the banks by the recordkeeping requirements show that the Bank of America, one of the largest banks in the United States, with 997 branches, $29 billion in deposits, and a net income in excess of $178 million (Moody's Bank and Finance Manual 633—636 (1972)), expended $392,000 in 1971, including start-up costs, to comply with the microfilming requirements of Title I of the Act. Affidavit of William Ehler, App. 24—25.

The hearings before the House Committee on Banking and Currency indicated that the cost of making microfilm copies of checks ranged from 1 1/2 mills per check for small banks down to about 1/2 mill or less for large banks. See House Hearings, supra, n. 1, at 341, 354—356; H.Rep.No.91—975, supra, at 11. The House Report further indicates that the legislation was not expected to significantly increase the costs of the banks involved since it was found that many banks already followed the practice of maintaining the records contemplated by the legislation.

[23] See n. 18, supra.

[24] Chapter 4 of the Act, s 241, 31 U.S.C. s 1121, authorizes the Secretary to require by regulation the maintenance of records by persons who engage in any transaction or maintain a relationship, directly or indirectly, on behalf of themselves or others, with a foreign financial agency. The Secretary has, by regulation, required the maintenance of such records by persons having such financial interests and by domestic financial institutions which engage in monetary transactions outside the United States. 31 CFR ss 103.32, 103.33. The Act also provides that production of such records shall be compelled only by ‘a subpena or summons duly authorized and issued or as may otherwise be required by law.’ 31 U.S.C. s 1121(b). Though it is not apparent from the various briefs filed in this Court by the plaintiffs below whether this particular recordkeeping requirement is challenged, our holding that a mere requirement that records be kept does not violate any constitutional right of the banks or of the depositors necessarily disposes of such a claim, since there is no indication at this point that there has been any attempt tocompel the there has been any attempt to compel the

[25] The ACLU recognizes that these cases, and the other cases it cites involved situations in which a subpoena or summons had already issued. Brief for Appellant ACLU in No. 72—1196, p. 57. See Lamont v. Postmaster General, 381 U.S. 301, 85 S.Ct. 1493, 14 L.Ed.2d 398 (1965); Gibson v. Florida Legislative Investigation Comm., 372 U.S. 539, 83 S.Ct. 889, 9 L.Ed.2d 929 (1963); Louisiana ex rel. Gremillion v. NAACP, 366 U.S. 293, 81 S.Ct. 1333, 6 L.Ed.2d 301 (1961); Shelton v. Tucker, 364 U.S. 479, 81 S.Ct. 247, 5 L.Ed.2d 231 (1960); Bates v. Little Rock, 361 U.S. 516, 80 S.Ct. 412, 4 L.Ed.2d 480 (1960); NAACP v. Alabama, 357 U.S. 449, 78 S.Ct. 1163, 2 L.Ed.2d 1488 (1958); United States v. Rumely, 345 U.S. 41, 73 S.Ct. 543, 97 L.Ed. 770 (1953).

[26] The ACLU contends that present injunctive relief is essential, since the banks might not notify it of the fact that their records have been subpoenaed, and might comply with the subpoena without giving the ACLU a chance to obtain judicial review. While noting that ‘most banks formally prohibit’ it (citing American Banker, May 12, 1972, p. 1, cols. 3—4), the ACLU also contends that the ‘day-to-day practice of permitting ‘informal’ access to bank records is, unfortunately, widespread.' Brief for Appellant ACLU in No. 72—1196, p. 58.

The record contains no showing of any attempt by the Government, formal or informal, to compel the production of bank records containing information relating to the ACLU; we accordingly express no opinion whether notice would in such an instance be required by either the Act or the Constitution.

[27] See n. 29, infra.

[28] We hold here and in other parts of this opinion that certain of the plaintiffs did not make the requisite allegations in the District Court to give them standing to challenge the Act and the regulations issued pursuant to it. In so holding, we do not, of course, mean to imply that such claims would be meritorious if presented by a litigant who has standing.

[29] Plaintiffs similarly contend that the Secretary's regulation requiring the reporting of domestic currency transactions only by the banks or financial institutions which are parties thereto, violates a specific requirement of the Act. Section 222 of the Act, 31 U.S.C. s 1082, provides in pertinent part:

‘The report of any transaction required to be reported under this chapter shall be signed or otherwise made both by the domestic financial institution involved and by one or more of the other parties thereto or participants therein, as the Secretary may require.’ Plaintiffs contend that this language requires the Secretary to require either a signature on the report by the individual customer in the currency transaction, or a report from that customer. Since the Secretary has only required a report from the financial institution, plaintiffs urge, in addition, that there will not be notice to the individual customer of the report made by the financial institution.

In rebuttal, the Government urged in order argument, Tr. of Oral Arg. 64—70, that not only does s 206 of the Act, 31 U.S.C. s 1055, give the Secretary broad authority to make exceptions to the requirements of the Act in promulgating the regulations, but that the House and Senate Reports on the bills considered by each house of the Congress, each of which contained a provision identical to the language of s 222, indicated that each chamber read that language differently. The Senate Committee believed that the language permitted the Secretary to require reports from the financial institution, the customer, or both, S.Rep.No. 91—1139, supra, at 15, while the House Committee felt that the language required reports to be filed by both the financial institution and the customer, H.R.Rep.No. 91—975, supra, at 22.

We similarly do not reach this claim as it relates to the depositor plaintiffs since they failed to allege sufficient injury below. Whatever the merits of such a contention vis-a -vis the depositors, the regulation clearly has no adverse effect on any constitutional right of the banks, since the statute indisputably authorizes the Secretary to require a report from the bank.

30 There have been recent hearings in Congress on various legislative proposals to amend the Bank Secrecy Act. Hearings to Amend the Bank Secrecy Act (S. 3814 and S. 3828) before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess. (1972). See S. 3814 and S. 3828, 92d Cong., 2d Sess. (1972).

1 The House Report, No. 91—975, p. 10, states:

‘Petty criminals, members of the underworld, those engaging in ‘white collar’ crime and income tax evaders use, in one way or another, financial institutions in carrying on their affairs.' U.S.Code Cong. & Admin.News 1970, p. 4395.

That was the reason for requiring the report of large domestic cash transactions. ‘Criminals deal in money—cash or its equivalent. The deposit and withdrawal of large amounts of currency or its equivalent (monetary instruments) under unusual circumstances may betray a criminal activity. The money in many of these transactions may represent anything from the proceeds of a lottery racket to money for the bribery of public officials.’ Id., at 11, U.S.Code Cong. & Admin.News 1970, p. 4396.

A sponsor on the floor of the House stated: ‘With respect to full financial recordkeeping, the problem can be simply stated; in the past decade, as organized crime and criminals have become more sophisticated, more and greater use has been made by criminal elements of our Nation's financial institutions. Law enforcement officials believe that an effective attack on organized crime requires the maintenance of adequate and appropriate records by financial institutions.’ 116 Cong.Rec. 16950.

Congressman Patman, author of the bill, stated: ‘This is really a bill which, if enacted into law, will be the longest step in the direction of stopping crime than any other we have had before this Congress in a long time.’ Id., at 16951.

While it started with a different objective, it was changed to serve an additional purpose: ‘We also discovered that secret foreign bank accounts were not the only criminal activities related to the banking field. The major law enforcement authority —the Justice Department—of the U.S. Government called our attention to the urgent need for regulations which would make uniform and adequate the present recordkeeping practices, or lack of recordkeeping practices, by domestic banks and other financial institutions.’ Id., at 16952.

2 The Senate Report, No. 91—1139, is replete with the same philosophy. See pp. 1, 5, 7, 8.

3 The Act authorizes the Secretary to issue regulations to carry out its purposes, 12 U.S.C. s 1829b(b). It empowers him to define institutions or persons affected, 12 U.S.C. ss 1953(a), (b)(5), to make exceptions, exemptions, or other special arrangements, 12 U.S.C. ss 1829(c), (f); to seek injunctions, 12 U.S.C. s 1954; and to assess and collect civil penalties, 12 U.S.C. s 1955.

4 Title 31 CFR s 103.34 at the time this litigation was commenced provided that banks shall:

‘(a) . . . secure and maintain a record of the taxpayer identification number of the person maintaining the account; or in the case of an account of one or more individuals, such bank shall secure and maintain a record of the social security number of an individual having a financial interest in that account.

‘(b) Each bank shall, in addition, retain either the original or a microfilm or other copy or reproduction of each of the following:

‘(1) Each document granting signature authority over each deposit or share account;

‘(2) Each statement, ledger card or other record on each deposit or share account, showing each transaction in, or with respect to, that account;

‘(3) Each check, clean draft, or money order drawn on the bank or issued and payable by it, except those drawn on accounts which can be expected to have drawn on them an average of at least 100 checks per month over the calendar year or on each occasion on which such checks are issued, and which are (i) dividend checks, (ii) payroll checks, (iii) employee benefit checks, (iv) insurance claim checks, (v) medical benefit checks, (vi) checks drawn on governmental agency accounts, (vii) checks drawn by brokers or dealers in securities, (viii) checks drawn on fiduciary accounts, (ix) checks drawn on other financial institutions, or (x) pension or annuity checks;

‘(4) Each item other than bank charges or periodic charges made pursuant to agreement with the customer, comprising a debit to a customer's deposit or share account, not required to be kept, and not specifically exempted, under subparagraph (b)(3) of this section;

‘(5) Each item, including checks, drafts, or transfers of credit, of more than $10,000 remitted or transferred to a person, account or place outside the United States;

‘(6) A record of each remittance or transfer of funds, or of currency, other monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account or place outside the United States;

‘(7) Each check or draft in an amount in excess of $10,000 drawn on or issued by a foreign bank, purchased, received for credit or collection, or otherwise acquired by the bank;

‘(8) Each item, including checks, drafts or transfers of credit, of more than $10,000 received directly and not through a domestic financial institution, by letter, cable or any other means, from a person, account or place outside the United States;

‘(9) A record of each receipt of currency, other monetary instruments, checks, or investment securities, and of each transfer of funds or credit, of more than $10,000 received on any one occasion directly and not through a domestic financial institution, from a person, account or place outside the United States; and

‘(10) Records prepared or received by a bank in the ordinary course of business, which would be needed to reconstruct a demand deposit account and to trace a check deposited in such account through its domestic processing system or to supply a description of a deposited check. This subparagraph shall be applicable only with respect to demand deposits.’ 37 Fed.Reg. 6914.

During this litigation the above provision was amended by the Secretary making it unnecessary to microfilm copies of checks ‘drawn for $100 or less,’ 31 CFR s 103.34(b)(3) (1973). Since banks must copy all checks it is hard to see how this new exemption is meaningful.

[5] Like requirements are placed on brokers and dealers in securities, 31 CFR s 103.35.

[6] Hearings on Foreign Bank Secrecy and Bank Records (H.R. 15073) before the House Committee on Banking and Currency, 91st Cong., 1st and 2d Sess., 320 (1969—1970).

[7] And see Roe v. Wade, 410 U.S. 113, 155, 93 S.Ct. 705, 728, 35 L.Ed.2d 147; Police Dept. of Chicago v. Mosley, 408 U.S. 92, 101, 92 S.Ct. 2286, 2293, 33 L.Ed.2d 212; Gooding v. Wilson, 405 U.S. 518, 522, 92 S.Ct. 1103, 1106, 31 L.Ed.2d 408; Shuttlesworth v. Birmingham, 394 U.S. 147, 151, 89 935, 938, 22 L.Ed.2d 162; Cameron v. Johnson, 390 U.S. 611, 617, 88 S.Ct. 1335, 1338, 20 L.Ed.2d 182; Zwickler v. Koota, 389 U.S. 241, 250, 88 S.Ct. 391, 396, 19 L.Ed.2d 444; Whitehill v. Elkins, 389 U.S. 54, 62, 88 S.Ct. 184, 188, 19 L.Ed.2d 228; Ashton v. Kentucky, 384 U.S. 195, 201, 86 S.Ct. 1407, 1410, 16 L.Ed.2d 469; Elfbrandt v. Russell, 384 U.S. 11, 18, 86 S.Ct. 1238, 1241, 16 L.Ed.2d 321.

The same view is often expressed in concurring opinions. See Doe v. Bolton, 410 U.S. 179, 216, 93 S.Ct. 739, 760, 35 L.Ed.2d 201 (Douglas, J., concurring); Gregory v. Chicago, 394 U.S. 111, 119, 89 S.Ct. 946, 950, 22 L.Ed.2d 134 (Black, J., concurring); United States v. Robel, 389 U.S. 258, 270, 88 S.Ct. 419, 427, 19 L.Ed.2d 508 (Brennan, J., concurring in result).

[8] 31 U.S.C. s 1101.

[9] 31 U.S.C. s 1121. The Secretary requires reports in yearly tax returns of any ‘financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country,’ 31 CFR s 103.24.

[10] 31 U.S.C. ss 1056, 1102, 1103; 31 CFR ss 103.47—103.48.

[11] 31 U.S.C. ss 1058, 1059; 31 CFR s 103.49

[12] 31 U.S.C s 1061. The regulations read as follows:

‘The Secretary may make any information set forth in any report received pursuant to this part available to any other department or agency of the United States upon the request of the head of such department or agency, made in writing and stating the particular information desired, the criminal, tax or regulatory investigation or proceeding in connection with which the information is sought and the official need therefor.’ 31 CFR s 103.43.

[13] 31 U.S.C. s 1060. The Court in Kastigar v. United States, 406 U.S. 441, 92 S.Ct. 1653, 32 L.Ed.2d 212, held that ‘use immunity’ satisfies the Self-Incrimination Clause of the Fifth Amendment. I disagreed then and persist in my view that it is ‘transactional’ immunity, not ‘use’ immunity, that is required to lift this constitutional protection. See id., at 462—467, 92 S.Ct., at 1665—1668 (dissenting opinion). But since ‘use’ immunity is ‘the law’ of the present Court—though I doubt if it can long survive—I do not write this dissent against the narrow immunity that is granted.

[14] 31 CFR s 103.22.

[15] 31 U.S.C. s 1082.

16 At that time 31 CFR s 103.45 read as follows: '(a) The Secretary, in his sole discretion, may be written order or authorization make exceptions to, grant exemptions from, impose additional recordkeeping or reporting requirements authorized by statute, or otherwise modify, the requirements of this part. Such exceptions, exemptions, requirements or modifications may be conditional or unconditional, may apply to particular persons or to classes of persons, and may apply to particular transactions or classes of transactions. They shall, however, be applicable only as expressly stated in the order or authorization, and they shall be revocable in the sole discretion of the Secretary.

'(b) The Secretary shall have authority to further define all terms used herein.'

Since then, the language 'impose additional recordkeeping or reporting requirements authorized by statute, or otherwise modify' has been deleted from s 103.45.

17 A criminal prosecution in this country for not reporting an overseas transaction is still a criminal prosecution under the Bill of Rights; and to these the Fourth Amendment has been applicable from the beginning. Cases of immigration officers stopping people at the border who are leaving or entering the country are obviously inapposite and certainly the Court cannot be serious in saying that the monetary value of the article being seized is relevant to whether the search and seizure without a warrant was constitutional. As said in Katz it is 'persons' not 'places' that the Fourth Amendment protects; and it would labor the point to engage in lengthy argument that 'things' as well as 'places' are not the object of the Fourth Amendment's concerns.

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118 S.Ct. 2028
Supreme Court of the United States

UNITED STATES, Petitioner,
v.
Hosep Krikor BAJAKAJIAN.

No. 96–1487.
|
Argued Nov. 4, 1997.
|
Decided June 22, 1998.

Synopsis
After defendant pleaded guilty to failure to report exported currency, the United States District Court for the Central District of California, John G. Davies, J., determined that defendant was required to forfeit only $15,000 of the $357,144 at issue. Government appealed. The Court of Appeals for the Ninth Circuit, 84 F.3d 334, affirmed. Government filed petition for writ of certiorari. The Supreme Court, Justice Thomas, held that forfeiture of entire amount possessed by defendant would violate Excessive Fines Clause.

Affirmed.

Justice Kennedy dissented and filed opinion in which Chief Justice Rehnquist and Justices O'Connor and Scalia joined.

****2029 *321** *Syllabus*[*]

After customs inspectors found respondent and his family preparing to board an international flight carrying $357,144, he was charged with, *inter alia,* attempting to leave the United States without reporting, as required by 31 U.S.C. § 5316(a)(1)(A), that he was transporting more than $10,000 in currency. The Government also sought forfeiture of the $357,144 under 18 U.S.C. § 982(a)(1), which provides that a person convicted of willfully violating § 5316 shall forfeit "any property ... involved in such an offense." Respondent pleaded guilty to the failure to report and elected to have a bench trial on the forfeiture. The District Court found, among other things, that the entire $357,144 was subject to forfeiture because it was "involved in" the offense, that the funds were not connected to any other crime, and that respondent was transporting the money to repay a lawful debt. Concluding that full forfeiture would be grossly disproportional to ****2030** the offense in question and would therefore violate the Excessive Fines Clause of the Eighth Amendment, the court ordered forfeiture of $15,000, in addition to three years' probation and the maximum fine of $5,000 under the Sentencing Guidelines. The Ninth Circuit affirmed, holding that a forfeiture must fulfill two conditions to satisfy the Clause: The property forfeited must be an "instrumentality" of the crime committed, and the property's value must be proportional to its owner's culpability. The court determined that respondent's currency was not an "instrumentality" of the crime of failure to report, which involves the withholding of information rather than the possession or transportation of money; that, therefore, § 982(a)(1) could never satisfy the Clause in a currency forfeiture case; that it was unnecessary to apply the "proportionality" prong of the test; and that the Clause did not permit forfeiture of *any* of the unreported currency, but that the court lacked jurisdiction to set the $15,000 forfeiture aside because respondent had not cross-appealed to challenge it.

Held: Full forfeiture of respondent's $357,144 would violate the Excessive Fines Clause. Pp. 2033–2041.

(a) The forfeiture at issue is a "fine" within the meaning of the Clause, which provides that "excessive fines [shall not be] imposed." The Clause limits the Government's power to extract payments, whether in cash or in kind, as punishment for some offense. *Austin v. United* ***322** *States,* 509 U.S. 602, 609–610, 113 S.Ct. 2801, 2805–2806, 125 L.Ed.2d 488. Forfeitures—payments in kind—are thus "fines" if they constitute punishment for an offense. Section 982(a)(1) currency forfeitures do so. The statute directs a court to order forfeiture as an additional sanction when "imposing sentence on a person convicted of" a willful violation of § 5316's reporting requirement. The forfeiture is thus imposed at the culmination of a criminal proceeding and requires conviction of an underlying felony, and it cannot be imposed upon an innocent owner of unreported currency. Cf. *id.,* at 619, 113 S.Ct., at 2810–2811. The Court rejects the Government's argument that such forfeitures serve important remedial purposes—by deterring illicit movements of cash and giving the Government valuable information to investigate and detect criminal activities associated with that cash—because the asserted loss of information here would not be remedied by confiscation of respondent's $357,144. The Government's argument that the § 982(a)(1) forfeiture is constitutional because it falls within a class of historic forfeitures of property tainted by crime is also rejected. In so arguing, the Government relies upon a series of cases involving traditional civil *in rem* forfeitures that are inapposite because such forfeitures were historically considered nonpunitive. See, *e.g., The Palmyra,* 12 Wheat. 1, 14–15, 6 L.Ed. 531. Section 982(a)(1) descends from a different historical tradition: that of *in personam* criminal forfeitures. Similarly, the Court declines to accept the Government's contention that the forfeiture here is constitutional because it involves an "instrumentality" of respondent's crime. Because instrumentalities historically have been treated as a form of "guilty property" forfeitable in civil *in rem* proceedings, it is irrelevant whether respondent's currency is an instrumentality; the forfeiture is punitive, and the test for its excessiveness involves solely a proportionality determination. Pp. 2033–2036.

(b) A punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of the offense that it is designed to punish. Although the proportionality principle has always been the touchstone of the inquiry, see, *e.g., Austin, supra,* at 622–623, 113 S.Ct., at 2812–2813, the Clause's text and history provide little guidance as to how disproportional a forfeiture must be to be "excessive." Until today, the Court has not articulated a governing standard. In deriving the standard, the Court finds two considerations particularly relevant. The first, previously emphasized in cases interpreting the Cruel and Unusual Punishments Clause, is that judgments about the appropriate punishment belong in the first instance to the legislature. See, *e.g., Solem v. Helm,* 463 U.S. 277, 290, 103 S.Ct. 3001, 3009–3010, 77 L.Ed.2d 637. The second is that any judicial determination regarding ****2031** the gravity of a particular criminal offense will be inherently imprecise. Because both considerations counsel against requiring strict ***323** proportionality, the Court adopts the gross disproportionality standard articulated in, *e.g., id.,* at 288, 103 S.Ct., at 3008–3009. Pp. 2036–2038.

(c) The forfeiture of respondent's entire $357,144 would be grossly disproportional to the gravity of his offense. His crime was solely a reporting offense. It was permissible to transport the currency out of the country so long as he reported it. And because § 982(a)(1) orders currency forfeited for a "willful" reporting violation, the essence of the crime is a willful failure to report. Furthermore, the District Court found his violation to be unrelated to any other illegal activities. Whatever his other vices, respondent does not fit into the class of persons for whom the statute was principally designed: money launderers, drug traffickers, and tax evaders. And the maximum penalties that could have been imposed under the Sentencing Guidelines, a 6–month sentence and a $5,000 fine, confirm a minimal level of culpability and are dwarfed by the $357,144 forfeiture sought by the Government. The harm that respondent caused was also minimal. The failure to report affected only the Government, and in a relatively minor way. There was no fraud on the Government and no loss to the public fisc. Had his crime gone undetected, the Government would have been deprived only of the information that $357,144 had left the country. Thus, there is no articulable correlation between the $357,144 and any Government injury. Pp. 2038–2039.

(d) The Court rejects the contention that the proportionality of full forfeiture is demonstrated by the fact that the First Congress, at roughly the same time the Eighth Amendment was ratified, enacted statutes requiring full forfeiture of goods involved in customs offenses or the payment of monetary penalties proportioned to the goods' value. The early customs statutes do not support the Government's assertion because, unlike § 982(a)(1), the type of forfeiture they imposed was not considered punishment for a criminal offense, but rather was civil *in rem* forfeiture, in which the Government proceeded against the "guilty" property itself. See, *e.g., Harford v. United States,* 8 Cranch 109, 3 L.Ed. 504. Similarly, the early statutes imposing monetary "forfeitures" proportioned to the value of the goods involved were considered not as punishment for an offense, but rather as serving the remedial purpose of reimbursing the Government for the losses accruing from evasion of customs duties. See, *e.g., Stockwell v. United States,* 13 Wall. 531, 546–547, 20 L.Ed. 491. Pp. 2039–2041.

84 F.3d 334, affirmed.

THOMAS, J., delivered the opinion of the Court, in which STEVENS, SOUTER, GINSBURG, and BREYER, JJ., joined. KENNEDY, J., filed a dissenting ***324** opinion, in which REHNQUIST, C.J., and O'CONNOR and SCALIA, JJ., joined, *post,* p. 2041.

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Opinion

Justice THOMAS delivered the opinion of the Court.

Respondent Hosep Bajakajian attempted to leave the United States without reporting, as required by federal law, that he was transporting more than $10,000 in currency. Federal law also provides that a person convicted of willfully violating this reporting requirement shall forfeit to the Government "any property ... involved in such offense." 18 U.S.C. § 982(a)(1). The question in this case is whether forfeiture of the entire $357,144 that respondent failed to declare would violate the Excessive Fines Clause of the Eighth Amendment. We hold that it would, because full forfeiture of respondent's currency would be grossly disproportional to the gravity of his offense.

****2032** I

On June 9, 1994, respondent, his wife, and his two daughters were waiting at Los Angeles International Airport to board a flight to Italy; their final destination was Cyprus. Using dogs trained to detect currency by its smell, customs inspectors discovered some $230,000 in cash in the Bajakajians' checked baggage. A customs inspector approached respondent and his wife and told them that they were required to report all money in excess of $10,000 in their possession or in their baggage. Respondent said that he had $8,000 and ***325** that his wife had another $7,000, but that the family had no additional currency to declare. A search of their carry-on bags, purse, and wallet revealed more cash; in all, customs inspectors found $357,144. The currency was seized and respondent was taken into custody.

A federal grand jury indicted respondent on three counts. Count One charged him with failing to report, as required by 31 U.S.C. § 5316(a)(1)(A),[1] that he was transporting more than $10,000 outside the United States, and with doing so "willfully," in violation of § 5322(a).[2] Count Two charged him with making a false material statement to the United States Customs Service, in violation of 18 U.S.C. § 1001. Count Three sought forfeiture of the $357,144 pursuant to 18 U.S.C. § 982(a)(1), which provides:

> "The court, in imposing sentence on a person convicted of an offense in violation of section ... 5316, ... shall order that the person forfeit to the United States any property, real or personal, involved in such offense, or any property traceable to such property." 18 U.S.C. § 982(a)(1).

Respondent pleaded guilty to the failure to report in Count One; the Government agreed to dismiss the false statement charge in Count Two; and respondent elected to have a bench trial on the forfeiture in Count Three. After the bench trial, the District Court found that the entire $357,144 was subject to forfeiture because it was "involved ***326** in" the offense. *Ibid.* The court also found that the funds were not connected to any other crime and that respondent was transporting the money to repay a lawful debt. Tr. 61–62 (Jan. 19, 1995). The District Court further found that respondent had failed to report that he was taking the currency out of the United States because of fear stemming from "cultural differences": Respondent, who had grown up as a member of the Armenian minority in Syria, had a "distrust for the Government." *Id.,* at 63; see Tr. of Oral Arg. 30.

Although § 982(a)(1) directs sentencing courts to impose full forfeiture, the District Court concluded that such forfeiture would be "extraordinarily harsh" and "grossly disproportionate to the offense in question," and that it would therefore violate the Excessive Fines Clause. Tr. 63. The court instead ordered forfeiture of $15,000, in addition to a sentence of three years of probation and a fine of $5,000—the maximum fine under the Sentencing Guidelines—because the court believed that the maximum Guidelines fine was "too little" and that a $15,000 forfeiture would "make up for what I think a reasonable fine should be." *Ibid.*

The United States appealed, seeking full forfeiture of respondent's currency as provided in § 982(a)(1). The Court of Appeals for the Ninth Circuit affirmed. 84 F.3d 334 (1996). Applying Circuit precedent, the court held that, to satisfy the Excessive Fines Clause, a forfeiture must fulfill two conditions: The property forfeited must be an "instrumentality" of the crime committed, and the value of the property must be proportional to the culpability of the owner. *Id.,* at 336 (citing *United States v. Real Property Located in El Dorado County,* 59 F.3d 974, 982 (C.A.9 1995)). A majority of the panel determined that the currency was not an ****2033** "instrumentality" of the crime of failure to report because " '[t]he crime [in a currency reporting offense] is the withholding of information, ... not the possession or the transportation of the money.' " 84 F.3d, at 337 (quoting *United States v. $69,292* ***327** *in United States Currency,* 62 F.3d 1161, 1167 (C.A.9 1995)). The majority therefore held that § 982(a)(1) could never satisfy the Excessive Fines Clause in cases involving forfeitures of currency and that it was unnecessary to apply the "proportionality" prong of the test. Although the panel majority concluded that the Excessive Fines Clause did not permit forfeiture of *any* of the unreported currency, it held that it lacked jurisdiction to set the $15,000 forfeiture aside because respondent had not cross-appealed to challenge that forfeiture. 84 F.3d, at 338.

Judge Wallace concurred in the result. He viewed respondent's currency as an instrumentality of the crime because "without the currency, there can be no offense," *id.,* at 339, and he criticized the majority for "strik[ing] down a portion of" the statute, *id.,* at 338. He nonetheless agreed that full forfeiture would violate the Excessive Fines Clause in respondent's case, based upon the "proportionality" prong of the Ninth Circuit test. Finding no clear error in the District Court's factual findings, he concluded that the reduced forfeiture of $15,000 was proportional to respondent's culpability. *Id.,* at 339–340.

Because the Court of Appeals' holding—that the forfeiture ordered by § 982(a)(1) was *per se* unconstitutional in cases of currency forfeiture—invalidated a portion of an Act of Congress, we granted certiorari. 520 U.S. 1239, 117 S.Ct. 1841, 137 L.Ed.2d 1045 (1997).

II

[1] **[2]** The Eighth Amendment provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const., Amdt. 8. This Court has had little occasion to interpret, and has never actually applied, the Excessive Fines Clause. We have, however, explained that at the time the Constitution was adopted, "the word 'fine' was understood to mean a payment to a sovereign as punishment for some offense." *Browning–Ferris Industries of Vt., Inc. v. Kelco Disposal,* ***328** *Inc.,* 492 U.S. 257, 265, 109 S.Ct. 2909, 2915, 106 L.Ed.2d 219 (1989). The Excessive Fines Clause thus "limits the government's power to extract payments, whether in cash or in kind, 'as punishment for some offense.' " *Austin v. United States,* 509 U.S. 602, 609–610, 113 S.Ct. 2801, 2805, 125 L.Ed.2d 488 (1993) (emphasis deleted). Forfeitures—payments in kind—are thus "fines" if they constitute punishment for an offense.

[3] We have little trouble concluding that the forfeiture of currency ordered by § 982(a)(1) constitutes punishment. The statute directs a court to order forfeiture as an additional sanction when "imposing sentence on a person convicted of" a willful violation of § 5316's reporting requirement. The forfeiture is thus imposed at the culmination of a criminal proceeding and requires conviction of an underlying felony, and it cannot be imposed upon an innocent owner of unreported currency, but only upon a person who has himself been convicted of a § 5316 reporting violation. [3] Cf. ****2034** *id.,* at 619, 113 S.Ct., at 2810 (holding forfeiture to be a "fine" in part because the forfeiture statute "expressly provide[d] an 'innocent owner' defense" and thus "look[ed] ... like punishment").

***329** The United States argues, however, that the forfeiture of currency under § 982(a)(1) "also serves important remedial purposes." Brief for United States 20. The Government asserts that it has "an overriding sovereign interest in controlling what property leaves and enters the country." *Ibid.* It claims that full forfeiture of unreported currency supports that interest by serving to "dete[r] illicit movements of cash" and aiding in providing the Government with "valuable information to investigate and detect criminal activities associated with that cash." *Id.,* at 21. Deterrence, however, has traditionally been viewed as a goal of punishment, and forfeiture of the currency here does not serve the remedial purpose of compensating the Government for a loss. See Black's Law Dictionary 1293 (6th ed. 1990) ("[R]emedial action" is one "brought to obtain compensation or indemnity"); *One Lot Emerald Cut Stones v. United States,* 409 U.S. 232, 93 S.Ct. 489, 34 L.Ed.2d 438 (1972) *(per curiam)* (monetary penalty provides "a reasonable form of liquidated damages," *id.,* at 237, 93 S.Ct., at 493, to the Government and is thus a "remedial" sanction because it compensates Government for lost revenues). Although the Government has asserted a loss of information regarding the amount of currency leaving the country, that loss would not be remedied by the Government's confiscation of respondent's $357,144.[4]

The United States also argues that the forfeiture mandated by § 982(a)(1) is constitutional because it falls within a class of historic forfeitures of property tainted by crime. See Brief for United States 16 (citing, *inter alia,* ***330** *The Palmyra,* 12 Wheat. 1, 13, 6 L.Ed. 531 (1827) (forfeiture of ship); *Dobbins's Distillery v. United States,* 96 U.S. 395, 400–401, 24 L.Ed. 637 (1877) (forfeiture of distillery)). In so doing, the Government relies upon a series of cases involving traditional civil *in rem* forfeitures that are inapposite because such forfeitures were historically considered nonpunitive.

The theory behind such forfeitures was the fiction that the action was directed against "guilty property," rather than against the offender himself.[5] See, *e.g., Various Items of Personal Property v. United States,* 282 U.S. 577, 581, 51 S.Ct. 282, 284, 75 L.Ed. 558 (1931) ("[I]t is the property which is proceeded against, and, by resort to a legal fiction, held guilty and condemned as though it were conscious instead of inanimate and insentient"); see also R. Waples, Proceedings In Rem 13, 205–209 (1882). Historically, the conduct of the property owner was irrelevant; indeed, the owner of forfeited property could be entirely innocent of any crime. See, *e.g., Origet v. United States,* 125 U.S. 240, 246, 8 S.Ct. 846, 850, 31 L.Ed. 743 (1888) ("[T]he merchandise is to be forfeited irrespective of any criminal prosecution.... The person punished for the offence may be an entirely different person from the owner of the merchandise, or any person interested in it. The forfeiture of the goods of the principal can form no part of the personal punishment of his agent"). As Justice Story explained:

> ****2035** "The thing is here primarily considered as the offender, or rather the offence is attached primarily to the thing; and this, whether the offence be *malum prohibitum,* or ***331** *malum in se* ... .[T]he practice has been, and so this Court understand the law to be, that the proceeding *in rem* stands independent of, and wholly unaffected by any criminal proceeding *in personam." The Palmyra,* 12 Wheat., at 14–15, 6 L.Ed. 531.

[4] **[5]** Traditional *in rem* forfeitures were thus not considered punishment against the individual for an offense. See *id.,* at 14; *Dobbins's Distillery v. United States, supra,* 96 U.S., at 401; *Van Oster v. Kansas,* 272 U.S. 465, 467–468, 47 S.Ct. 133, 134, 71 L.Ed. 354 (1926); *Calero—Toledo v. Pearson Yacht Leasing Co.,* 416 U.S. 663, 683–684, 94 S.Ct. 2080, 2091–2092, 40 L.Ed.2d 452 (1974); *Taylor v. United States,* 3 How. 197, 210, 11 L.Ed. 559 (1845) (opinion of Story, J.) (laws providing for *in rem* forfeiture of goods imported in violation of customs laws, although in one sense "imposing a penalty or forfeiture[,] ... truly deserve to be called, remedial"); see also *United States v. Ursery,* 518 U.S. 267, 293, 116 S.Ct. 2135, 2150, 135 L.Ed.2d 549 (1996) (KENNEDY, J., concurring) ("[C]ivil *in rem* forfeiture is not punishment of the wrongdoer for his criminal offense"). Because they were viewed as nonpunitive, such forfeitures traditionally were considered to occupy a place outside the domain of the Excessive Fines Clause. Recognizing the nonpunitive character of such proceedings, we have held that the Double Jeopardy Clause does not bar the institution of a civil, *in rem* forfeiture action after the criminal conviction of the defendant. See *id.,* at 278, 116 S.Ct., at 2142.[6]

The forfeiture in this case does not bear any of the hallmarks of traditional civil *in rem* forfeitures. The Government ***332** has not proceeded against the currency itself, but has instead sought and obtained a criminal conviction of respondent personally. The forfeiture serves no remedial purpose, is designed to punish the offender, and cannot be imposed upon innocent owners.

Section 982(a)(1) thus descends not from historic *in rem* forfeitures of guilty property, but from a different historical tradition: that of *in personam,* criminal forfeitures. Such forfeitures have historically been treated as punitive, being part of the punishment imposed for felonies and treason in the Middle Ages and at common law. See W. McKechnie, Magna Carta 337–339 (2d ed.1958); 2 F. Pollock & F. Maitland, The History of English Law 460–466 (2d ed.1909). Although *in personam* criminal forfeitures were well established in England at the time of the founding, they were rejected altogether in the laws of this country until very recently.[7]

****2036** **[6]** ***333** The Government specifically contends that the forfeiture of respondent's currency is constitutional because it involves an "instrumentality" of respondent's crime.[8] According to the Government, the unreported cash is an instrumentality because it "does not merely facilitate a violation of law," but is " 'the very *sine qua non* of the crime.' " Brief for United States 20 (quoting *United States v. United States Currency in the Amount of One Hundred Forty–Five Thousand, One Hundred Thirty–Nine Dollars,* 18 F.3d 73, 75 (C.A.2), cert. denied *sub nom. Etim v. United States,* 513 U.S. 815, 115 S.Ct. 72, 130 L.Ed.2d 27 (1994)). The Government reasons that "there would be no violation at all without the exportation (or attempted exportation) of the cash." Brief for United States 20.

Acceptance of the Government's argument would require us to expand the traditional understanding of instrumentality forfeitures. This we decline to do. Instrumentalities historically have been treated as a form of "guilty property" that can be forfeited in civil *in rem* proceedings. In this case, however, the Government has sought to punish respondent by proceeding against him criminally, *in personam,* rather than proceeding *in rem* against the currency. It is therefore irrelevant whether respondent's currency is an instrumentality; the forfeiture is punitive, and the test for ***334** the excessiveness of a punitive forfeiture involves solely a proportionality determination. See *infra,* at 2036–2038.[9]

III

Because the forfeiture of respondent's currency constitutes punishment and is thus a "fine" within the meaning of the Excessive Fines Clause, we now turn to the question whether it is "excessive."

A

[7] [8] The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the forfeiture must bear some relationship to the gravity of the offense that it is designed to punish. See *Austin v. United States,* 509 U.S., at 622–623, 113 S.Ct., at 2812 (noting Court of Appeals' statement that " 'the government is exacting too high a penalty in relation to the offense committed' "); *Alexander v. United States,* 509 U.S. 544, 559, 113 S.Ct. 2766, 2776, 125 L.Ed.2d 441 (1993) ("It is in the light of the extensive criminal activities which petitioner apparently conducted ... that the question whether the forfeiture was 'excessive' must be considered"). Until today, however, we have not articulated a standard for determining whether a punitive forfeiture is constitutionally excessive. We now hold that a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of a defendant's offense.

***335** The text and history of the Excessive Fines Clause demonstrate the centrality of proportionality to the excessiveness inquiry; nonetheless, they provide little guidance as to how disproportional a punitive forfeiture ****2037** must be to the gravity of an offense in order to be "excessive." Excessive means surpassing the usual, the proper, or a normal measure of proportion. See 1 N. Webster, American Dictionary of the English Language (1828) (defining excessive as "beyond the common measure or proportion"); S. Johnson, A Dictionary of the English Language 680 (4th ed. 1773) ("[b]eyond the common proportion"). The constitutional question that we address, however, is just how proportional to a criminal offense a fine must be, and the text of the Excessive Fines Clause does not answer it.

Nor does its history. The Clause was little discussed in the First Congress and the debates over the ratification of the Bill of Rights. As we have previously noted, the Clause was taken verbatim from the English Bill of Rights of 1689. See *Browning–Ferris Industries of Vt., Inc. v. Kelco Disposal, Inc.,* 492 U.S., at 266–267, 109 S.Ct., at 2915–2916. That document's prohibition against excessive fines was a reaction to the abuses of the King's judges during the reigns of the Stuarts, *id.,* at 267, 109 S.Ct., at 2916, but the fines that those judges imposed were described contemporaneously only in the most general terms. See *Earl of Devonshire's Case,* 11 State Tr. 1367, 1372 (H.L.1689) (fine of & pound;30,000 "excessive and exorbitant, against Magna Charta, the common right of the subject, and the law of the land"). Similarly, Magna Charta—which the Stuart judges were accused of subverting—required only that amercements (the medieval predecessors of fines) should be proportioned to the offense and that they should not deprive a wrongdoer of his livelihood:

> "A Free-man shall not be amerced for a small fault, but after the manner of the fault; and for a great fault after the greatness thereof, saving to him his contenement; (2) and a Merchant likewise, saving to him his ***336**

> merchandise; (3) and any other's villain than ours shall be likewise amerced, saving his wainage." Magna Charta, 9 Hen. III, ch. 14 (1225), 1 Stat. at Large 6–7 (1762 ed.).

None of these sources suggests how disproportional to the gravity of an offense a fine must be in order to be deemed constitutionally excessive.

[9] We must therefore rely on other considerations in deriving a constitutional excessiveness standard, and there are two that we find particularly relevant. The first, which we have emphasized in our cases interpreting the Cruel and Unusual Punishments Clause, is that judgments about the appropriate punishment for an offense belong in the first instance to the legislature. See, *e.g., Solem v. Helm,* 463 U.S. 277, 290, 103 S.Ct. 3001, 3009, 77 L.Ed.2d 637 (1983) ("Reviewing courts ... should grant substantial deference to the broad authority that legislatures necessarily possess in determining the types and limits of punishments for crimes"); see also *Gore v. United States,* 357 U.S. 386, 393, 78 S.Ct. 1280, 1285, 2 L.Ed.2d 1405 (1958) ("Whatever views may be entertained regarding severity of punishment, ... these are peculiarly questions of legislative policy"). The second is that any judicial determination regarding the gravity of a particular criminal offense will be inherently imprecise. Both of these principles counsel against requiring strict proportionality between the amount of a punitive forfeiture and the gravity of a criminal offense, and we therefore adopt the standard of gross disproportionality articulated in our Cruel and Unusual Punishments Clause precedents. See, *e.g., Solem v. Helm, supra,* at 288, 103 S.Ct., at 3008; *Rummel v. Estelle,* 445 U.S. 263, 271, 100 S.Ct. 1133, 1137–1138, 63 L.Ed.2d 382 (1980).

[10] In applying this standard, the district courts in the first instance, and the courts of appeals, reviewing the proportionality determination *de novo,* [10] must compare ****2038** the amount ***337** of the forfeiture to the gravity of the defendant's offense. If the amount of the forfeiture is grossly disproportional to the gravity of the defendant's offense, it is unconstitutional.

B

[11] Under this standard, the forfeiture of respondent's entire $357,144 would violate the Excessive Fines Clause. [11] Respondent's crime was solely a reporting offense. It was permissible to transport the currency out of the country so long as he reported it. Section 982(a)(1) orders currency to be forfeited for a "willful" violation of the reporting requirement. Thus, the essence of respondent's crime is a willful failure to report the removal of currency from the United States. [12] Furthermore, as the District Court found, respondent's ***338** violation was unrelated to any other illegal activities. The money was the proceeds of legal activity and was to be used to repay a lawful debt. Whatever his other vices, respondent does not fit into the class of persons for whom the statute was principally designed: He is not a money launderer, a drug trafficker, or a tax evader. [13] See Brief for United States 2–3. And under the Sentencing Guidelines, the maximum sentence that could have been imposed on respondent was six months, while the maximum fine was $5,000. App. to Pet. for Cert. 17a (transcript of District Court sentencing hearing); United States Sentencing Commission, Guidelines Manual § 5(e) 1.2, Sentencing Table ***339** Nov.1994). Such penalties confirm a minimal level of culpability. [14]

****2039** The harm that respondent caused was also minimal. Failure to report his currency affected only one party, the Government, and in a relatively minor way. There was no fraud on the United States, and respondent caused no loss to the public fisc. Had his crime gone undetected, the Government would have been deprived only of the information that $357,144 had left the country. The Government and the dissent contend that there is a correlation between the amount forfeited and the harm that the Government would have suffered had the crime gone undetected. See Brief for United States 30 (forfeiture is "perfectly calibrated"); *post,*at 2041 ("a fine calibrated with this accuracy"). We disagree. There is no inherent proportionality in such a forfeiture. It is impossible to conclude, for example, that the harm respondent caused is anywhere near 30 times greater than that caused by a hypothetical drug dealer who willfully fails to report taking $12,000 out of the country in order to purchase drugs.

Comparing the gravity of respondent's crime with the $357,144 forfeiture the Government seeks, we conclude that such a forfeiture would be grossly disproportional to the ***340** gravity of his offense. [15] It is larger than the $5,000 fine imposed by the District Court by many orders of magnitude, and it bears no articulable correlation to any injury suffered by the Government.

C

Finally, we must reject the contention that the proportionality of full forfeiture is demonstrated by the fact that the First Congress enacted statutes requiring full forfeiture of goods involved in customs offenses or the payment of monetary penalties proportioned to the goods' value. It is argued that the enactment of these statutes at roughly the same time that the Eighth Amendment was ratified suggests that full forfeiture, in the customs context at least, is a proportional punishment. The early customs statutes, however, do not support such a conclusion because, unlike § 982(a)(1), the type of forfeiture that they imposed was not considered punishment for a criminal offense.

Certain of the early customs statutes required the forfeiture of goods imported in violation of the customs laws, and, in some instances, the vessels carrying them as well. See, *e.g.,* Act of Aug. 4, 1790, § 27, 1 Stat. 163 (goods unladen without a permit from the collector). These forfeitures, however, were civil *in rem* forfeitures, in which the Government proceeded against the property itself on the theory that it was guilty, not against a criminal defendant. See, *e.g., Harford v. United States,* 8 Cranch 109, 3 L.Ed. 504 (1814) (goods unladen without a permit); *Locke v. United States,* 7 Cranch 339, 340, 3 L.Ed. 364 (1813) (same). Such forfeitures sought to vindicate the Government's underlying property right in customs duties, and like other traditional *in rem* forfeitures, they were not considered at the founding to be punishment for an offense. See *supra,* at 2035. They therefore indicate ***341** nothing about the proportionality of the punitive forfeiture at issue here. *Ibid.* [16]

****2040** Other statutes, however, imposed monetary "forfeitures" proportioned to the value of the goods involved. See, *e.g.,* Act of July 31, 1789, § 22, 1 Stat. 42 (if an importer, "with design to defraud the revenue," did not invoice his goods at their actual cost at the place of export, "all such goods, wares or merchandise, or the value thereof ... shall be forfeited"); § 25, *id.,* at 43 (any person concealing or purchasing goods, knowing they were liable to seizure for violation of the customs laws, was liable to "forfeit and pay a sum double the value of the goods so concealed or purchased"); see also Act of Aug. 4, 1790, §§ 10, 14, 22, *id.,* at 156, 158, 161. Similar statutes were passed in later Congresses. See, *e.g.,* Act of Mar. 2, 1799, §§ 24, 28, 45, 46, 66, 69, 79, 84, *id.,* at 646, 648, 661, 662, 677, 678, 687, 694; Act of Mar. 3, 1823, ch. 58, § 1, 3 Stat. 781.

These "forfeitures" were similarly not considered punishments for criminal offenses. This Court so recognized in *Stockwell v. United States,* 13 Wall. 531, 20 L.Ed. 491 (1871), a case interpreting a statute that, like the Act of July 31, 1789, provided that a person who had concealed goods liable to seizure for customs violations should "forfeit and pay a sum double the amount or value of the goods." Act of Mar. 3, 1823, ch. 58, § 2, 3 Stat. 781–782. The *Stockwell* Court rejected the defendant's ***342** contention that this provision was "penal," stating instead that it was "fully as remedial in its character, designed as plainly to secure [the] rights [of the Government], as are the statutes rendering importers liable to duties." 13 Wall., at 546, 20 L.Ed. 491. The Court reasoned:

> "When foreign merchandise, subject to duties, is imported into the country, the act of importation imposes on the importer the obligation to pay the legal charges. Besides this the goods themselves, if the duties be not paid, are subject to seizure.... Every act, therefore, which interferes with the right of the government to seize and appropriate the property which has been forfeited to it ... is a wrong to property rights, and is a fit subject for indemnity." *Id.,* 13 Wall, at 546.

Significantly, the fact that the forfeiture was a multiple of the value of the goods did not alter the Court's conclusion:

> "The act of abstracting goods illegally imported, receiving, concealing, or buying them, interposes difficulties in the way of a government seizure, and impairs, therefore, the value of the government right. It is, then, hardly accurate to say that the only loss the government can sustain from concealing the goods liable to seizure is their single value .... Double the value may not be more than complete indemnity." *Ibid.*

The early monetary forfeitures, therefore, were considered not as punishment for an offense, but rather as serving the remedial purpose of reimbursing the Government for the losses accruing from the evasion of customs duties. [17] They ***343** were thus no different in purpose and effect than the *in rem* forfeitures of the goods to whose value they were proportioned. [18] Cf. *One Lot Emerald* ****2041** *Cut Stones v. United States,* 409 U.S., at 237, 93 S.Ct., at 493 *(per curiam)* (customs statute requiring the forfeiture of undeclared goods concealed in baggage and imposing a monetary penalty equal to the value of the goods imposed a "remedial, rather than [a] punitive sanctio[n]"). [19] By contrast, ***344** the full forfeiture mandated by § 982(a)(1) in this case serves no remedial purpose; it is clearly punishment. The customs statutes enacted by the First Congress, therefore, in no way suggest that § 982(a)(1)'s currency forfeiture is constitutionally proportional.

For the foregoing reasons, the full forfeiture of respondent's currency would violate the Excessive Fines Clause. The judgment of the Court of Appeals is

Affirmed.

Justice KENNEDY, with whom THE CHIEF JUSTICE, Justice O'CONNOR, and Justice SCALIA join, dissenting.

For the first time in its history, the Court strikes down a fine as excessive under the Eighth Amendment. The decision is disturbing both for its specific holding and for the broader upheaval it foreshadows. At issue is a fine Congress fixed in the amount of the currency respondent sought to smuggle or to transport without reporting. If a fine calibrated with this accuracy fails the Court's test, its decision portends serious disruption of a vast range of statutory fines. The Court all but says the offense is not serious anyway. This disdain for the statute is wrong as an empirical matter and disrespectful of the separation of powers. The irony of the case is that, in the end, it may stand for narrowing constitutional protection rather than enhancing it. To make its rationale work, the Court appears to remove important classes of fines from any excessiveness inquiry at all. This, too, is unsound; and with all respect, I dissent.

I

A

In striking down this forfeiture, the majority treats many fines as "remedial" penalties even though they far exceed the ***345** harm suffered. Remedial penalties, the Court holds, are not subject to the Excessive Fines Clause at all. See, *e.g., ante,* at 2040. Proceeding from this premise, the majority holds customs fines are remedial and not at all punitive, even if they amount to many times the duties due on the goods. See *ante,* at 2040–2041. In the majority's universe, a fine is not a punishment even if it is much larger than the money owed. This confuses whether a fine is excessive with whether it is a punishment.

This novel, mistaken approach requires reordering a tradition existing long before the Republic and confirmed in its early years. The Court creates its category to reconcile ****2042** its unprecedented holding with a six-century-long tradition of *in personam* customs fines equal to one, two, three, or even four times the value of the goods at issue. *E.g., Cross v. United States,* 6 F.Cas. 892, No. 3,434 (C.C.D.Mass.1812) (Story, J., Cir. J.); *United States v. Riley,* 88 F. 480 (S.D.N.Y.1898); *United States v. Jordan,* 26 F.Cas. 661, No. 15,498 (D.C.Mass.1876); *In re Vetterlein,* 28 F.Cas. 1172, No. 16,929 (C.C.S.D.N.Y.1875); *United States v. Hughes,* 26 F.Cas. 417, No. 15,417 (C.C.S.D.N.Y.1875); *McGlinchy v. United States,* 16 F.Cas. 118, No. 8,803 (C.C.Me.1875); *United States v. Hutchinson,* 26 F.Cas. 446, No. 15,431 (D.Me.1868); Tariff Act of 1930, § 497, 46 Stat. 728, as amended, 19 U.S.C. § 1497(a) (failing to declare goods); Act of Mar. 3, 1863, § 1, 12 Stat. 738 (same); Act of Mar. 3, 1823, ch. 58, § 1, 3 Stat. 781 (importing without a manifest); Act of Mar. 2, 1799, §§ 46, 79, 84, 1 Stat. 662, 687, 694 (failing to declare goods; failing to re-export goods; making false entries on forms); Act of Aug. 4, 1790, §§ 10, 14, 22, 1 Stat. 156, 158, 161 (submitting incomplete manifests; unloading before customs; unloading duty-free goods); Act of July 31, 1789, §§ 22, 25, 1 Stat. 42, 43 (using false invoices; buying uncustomed goods); *King v. Manning,* 2 Comyns 616, 92 Eng. Rep. 1236 (K.B.1738) (assisting smugglers); 1 Eliz. 1, ch. 11, § 5 (1558–1559) (Eng.) (declaring goods under wrong person's name); 1 & 2 Phil. & ***346** M., ch. 5, §§ 1, 3 (1554–1555) (Eng.) (exporting food without a license; exporting more food than the license allowed); 5 Rich. 2, Stat. 1, chs. 2, 3 (1381) (Eng.) (exporting gold or silver without a license; using ships other than those of the King's allegiance).

In order to sweep all these precedents aside, the majority's remedial analysis assumes the settled tradition was limited to "reimbursing the Government for" unpaid duties. *Ante,* at 2040. The assumption is wrong. Many offenses did not require a failure to pay a duty at all. See, *e.g.,* Act of Mar.

3, 1863, § 1, 12 Stat. 738 (importing under false invoices); Act of Mar. 3, 1823, ch. 58, § 1, 3 Stat. 781 (failing to deliver ship's manifest); Act of Mar. 2, 1799, § 28, 1 Stat. 648 (transferring goods from one ship to another); Act of Aug. 4, 1790, § 14, 1 Stat. 158 (same); 5 Rich. II, st. 1, ch. 2 (1381) (Eng.) (exporting gold or silver without a license). None of these *in personam* penalties depended on a compensable monetary loss to the Government. True, these offenses risked causing harm, *ante,* at 2040, n. 17, but so does smuggling or not reporting cash. A sanction proportioned to potential rather than actual harm is punitive, though the potential harm may make the punishment a reasonable one. See *TXO Production Corp. v. Alliance Resources Corp.,* 509 U.S. 443, 460–462, 113 S.Ct. 2711, 2721–2723, 125 L.Ed.2d 366 (1993) (opinion of STEVENS, J.). The majority nonetheless treats the historic penalties as nonpunitive and thus not subject to the Excessive Fines Clause, though they are indistinguishable from the fine in this case. (It is a mark of the Court's doctrinal difficulty that we must speak of nonpunitive penalties, which is a contradiction in terms.)

Even if the majority's typology were correct, it would have to treat the instant penalty as nonpunitive. In this respect, the Court cannot distinguish the case on which it twice relies, *One Lot Emerald Cut Stones v. United States,* 409 U.S. 232, 93 S.Ct. 489, 34 L.Ed.2d 438 (1972) *(per curiam). Ante,* at 2034, 2040–2041. *Emerald Stones* held forfeiture of smuggled goods plus a fine equal to their value was remedial and not punitive, for purposes of ***347** double jeopardy, because the fine "serves to reimburse the Government for investigation and enforcement expenses." 409 U.S., at 237, 93 S.Ct., at 493. The logic, however, applies with equal force here. Forfeiture of the money involved in the offense would compensate for the investigative and enforcement expenses of the Customs Service. There is no reason to treat the cases differently, just because a small duty was at stake in one and a disclosure form in the other. See *Bollinger's Champagne,* 3 Wall. 560, 564, 18 L.Ed. 78 (1865) (holding falsehoods on customs forms justify forfeiture even if the lies do not affect the duties due and paid). The majority, in short, is not even faithful to its own artificial category of remedial penalties.

****2043** B

The majority's novel holding creates another anomaly as well. The majority suggests *in rem* forfeitures of the instrumentalities of crimes are not fines at all. See *ante,* at 2036, and nn. 8, 9. The point of the instrumentality theory is to distinguish goods having a "close enough relationship to the offense" from those incidentally related to it. *Austin v. United States,* 509 U.S. 602, 628, 113 S.Ct. 2801, 2815, 125 L.Ed.2d 488 (1993) (SCALIA, J., concurring in part and concurring in judgment). From this, the Court concludes the money in a cash-smuggling or nonreporting offense cannot be an instrumentality, unlike, say, a car used to transport goods concealed from taxes. *Ante,* at 2036, n. 9. There is little logic in this rationale. The car plays an important role in the offense but is not essential; one could also transport goods by jet or by foot. The link between the cash and the cash-smuggling offense is closer, as the offender must fail to report while smuggling more than $10,000. See 31 U.S.C. §§ 5316(a), 5322(a). The cash is not just incidentally related to the offense of cash smuggling. It is essential, whereas the car is not. Yet the car plays an important enough role to justify forfeiture, as the majority concedes. *A fortiori,* the cash does as well. Even if there were a clear distinction between instrumentalities ***348** and incidental objects, when the Court invokes the distinction it gets the results backwards.

II

Turning to the question of excessiveness, the majority states the test: A defendant must prove a gross disproportion before a court will strike down a fine as excessive. See *ante,* at 2036. This test would be a proper way to apply the Clause, if only the majority were faithful in applying it. The Court does not, however, explain why in this case forfeiture of all of the cash would have suffered from a gross disproportion. The offense is a serious one, and respondent's smuggling and failing to report were willful. The cash was lawful to own, but this fact shows only that the forfeiture was a fine; it cannot also prove that the fine was excessive.

The majority illuminates its test with a principle of deference. Courts " 'should grant substantial deference to the broad authority that legislatures necessarily possess' " in setting punishments. *Ante,* at 2037 (quoting *Solem v. Helm,* 463 U.S. 277, 290, 103 S.Ct. 3001, 3009, 77 L.Ed.2d 637 (1983)). Again, the principle is sound but the implementation is not. The majority's assessment of the crime accords no deference, let alone substantial deference, to the judgment of Congress. Congress deems the crime serious, but the Court does not. Under the congressional statute, the crime is punishable by a prison sentence, a heavy fine, and the forfeiture here at issue. As the statute makes clear, the Government needs the information to investigate other serious crimes, and it needs the penalties to ensure compliance.

A

By affirming, the majority in effect approves a meager $15,000 forfeiture. The majority's holding purports to be narrower, saying only that forfeiture of the entire $357,144 would be excessive. *Ante,* at 2038, and n. 11. This narrow holding is artificial in constricting the question presented for this Court's review. The statute mandates forfeiture of ***349** the entire $357,144. See 18 U.S.C. § 982(a)(1). The only ground for reducing the forfeiture, then, is that any higher amount would be unconstitutional. The majority affirms the reduced $15,000 forfeiture on *de novo* review, see *ante,* at 2038, and n. 11, which it can do only if a forfeiture of even $15,001 would have suffered from a gross disproportion. Indeed, the majority leaves open whether the $15,000 forfeiture itself was too great. See *ante,* at 2038, n. 11. Money launderers, among the principal targets of this statute, may get an even greater return from their crime.

The majority does not explain why respondent's knowing, willful, serious crime deserves no higher penalty than $15,000. It gives only a cursory explanation of why forfeiture of all of the money would have suffered from a gross disproportion. The majority justifies its evisceration of the fine because the money was legal to have and ****2044** came from a legal source. See *ante,* at 2038. This fact, however, shows only that the forfeiture was a fine, not that it was excessive. As the majority puts it, respondent's money was lawful to possess, was acquired in a lawful manner, and was lawful to export. *Ante,* at 2038. It was not, however, lawful to possess the money while concealing and smuggling it. Even if one overlooks this problem, the apparent lawfulness of the money adds nothing to the argument. If the items possessed had been dangerous or unlawful to own, for instance, narcotics, the forfeiture would have been remedial and would not have been a fine at all. See *Austin, supra,* at 621, 113 S.Ct., at 2811–2812; *e.g., United States v. One Assortment of 89 Firearms,* 465 U.S. 354, 364, 104 S.Ct. 1099, 1105–1106, 79 L.Ed.2d 361 (1984) (unlicensed guns); *Commonwealth v. Dana,* 43 Mass. 329, 337 (1841) (forbidden lottery tickets). If respondent had acquired the money in an unlawful manner, it would have been forfeitable as proceeds of the crime. As a rule, forfeitures of criminal proceeds serve the nonpunitive ends of making restitution to the rightful owners and of compelling the surrender of property held without right or ownership. See ***350** *United States v. Ursery,* 518 U.S. 267, 284, 116 S.Ct. 2135, 2145, 135 L.Ed.2d 549 1996). Most forfeitures of proceeds, as a consequence, are not fines at all, let alone excessive fines. Hence, the lawfulness of the money shows at most that the forfeiture was a fine; it cannot at the same time prove that the fine was excessive.

B

1

In assessing whether there is a gross disproportion, the majority concedes, we must grant " 'substantial deference' " to Congress' choice of penalties. *Ante,* at 2037 (quoting *Solem, supra,* at 290, 103 S.Ct., at 3009–3010). Yet, ignoring its own command, the Court sweeps aside Congress' reasoned judgment and substitutes arguments that are little more than speculation.

Congress considered currency smuggling and non-reporting a serious crime and imposed commensurate penalties. It authorized punishments of five years' imprisonment, a $250,000 fine, plus forfeiture of all the undeclared cash. 31 U.S.C. § 5322(a); 18 U.S.C. § 982(a)(1). Congress found the offense standing alone is a serious crime, for the same statute doubles the fines and imprisonment for failures to report cash "while violating another law of the United States." 31 U.S.C. § 5322(b). Congress experimented with lower penalties on the order of one year in prison plus a $1,000 fine, but it found the punishments inadequate to deter lucrative money laundering. See President's Commission on Organized Crime, The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering 27, 60 (Oct.1984). The Court today rejects this judgment.

The Court rejects the congressional judgment because, it says, the Sentencing Guidelines cap the appropriate fine at $5,000. See *ante,* at 2038–2039, and n. 14. The purpose of the Guidelines, however, is to select punishments with precise proportion, not to opine on what is a gross disproportion. In addition, there is no authority for elevating the Commission's judgment of what is prudent over the congressional judgment ***351** of what is constitutional. The majority, then, departs from its promise of deference in the very case announcing the standard.

The Court's argument is flawed, moreover, by a serious misinterpretation of the Guidelines on their face. The Guidelines do not stop at the $5,000 fine the majority cites. They augment it with this vital point: "Forfeiture is to be imposed upon a convicted defendant as provided by statute." United States Sentencing Commission, Guidelines Manual § 5E1.4 (Nov.1995). The fine thus supplements the forfeiture; it does not replace it. Far from contradicting congressional judgment on the offense, the Guidelines implement and mandate it.

2

The crime of smuggling or failing to report cash is more serious than the Court is willing to acknowledge. The drug trade, money laundering, and tax evasion all depend in part on smuggled and unreported cash. Congress enacted the reporting requirement ****2045** because secret exports of money were being used in organized crime, drug trafficking, money laundering, and other crimes. See H.R.Rep. No. 91–975, pp. 12–13 (1970). Likewise, tax evaders were using cash exports to dodge hundreds of millions of dollars in taxes owed to the Government. See *ibid.*

The Court does not deny the importance of these interests but claims they are not implicated here because respondent managed to disprove any link to other crimes. Here, to be sure, the Government had no affirmative proof that the money was from an illegal source or for an illegal purpose. This will often be the case, however. By its very nature, money laundering is difficult to prove; for if the money launderers have done their job, the money appears to be clean. The point of the statute, which provides for even heavier penalties if a second crime can be proved, is to mandate forfeiture regardless. See 31 U.S.C. § 5322(b); ***352** 18 U.S.C. § 982(a)(1). It is common practice, of course, for a cash courier not to confess a tainted source but to stick to a well-rehearsed story. The kingpin, the real owner, need not come forward to make a legal claim to the funds. He has his own effective enforcement measures to ensure delivery at destination or return at origin if the scheme is thwarted. He is, of course, not above punishing the courier who deviates from the story and informs. The majority is wrong, then, to assume *in personam* forfeitures cannot affect kingpins, as their couriers will claim to own the money and pay the penalty out of their masters' funds. See *ante,* at 2033, n. 3. Even if the courier confessed, the kingpin could face an *in personam* forfeiture for his agent's authorized acts, for the kingpin would be a co-principal in the commission of the crime. See 18 U.S.C. § 2.

In my view, forfeiture of all the unreported currency is sustainable whenever a willful violation is proved. The facts of this case exemplify how hard it can be to prove ownership and other crimes, and they also show respondent is far from an innocent victim. For one thing, he was guilty of repeated lies to Government agents and suborning lies by others. Customs inspectors told respondent of his duty to report cash. He and his wife claimed they had only $15,000 with them, not the $357,144 they in fact had concealed. He then told customs inspectors a friend named Abe Ajemian had lent him about $200,000. Ajemian denied this. A month later, respondent said Saeed Faroutan had lent him $170,000. Faroutan, however, said he had not made the loan and respondent had asked him to lie. Six months later, respondent resurrected the fable of the alleged loan from Ajemian, though Ajemian had already contradicted the story. As the District Court found, respondent "has lied, and has had his friends lie." Tr. 54 (Jan. 19, 1995). He had proffered a "suspicious and confused story, documented in the poorest way, and replete with past misrepresentation." *Id.,* at 61–62.

***353** Respondent told these lies, moreover, in most suspicious circumstances. His luggage was stuffed with more than a third of a million dollars. All of it was in cash, and much of it was hidden in a case with a false bottom.

The majority ratifies the District Court's see-no-evil approach. The District Court ignored respondent's lies in assessing a sentence. It gave him a two-level downward adjustment for acceptance of responsibility, instead of an increase for obstruction of justice. See *id.,* at 62. It dismissed the lies as stemming from "distrust for the Government" arising out of "cultural differences." *Id.,* at 63. While the majority is sincere in not endorsing this excuse, *ante,* at 2038, n. 12, it nonetheless affirms the fine tainted by it. This patronizing excuse demeans millions of law-abiding American immigrants by suggesting they cannot be expected to be as truthful as every other citizen. Each American, regardless of culture or ethnicity, is equal before the law. Each has the same obligation to refrain from perjury and false statements to the Government.

In short, respondent was unable to give a single truthful explanation of the source of the cash. The multitude of lies and suspicious circumstances points to some form of crime. Yet, though the Government rebutted each and every fable respondent proffered, it was unable to adduce affirmative proof of another crime in this particular case.

****2046** Because of the problems of individual proof, Congress found it necessary to enact a blanket punishment. See S.Rep. No. 99–130, p. 21 (1985); see also Drug Money Laundering Control Efforts, Hearing before the Subcommittee on Consumer and Regulatory Affairs of the Senate Banking, Housing, and Urban Affairs Committee, 101st Cong., 1st Sess., 84 (1989) (former Internal Revenue Service agent found it " 'unbelievably difficult' " to discern which money flows were legitimate and which were tied to crime). One of the few reliable warning signs of some serious crimes is the use of large sums of cash. See *id.,* at 83. So Congress ***354** punished all cash smuggling or nonreporting, authorizing single penalties for the offense alone and double penalties for the offense coupled with proof of other crimes. See 31 U.S.C. §§ 5322(a), (b). The requirement of willfulness, it judged, would be enough to protect the innocent. See *ibid.* The majority second-guesses this judgment without explaining why Congress' blanket approach was unreasonable.

Money launderers will rejoice to know they face forfeitures of less than 5% of the money transported, provided they hire accomplished liars to carry their money for them. Five percent, of course, is not much of a deterrent or punishment; it is comparable to the fee one might pay for a mortgage lender or broker. Cf. 15 U.S.C. § 1602(aa)(1)(B) (high-cost mortgages cost more than 8% in points and fees). It is far less than the 20%–26% commissions some drug dealers pay money launderers. See Hearing on Money Laundering and the Drug Trade before the Subcommittee on Crime of the House Judiciary Committee, 105th Cong., 1st Sess., 62 (1997) (testimony of M. Zeldin); Andelman, The Drug Money Maze, 73 Foreign Affairs 108 (July/Aug. 1994). Since many couriers evade detection, moreover, the average forfeiture per dollar smuggled could amount, courtesy of today's decision, to far less than 5%. In any event, the fine permitted by the majority would be a modest cost of doing business in the world of drugs and crime. See US/Mexico Bi–National Drug Threat Assessment 84 (Feb.1997) (to drug dealers, transaction costs of 13%–15% are insignificant compared to their enormous profit margins).

Given the severity of respondent's crime, the Constitution does not forbid forfeiture of all of the smuggled or unreported cash. Congress made a considered judgment in setting the penalty, and the Court is in serious error to set it aside.

III

The Court's holding may in the long run undermine the purpose of the Excessive Fines Clause. One of the main ***355** purposes of the ban on excessive fines was to prevent the King from assessing unpayable fines to keep his enemies in debtor's prison. See *Browning–Ferris Industries of Vt., Inc. v. Kelco Disposal, Inc.,* 492 U.S. 257, 267, 109 S.Ct. 2909, 2916, 106 L.Ed.2d 219 (1989); 4 W. Blackstone, Commentaries on the Laws of England 373 (1769) ("[C]orporal punishment, or a stated imprisonment, ... is better than an excessive fine, for that amounts to imprisonment for life. And this is the reason why fines in the king's court are frequently denominated ransoms ..."). Concern with imprisonment may explain why the Excessive Fines Clause is coupled with, and follows right after, the Excessive Bail Clause. While the concern is not implicated here—for of necessity the money is there to satisfy the forfeiture—the Court's restrictive approach could subvert this purpose. Under the Court's holding, legislators may rely on mandatory prison sentences in lieu of fines. Drug lords will be heartened by this, knowing the prison terms will fall upon their couriers while leaving their own wallets untouched.

At the very least, today's decision will encourage legislatures to take advantage of another avenue the majority leaves open. The majority subjects this forfeiture to scrutiny because it is *in personam,* but it then suggests most *in rem* forfeitures (and perhaps most civil forfeitures) may not be fines at all. *Ante,* at 2035, 2039–2040, and n.

16; but see *ante,* at 2035, n. 6. The suggestion, one might note, is inconsistent or at least in tension with *Austin v. United States,* 509 U.S. 602, 113 S.Ct. 2801, 125 L.Ed.2d 488 (1993). In any event, these remarks may ****2047** encourage a legislative shift from *in personam* to *in rem* forfeitures, avoiding *mens rea* as a predicate and giving owners fewer procedural protections. By invoking the Excessive Fines Clause with excessive zeal, the majority may in the long run encourage Congress to circumvent it.

IV

The majority's holding may not only jeopardize a vast range of fines but also leave countless others unchecked by ***356** the Constitution. Nonremedial fines may be subject to deference in theory but overbearing scrutiny in fact. So-called remedial penalties, most *in rem* forfeitures, and perhaps civil fines may not be subject to scrutiny at all. I would not create these exemptions from the Excessive Fines Clause. I would also accord genuine deference to Congress' judgments about the gravity of the offenses it creates. I would further follow the long tradition of fines calibrated to the value of the goods smuggled. In these circumstances, the Constitution does not forbid forfeiture of all of the $357,144 transported by respondent. I dissent.

All Citations

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Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

[1] The statutory reporting requirement provides:

> "[A] person or an agent or bailee of the person shall file a report ... when the person, agent, or bailee knowingly—
>
> "(1) transports, is about to transport, or has transported, monetary instruments of more than $10,000 at one time—
>
> "(A) from a place in the United States to or through a place outside the United States...." 31 U.S.C. § 5316(a).

[2] Section 5322(a) provides: "A person willfully violating this subchapter ... shall be fined not more than $250,000, or imprisoned for not more than five years, or both."

[3] Although the currency reporting statute provides that "a person or an agent or bailee of the person shall file a report," 31 U.S.C. § 5316(a), the statute ordering the criminal forfeiture of unreported currency provides that "[t]he court, in imposing sentence on a person convicted of" failure to file the required report, "shall order that the person forfeit to the United States" any property "involved in" or "traceable to" the offense, 18 U.S.C. § 982(a)(1). The combined effect of these two statutes is that an owner of unreported currency is not subject to criminal forfeiture if his agent or bailee is the one who fails to file the required report, because such an owner could not be convicted of the reporting offense. The United States endorsed this interpretation at oral argument in this case. See Tr. of Oral Arg. 24–25.

For this reason, the dissent's speculation about the effect of today's holding on "kingpins" and "cash couriers" is misplaced. See *post,* at 2045, 2046. Section 982(a)(1)'s criminal *in personam* forfeiture reaches only currency owned by someone who himself commits a reporting crime. It is unlikely that the Government, in the course of criminally indicting and prosecuting a cash courier, would not bother to investigate the source and true ownership of unreported funds.

[4] We do not suggest that merely because the forfeiture of respondent's currency in this case would not serve a remedial purpose, other forfeitures may be classified as nonpunitive (and thus not "fines") if they serve some remedial purpose as well as being punishment for an offense. Even if the Government were correct in claiming that the forfeiture of respondent's currency is remedial in some way, the forfeiture would still be punitive in part. (The Government concedes as much.) This is sufficient to bring the forfeiture within the purview of the Excessive Fines Clause. See *Austin v. United States,* 509 U.S. 602, 621–622, 113 S.Ct. 2801, 2811–2812, 125 L.Ed.2d 488 (1993).

[5] The "guilty property" theory behind *in rem* forfeiture can be traced to the Bible, which describes property being sacrificed to God as a means of atoning for an offense. See Exodus 21:28. In medieval Europe and at common law, this concept evolved into the law of deodand, in which offending property was condemned and confiscated by the church or the Crown in remediation for the harm it had caused. See 1 M. Hale, Pleas of the Crown 420–424 (1st Am. ed. 1847); 1

W. Blackstone, Commentaries on the Laws of England 290–292 (1765); O. Holmes, The Common Law 10–13, 23–27 (M. Howe ed.1963).

6 It does not follow, of course, that all modern civil *in rem* forfeitures are nonpunitive and thus beyond the coverage of the Excessive Fines Clause. Because some recent federal forfeiture laws have blurred the traditional distinction between civil *in rem* and criminal *in personam* forfeiture, we have held that a modern statutory forfeiture is a "fine" for Eighth Amendment purposes if it constitutes punishment even in part, regardless of whether the proceeding is styled *in rem* or *in personam.* See *Austin v. United States, supra,* at 621–622, 113 S.Ct., at 2811–2812 (although labeled *in rem,* civil forfeiture of real property used "to facilitate" the commission of drug crimes was punitive in part and thus subject to review under the Excessive Fines Clause).

7 The First Congress explicitly rejected *in personam* forfeitures as punishments for federal crimes, see Act of Apr. 30, 1790, ch. 9, § 24, 1 Stat. 117 ("[N]o conviction or judgment ... shall work corruption of blood, or any forfeiture of estate"), and Congress reenacted this ban several times over the course of two centuries. See Rev. Stat. § 5326 (1875); Act of Mar. 4, 1909, ch. 321, § 341, 35 Stat. 1159; Act of June 25, 1948, ch. 645, § 3563, 62 Stat. 837, codified at 18 U.S.C. § 3563 (1982 ed.); repealed effective Nov. 1, 1987, Pub.L. 98–473, 98 Stat.1987.

It was only in 1970 that Congress resurrected the English common law of punitive forfeiture to combat organized crime and major drug trafficking. See Organized Crime Control Act of 1970, 18 U.S.C. § 1963, and Comprehensive Drug Abuse Prevention and Control Act of 1970, 21 U.S.C. § 848(a). In providing for this mode of punishment, which had long been unused in this country, the Senate Judiciary Committee acknowledged that "criminal forfeiture ... represents an innovative attempt to call on our common law heritage to meet an essentially modern problem." S.Rep. No. 91–617, p. 79 (1969). Indeed, it was not until 1992 that Congress provided for the criminal forfeiture of currency at issue here. See 18 U.S.C. § 982(a).

8 Although the term "instrumentality" is of recent vintage, see *Austin v. United States,* 509 U.S., at 627–628, 113 S.Ct., at 2814–2815 (SCALIA, J., concurring in part and concurring in judgment), it fairly characterizes property that historically was subject to forfeiture because it was the actual means by which an offense was committed. See *infra,* at 2036; see, *e.g., J.W. Goldsmith, Jr.-Grant Co. v. United States,* 254 U.S. 505, 508–510, 41 S.Ct. 189, 190–191, 65 L.Ed. 376 (1921). "Instrumentality" forfeitures have historically been limited to the property actually used to commit an offense and no more. See *Austin v. United States, supra,* at 627–628, 113 S.Ct., at 2814–2815 (SCALIA, J., concurring in part and concurring in judgment). A forfeiture that reaches beyond this strict historical limitation is *ipso facto* punitive and therefore subject to review under the Excessive Fines Clause.

9 The currency in question is not an instrumentality in any event. The Court of Appeals reasoned that the existence of the currency as a "precondition" to the reporting requirement did not make it an "instrumentality" of the offense. See 84 F.3d 334, 337 (C.A.9 1996). We agree; the currency is merely the subject of the crime of failure to report. Cash in a suitcase does not facilitate the commission of that crime as, for example, an automobile facilitates the transportation of goods concealed to avoid taxes. See, *e.g., J.W. Goldsmith, Jr.-Grant Co. v. United States, supra,* at 508, 41 S.Ct., at 190. In the latter instance, the property is the actual means by which the criminal act is committed. See Black's Law Dictionary 801 (6th ed. 1990) ("Instrumentality" is "[s]omething by which an end is achieved; a means, medium, agency").

10 At oral argument, respondent urged that a district court's determination of excessiveness should be reviewed by an appellate court for abuse of discretion. See Tr. of Oral Arg. 32. We cannot accept this submission. The factual findings made by the district courts in conducting the excessiveness inquiry, of course, must be accepted unless clearly erroneous. See *Anderson v. Bessemer City,* 470 U.S. 564, 574–575, 105 S.Ct. 1504, 1511–1512, 84 L.Ed.2d 518 (1985). But the question whether a fine is constitutionally excessive calls for the application of a constitutional standard to the facts of a particular case, and in this context *de novo* review of that question is appropriate. See *Ornelas v. United States,* 517 U.S. 690, 697, 116 S.Ct. 1657, 1662, 134 L.Ed.2d 911 (1996).

11 The only question before this Court is whether the full forfeiture of respondent's $357,144 as directed by § 982(a)(1) is constitutional under the Excessive Fines Clause. We hold that it is not. The Government petitioned for certiorari seeking full forfeiture, and we reject that request. Our holding that full forfeiture would be excessive reflects no judgment that "a forfeiture of even $15,001 would have suffered from a gross disproportion," nor does it "affir[m] the reduced $15,000 forfeiture on *de novo* review." *Post,* at 2043. Those issues are simply not before us. Nor, indeed, do we address in *any* respect the validity of the forfeiture ordered by the District Court, including whether a court may disregard the terms of a statute that commands full forfeiture: As noted, *supra,* at 2033, respondent did not cross-appeal the $15,000 forfeiture ordered by the District Court. The Court of Appeals thus declined to address the $15,000 forfeiture, and that question is not properly presented here either.

12 Contrary to the dissent's contention, the nature of the nonreporting offense in this case was not altered by respondent's “lies” or by the “suspicious circumstances” surrounding his transportation of his currency. See *post,* at 2045–2046. A single willful failure to declare the currency constitutes the crime, the gravity of which is not exacerbated or mitigated by “fable[s]” that respondent told one month, or six months, later. See *post,* at 2045. The Government indicted respondent under 18 U.S.C. § 1001 for “lying,” but that separate count did not form the basis of the nonreporting offense for which § 982(a)(1) orders forfeiture.

Further, the District Court's finding that respondent's lies stemmed from a fear of the Government because of “cultural differences,” *supra,* at 2032, does not mitigate the gravity of his offense. We reject the dissent's contention that this finding was a “patronizing excuse” that “demeans millions of law-abiding American immigrants by suggesting they cannot be expected to be as truthful as every other citizen.” *Post,* at 2045. We are confident that the District Court concurred in the dissent's incontrovertible proposition that “[e]ach American, regardless of culture or ethnicity, is equal before the law.” *Ibid.* The District Court did nothing whatsoever to imply that “cultural differences” excuse lying, but rather made this finding in the context of establishing that respondent's willful failure to report the currency was unrelated to any other crime—a finding highly relevant to the determination of the gravity of respondent's offense. The dissent's charge of ethnic paternalism on the part of the District Court finds no support in the record, nor is there any indication that the District Court's factual finding that respondent “distrust[ed] ... the Government,” see *supra,* at 2032, was clearly erroneous.

13 Nor, contrary to the dissent's repeated assertion, see *post,* at 2041, 2042–2044, 2046, 2047, is respondent a “smuggl[er].” Respondent owed no customs duties to the Government, and it was perfectly legal for him to possess the $357,144 in cash and to remove it from the United States. His crime was simply failing to report the wholly legal act of transporting his currency.

14 In considering an offense's gravity, the other penalties that the Legislature has authorized are certainly relevant evidence. Here, as the Government and the dissent stress, Congress authorized a maximum fine of $250,000 plus five years' imprisonment for willfully violating the statutory reporting requirement, and this suggests that it did not view the reporting offense as a trivial one. That the maximum fine and Guideline sentence to which respondent was subject were but a fraction of the penalties authorized, however, undercuts any argument based solely on the statute, because they show that respondent's culpability relative to other potential violators of the reporting provision—tax evaders, drug kingpins, or money launderers, for example—is small indeed. This disproportion is telling notwithstanding the fact that a separate Guideline provision permits forfeiture if mandated by statute, see *post,* at 2044–2045. That Guideline, moreover, cannot override the constitutional requirement of proportionality review.

15 Respondent does not argue that his wealth or income are relevant to the proportionality determination or that full forfeiture would deprive him of his livelihood, see *supra,* at 2037, and the District Court made no factual findings in this respect.

16 The nonpunitive nature of these early forfeitures was not lost on the Department of Justice, in commenting on the punitive forfeiture provisions of the Organized Crime Control Act of 1970:

“ ‘The concept of forfeiture as a criminal penalty which is embodied in this provision differs from other presently existing forfeiture provisions under Federal statutes where the proceeding is *in rem* against the property and the thing which is declared unlawful under the statute, or which is used for an unlawful purpose, or in connection with the prohibited property or transaction, is considered the offender, *and the forfeiture is no part of the punishment for the criminal offense. Examples of such forfeiture provisions are those contained in the customs, narcotics, and revenue laws.*’ ” S.Rep. No. 91–617, p. 79 (1969) (emphasis added).

17 In each of the statutes from the early Congresses cited by the dissent, the activities giving rise to the monetary forfeitures, if undetected, were likely to cause the Government losses in customs revenue. The forfeiture imposed by the Acts of Aug. 4, 1790, and Mar. 2, 1799, was not simply for “transferring goods from one ship to another,” *post,* at 2042, but rather for doing so “before such ship ... shall come to the proper place for the discharge of her cargo ... and be there duly authorized by the proper officer or officers of the customs to unlade” the goods, see 1 Stat. 157, 158, 648, whereupon duties would be assessed. Similarly, the forfeiture imposed by the Act of Mar. 3, 1823, was for failing to deliver the ship's manifest of cargo—which was to list “merchandise subject to duty”—to the collector of customs. See Act of Mar. 2, 1821, § 1, 3 Stat. 616; Act of Mar. 3, 1823, § 1, *id.,* at 781. And the “invoices” that if “false” gave rise to the forfeiture imposed by the Act of Mar. 3, 1863, were to include the value or quantity of any dutiable goods. § 1, 12 Stat. 737–738.

18 The nonpunitive nature of the monetary forfeitures was also reflected in their procedure: like traditional *in rem* forfeitures, they were brought as civil actions, and as such are distinguishable from the punitive criminal fine at issue here. Instead of instituting an information of libel *in rem* against the goods, see, *e.g., Locke v. United States,* 7 Cranch 339, 3 L.Ed. 364 (1813), the Government filed “a civil action of debt” against the person from whom it sought payment. See, *e.g., Stockwell*

v. United States, 13 Wall. 531, 541–542, 20 L.Ed. 491 (1871). In both England and the United States, an action of debt was used to recover import duties owed the Government, being "the general remedy for the recovery of all sums certain, whether the legal liability arise from contract, or be created by a statute. And the remedy as well lies for the government itself, as for a citizen." *United States v. Lyman,* 26 F.Cas. 1024, 1030, No. 15,647 (C.C.Mass.1818) (Story, C.J.). Thus suits for the payment of monetary forfeitures were viewed no differently than suits for the customs duties themselves.

19 *One Lot Emerald Cut Stones* differs from this case in the most fundamental respect. We concluded that the forfeiture provision in *Emerald Cut Stones* was entirely remedial and thus nonpunitive, primarily because it "provide[d] a reasonable form of liquidated damages" to the Government. 409 U.S., at 237, 93 S.Ct., at 493. The additional fact that such a remedial forfeiture also "serves to reimburse the Government for investigation and enforcement expenses," *ibid.;* see *post,* at 2042, is essentially meaningless, because even a clearly punitive criminal fine or forfeiture could be said in some measure to reimburse for criminal enforcement and investigation. Contrary to the dissent's assertion, this certainly does not mean that the forfeiture in this case—which, as the dissent acknowledges, see *post,* at 2041 (respondent's forfeiture is a "fine"); *post,* at 2045–2046 (§ 982(a)(1) imposes a "punishment"), is clearly punitive—"would have to [be treated] as nonpunitive," *post,* at 2042.

* * *

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United States District Court,
S.D. Florida.

United States of America, Plaintiff,
v.
Carl R. Zwerner, Defendant.

CASE NO. 13–22082–CIV–ALTONAGA/O'Sullivan
|
Signed 04/29/2014

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ORDER

CECILIA M. ALTONAGA UNITED STATES DISTRICT JUDGE

***1 THIS CAUSE** came before the Court upon Plaintiff, the United States' Motion for Summary Judgment[1] ("Motion") [ECF No. 21], filed February 18, 2014. Defendant, Carl R. Zwerner ("Zwerner") filed an Opposition to the United States' Motion for Summary Judgment ("Response") [ECF No. 25] on March 7, 2014; and on March 17, 2014, the United States filed its Reply ... [ECF No. 26]. The Court has carefully considered the parties' written submissions, the record, and applicable law.

This case involves the collection of civil penalties assessed by the United States against Zwerner for failing to annually declare his foreign bank account on certain tax-related forms from 2004 to 2007. (*See* Mot. 1). In order to diversify his investments, Zwerner opened a foreign bank account in Europe around the late 1960s.[2] (*See id.* ¶ 8; Resp. 1–2, ¶ 8; Zwerner Dep. 62:25–63:24, 67:19–25, 78:18–20). At the advice of Swiss bankers and attorneys, Zwerner established a Bond Foundation ("Foundation") based in Lichtenstein and deposited approximately $200,000 into the account. (*See* Mot. ¶ 8; Resp. 1–2, ¶ 8). A board of directors managed the Foundation and maintained signature authority over the account. (*See* Mot. ¶ 8; Resp. 1–2, ¶ 8). The account's funds were comprised of money earned and taxed in the United States, as well as funds earned overseas. (*See* Mot. ¶ 9; Resp. 2, ¶ 9).

Zwerner did not file a Report of Foreign Bank and Financial Accounts ("FBAR") declaring his foreign account. (*See* Mot. ¶¶ 28, 42, 51). Zwerner states he did not realize it was necessary to report his ownership interest in a foreign account located abroad and funded with money he earned overseas. (*See* Zwerner Dep. 138:10–140:11). Zwerner mistakenly believed the account's assets and earned income would only need to be declared if the funds were transferred to the United States. (*See id.* 74:4–22, 138:21–140:11).

Between 2006 and 2007, Zwerner became aware of a taxpayer's obligation to report an interest in a foreign account or foundation after reading news articles on the subject. (*See id.* 139:12–20; 186:1–187:20). In May 2008, Zwerner disclosed the foreign account to his longtime accountant, Robert Bloomfield, who advised Zwerner to consult an attorney. (*See* Mot. ¶ 31; Resp. 4, ¶ 31). Zwerner subsequently retained attorney Dennis Kleinfeld, who also engaged attorney Marc Nurik ("Nurik"). (*See* Mot. ¶¶ 32, 37; Resp. 4–5, ¶¶ 32, 37).

On February 10, 2009, Nurik and a consultant met with Internal Revenue Service ("IRS") criminal agent, Betty Stewart ("Stewart"), regarding their client's voluntary disclosure. (*See* Mot. ¶ 39). After the meeting, Stewart sent Nurik a letter dated February 17, 2009 explaining a voluntary disclosure is not made until the client's identity is disclosed to the IRS. (*See id.* ¶ 41; Resp. 5, ¶ 41; Feb. 17, 2009 Letter, Pl.'s Ex. M [ECF No. 21–13]). In March 2009, Zwerner filed amended tax returns. (*See* Mot. ¶ 52). On April 6, 2009, Nurik sent Zwerner a letter updating him on the status of his voluntary disclosure and enclosing Stewart's February 10, 2009 letter. (*See id.* ¶ 44; Apr. 6, 2009 Letter, Pl.'s Ex. N [ECF No. 21–14]). The April 6, 2009 letter states, "in the attached letter dated February 17, 2009 ... the John Doe referenced as making a Voluntary Disclosure is you. You are free to represent the same to any entity making inquiries regarding whether or not Voluntary Disclosure was made anonymously to the

Internal Revenue Service." (Apr. 6, 2009 Letter, Pl.'s Ex. N) (alteration added).

***2** In June 2010, the IRS commenced an investigation of Zwerner's income tax returns after reviewing his amended returns, and IRS Agent Carlos Tarrago ("Agent Tarrago") contacted Zwerner. (*See* Mot. ¶ 52). After multiple conversations with Agent Tarrago, Zwerner drafted a letter dated August 9, 2010 regarding the reasons for and the events related to the disclosure of his foreign account. (*See* Aug. 9, 2010 Letter, Def.'s Ex. M [ECF No. 25–6]). In the letter, Zwerner states he believed his attorney, Nurik, made a voluntary disclosure during a February 10, 2009 meeting with the IRS. (*See id.*; Resp. ¶ 40). Zwerner also admits, "I was aware that this account should have been reported and I should have reported the income from the account." (Aug. 9, 2010 Letter, Def.'s Ex. M). At the end of the letter, Zwerner references his full cooperation with Agent Tarrago. (*See id.*).

Zwerner later submitted a Statement on Dissolved Entities [ECF No. 21–3] dated November 8, 2011 to the IRS acknowledging his ownership interest in his foreign account formed through the Bond Foundation, and subsequently the Livella Foundation. (*See* Mot. ¶ 15; Resp. 2–3, ¶¶ 14–15).

Summary judgment may only be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law. *See* FED. R. CIV. P. 56(a), (c). "[T]he court must view all evidence and make all reasonable inferences in favor of the party opposing summary judgment." *Chapman v. AI Transport*, 229 F.3d 1012, 1023 (11th Cir. 2000) (en banc) (quoting *Haves v. City of Miami*, 52 F.3d 918, 921 (11th Cir. 1995)).

In the Motion, the United States asks the Court to enter summary judgment against Zwerner for the FBAR penalties assessed against him from 2004 to 2007, totaling $3,630,119.29, including interest and statutory additions calculated as of January 31, 2014. (*See* Mot. 31). Specifically, the United States argues Zwerner's failure to comply with the FBAR requirements was willful, justifying the higher civil penalties assessed against him. (*See id.* 18–22). Zwerner argues he did not willfully violate any reporting requirements (*see* Resp. 16–17) and asserts a number of affirmative defenses, including his eligibility for one of the IRS's voluntary disclosure programs (*see* Resp. 17–27). The United States refutes Zwerner's affirmative defenses, contending: the FBAR penalties do not violate Defendant's Eighth Amendment right to be free from excessive fines (*see* Mot. 22–25; Reply 5–6); the IRS is not prohibited from treating U.S. taxpayers disparately (*see* Mot. 25–26; Reply 8); and Zwerner was not eligible for and did not complete the 2009 Voluntary Disclosure Program (*see* Mot. 26–30; Reply 8–10).

U.S. citizens must keep records and report their interests in foreign financial accounts as required by law. *See* 31 U.S.C.§§ 5314(a), (c). Pursuant to the Code of Federal Regulations for "Reports of foreign financial accounts,"

> [e]ach United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner of Internal Revenue for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. [section] 5314 to be filed by such persons. The form prescribed under section 5314 is the Report of Foreign Bank and Financial Accounts (TD–F 90–22.1).

31 C.F.R. § 1010.350(a) (alterations added). U.S. taxpayers must report foreign financial accounts exceeding $10,000 on or before June 30 of each calendar year for accounts maintained the previous calendar year. *Id.* § 1010.306(c).

Penalties for reporting violations regarding foreign financial agency transactions generally are not to exceed $10,000. *See* 31 U.S.C. § 5321(a)(5)(B)(i). Willful violations, however, have a maximum penalty of $100,000, or fifty percent of the balance in the account at the time of the violation, whichever is greater. *See id.* §§ 5321(a)(5)(C)–(D). For a willful violation, the United States must show: (1) a U.S. person (2) with a financial interest or signatory or other authority (3) over a foreign financial account (4) that exceeds $10,000 in value (5) willfully (6) failed to file a timely FBAR disclosing the account. *See id.* §§ 5314, 5321(a)(5); 31 C.F.R. §§

1010.306(c), 350(a). The Government's Motion asks the Court to decide there are no triable issues of fact that Zwerner's conduct was willful.

***3** The United States contends Zwerner is liable for willful conduct, and thus should be subject to the maximum civil penalty. (*See* Mot. 15–22). The definition of willfulness asserted by the United States includes reckless disregard. (*See id.* 17 (" 'willfulness' may be satisfied by establishing the individual's reckless disregard of a statutory duty, as opposed to acts that are known to violate the statutory duty at issue." (quoting *United States v. McBride*, 908 F. Supp. 2d 1186, 1204 (D. Utah 2012))). In *McBride*, the district court inferred willfulness from: the taxpayer's signature on his tax returns indicating constructive knowledge of relevant tax statutes, his familiarity with the accounting firm's promotional materials informing him of a duty to comply with FBAR requirements, and his disregard of the concerns he had over the legality of the accounting firm's strategies. *See id.* 908 F. Supp. 2d at 1205–06, 1208, 1210 (enforcing civil penalties against a taxpayer for willfully failing to comply with FBAR reporting requirements); *see also United States v. Williams*, 489 Fed.Appx. 655, 659–60 (4th Cir. 2012) (finding willful blindness and reckless conduct after a taxpayer had signed his tax return and was on inquiry notice of the FBAR reporting requirement but nonetheless failed to file). The United States maintains willfulness "does not require proof that the party knew he was acting wrongly." (Mot. 17 (citing *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57–58 (2007) (citations omitted) (holding that liability for willfully failing to comply with the Fair Credit Reporting Act extends to both known violations and violations based on reckless disregard of a statutory duty))).

Zwerner emphasizes a showing of willfulness requires a "voluntary, intentional violation of a known legal duty." *United States v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1991) (quoting *Cheek v. United States*, 498 U.S. 192, 192 (1991)). The Sixth Circuit in *Sturman* acknowledged "willfulness can be inferred from a conscious effort to avoid learning about reporting requirements." *Id.* (citation omitted) (applying the statutory willfulness standard in a criminal conviction for a taxpayer's failure to file an FBAR Form 90–22.1).[3] In *Cheek*, involving a conviction for income tax evasion and failure to file income tax returns, the Supreme Court held:

> [a] good-faith misunderstanding of the law or a good-faith belief that one is not violating the law negates willfulness, whether or not the claimed belief or misunderstanding is objectively reasonable. Statutory willfulness, which protects the average citizen from prosecution for innocent mistakes made due to the complexity of the tax laws, ... is the voluntary, intentional violation of a known legal duty.

498 U.S. at 192 (alterations added; internal citations omitted).

Under either intent standard, genuine issues of material fact remain in dispute. While Zwerner admits he intended his foreign account to be a private, secret account, he states it was not done to avoid paying U.S. taxes. (*See* Zwerner Dep. 91:5–92:17, 138:7–143:13, 161:21–162:5, 163:25–164:8). Zwerner insists he did know of any FBAR reporting obligations when he filed his tax returns from 2004 to 2007, as he was under the mistaken impression that funds earned or held overseas did not need to be declared and taxed. (*See id.* 138:14–141:19). Furthermore, Zwerner states he did not declare the foreign account on his accountant's tax organizer form because he believed: he did not have signatory authority over the account, he only had an indirect interest in the account, he did not know if he earned foreign income annually, and the funds initially deposited into the account were earned overseas. (*See id.* 66:14–25, 94:12–20; 139:6–141:19, 160:12–162:1, 163:8–164:12).

To refute Zwerner's arguments regarding his state of mind, the United States cites Zwerner's August 9, 2010 letter to the IRS, in which Zwerner admits he knew he should have reported his foreign account. (*See* Reply ¶ 8; Aug. 9, 2010 Letter, Def.'s Ex. M). But Zwerner explains he included the statement at Agent Tarrago's direction, despite not agreeing with it. (*See* Zwerner Dep. 224:1–226:1). Zwerner insists Agent Tarrago dictated the information to include in the letter (*see id.* 221:20–222:2), and Zwerner complied, noting he signed the letter in an effort to obtain a reduced civil penalty as Agent Tarrago hinted at. (*see id.* 226:2–21). As further evidence of the disputed factual record, Agent Tarrago denies he authored the letter and says Zwerner admitted he knew of the filing requirement during other conversations. (*See* Reply ¶ 8; Agent Tarrago Dep., Pl.'s Ex. T, 141:20–142:13, 153:23–155:25 [ECF No. 26–1]).

***4** Whether Zwerner willfully failed to file FBARs for tax years 2004 to 2007 clearly remains an issue to be decided by the trier of fact. *See McCormick v. United States*, 500 U.S. 257, 270 (1991) ("It goes without saying that matters of intent are for the jury to consider.") (citation omitted). Accordingly, it is

ORDERED AND ADJUDGED that Plaintiff's Motion for Summary Judgment **[ECF No. 21]** is **DENIED**.

DONE AND ORDERED.

All Citations

Slip Copy, 2014 WL 11878430

Footnotes

[1] The Court refers to the page numbers provided by the Court's electronic case management ("CM/ECF") system when citing to Plaintiff's Motion, which is otherwise unnumbered.

[2] While the precise date the account was opened is unknown, Zwerner testifies he opened the account approximately 35 to 45 years ago, likely in the late 1960s. (*See* Zwerner Dep. 62:25–63:24 [ECF No. 21–1]).

[3] The civil and criminal statutes governing the filing of FBARs both use the term "willful." *See* 31 U.S.C. §§ 5321, 5322. A "term appearing in several places in a statutory text is generally read the same way each time it appears." *Ratzlaf v. United States*, 510 U.S. 135, 143 (1994) (citation omitted).

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147 T.C. 121
United States Tax Court.

WHISTLEBLOWER 21276-13W, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent [*]

Docket Nos. 21276-13W, 21277-13W
|
Filed August 3, 2016

Synopsis

Background: In consolidated cases, claimants, a wife and her husband, sought awards after targeted business pled guilty and paid United States $74 million, and IRS's Whistleblower Office summarily rejected their claims because collection purportedly occurred before they filed their Forms 211, Application for Award for Original Information. Claimants appealed. The Tax Court, Jacobs, J., 144 T.C. 290, held that, in order to qualify for awards, claimants were not required to file Forms 211 prior to providing information, and remanded to Whistleblower Office. On remand, claimants and Whistleblower Office agreed on award of 24% of collected proceeds, but they disagreed as to whether business's criminal fine and civil forfeitures constituted part of collected proceeds.

Holdings: The Tax Court, Jacobs, J., held that:

[1] statutory term “collected proceeds” was not limited to amounts collected by IRS pursuant to Internal Revenue Code (IRC), and instead was broadly defined;

[2] statutory term “internal revenue laws” was not limited to laws codified under IRC;

[3] criminal fines that business agreed to in its guilty plea were part of broadly-defined “collected proceeds” used to calculate amount of award; and

[4] civil forfeitures that business agreed to in its guilty plea were part of broadly-defined “collected proceeds” used to calculate amount of award.

Decision for claimants.

Attorneys and Law Firms

Sealed, [1] for petitioners.

Richard L. Hatfield, John T. Arthur, and Jonathan D. Tepper, for respondent.

Ps, husband and wife, seek whistleblower awards authorized by I.R.C. sec. 7623(b). The Whistleblower Office rejected Ps' claims for awards as untimely and administratively closed their cases. In Whistleblower 21276-13W v. Commissioner, 144 T.C. 290 (2015), we (1) held that Ps' claims for awards were timely, (2) ordered the parties to attempt to resolve their differences and keep the Court informed as to their progress, and (3) retained jurisdiction. The parties subsequently agreed that Ps are eligible for an award of 24% of the collected proceeds.

The targeted taxpayer pleaded guilty to a violation of 18 U.S.C. sec. 371 and paid $74,131,694 in tax restitution, a criminal fine, and civil forfeitures to the Government. The parties agree that the tax restitution payment constitutes collected proceeds for purposes of an award under I.R.C. sec. 7623(b). They disagree as to whether payments of the criminal fine and civil forfeitures constitute collected proceeds.

Held: The criminal fine and civil forfeitures are collected proceeds for purposes of an award under I.R.C. sec. 7623(b).

SUPPLEMENTAL OPINION

JACOBS, Judge:

***121** Petitioners, husband and wife, seek whistleblower awards authorized by section 7623(b). [2] Each petitioner filed a Form 211, Application for Award for Original Information, with the Internal Revenue Service (IRS) Whistleblower Office. The Whistleblower Office summarily rejected petitioners' claims on the basis that “additional tax, penalties, interest or other proceeds” had been collected before petitioners filed their respective Forms 211 and ***122** administratively closed their cases. Petitioners appealed that rejection to this Court. See sec. 7623(b)(4). Because the documents in the IRS' administrative files were insufficient for us to conduct an effective review, a partial trial was held to determine (1) what information, disclosure, and/or action, if any, petitioners provided to employees, agents, and/or officers of the United States in detecting underpayments of tax and/or detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same, see sec. 7623(a)(1) and (2), and (2) whether that information, disclosure, and/or action satisfies the requirements of section 7623(b).

We rendered an Opinion that fleshed out the IRS' inadequate administrative file. Whistleblower 21276–13W v. Commissioner, 144 T.C. 290 (2015). In that Opinion we held that Form 211 is not required to be filed with the Whistleblower Office before the whistleblower supplies information to other parts of the IRS or other Government agencies in order to be eligible for an award under section 7623(b). We issued an order requiring the parties to attempt to resolve their differences and to keep the Court informed of their progress. We did not remand the case to the Whistleblower Office.

During a conference call, the parties informed the Court that: (1) they agree that petitioners are eligible for an award; and (2) the award is to be 24% of the collected proceeds, i.e., proceeds that are eligible for an award; but (3) they could not reach agreement as to the amount of the collected proceeds.

Background

The targeted taxpayer pleaded guilty to conspiring to defraud the IRS, file false Federal income tax returns, and evade Federal income tax in violation of 18 U.S.C. sec. 371.[3] ***123** The taxpayer paid $74,131,694 in tax restitution, a criminal fine, and civil forfeitures to the Government under 18 U.S.C. sec 3571.

The parties stipulated that the $74,131,694 collected from the taxpayer consisted of the following: tax restitution of $20,000,001; a criminal fine of $22,050,000;[4] a civil forfeiture of $15,821,000, representing gross fees the taxpayer received from its U.S. clients;[5] and the relinquishment of all claims to $16,260,693 that had been previously forfeited to the United States.[6]

Respondent determined, and petitioners agree, that the tax restitution payment constitutes collected proceeds for purposes of an award under section 7623(b)(1). The parties disagree as to whether payments of the criminal fine and civil forfeitures constitute collected proceeds.

Discussion

I. Introduction

The whistleblower program is one of the weapons used by the IRS to detect underpayments of tax and violations of the ***124** internal revenue laws. The program is based on the principle "if you know something, say something." The statute provides that if the IRS institutes an administrative or judicial action against a taxpayer and collects proceeds as a result of information provided by a whistleblower, the informant will be monetarily rewarded with a portion of the collected proceeds.

The dispute to be resolved concerns statutory interpretation. Therefore, we begin our task by examining the language of the statute.

II. Statutory Background and IRS Guidance

Section 7623 (b), enacted by the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, sec. 406, 120 Stat. at 2958, provides for a mandatory whistleblower award if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2 million and if certain other requirements are met. See sec. 7623(b)(3), (5), (6).[7] Section 7623(b)(1) provides:

> If the Secretary proceeds with any administrative or judicial action described in subsection (a) based on information brought to the Secretary's attention by an individual, such individual shall, subject to paragraph (2) [not applicable in this matter], receive an award at least 15 percent but not more than 30 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any

> related actions) or from any settlement in response to such action. The determination of the amount of such award by the Whistleblower Office shall depend upon the extent to which the individual substantially contributed to such action.

The administrative or judicial actions alluded to by section 7623(b)(1) relate to (1) the detection of underpayments of tax or (2) the detection and bringing to trial and punishment of persons guilty of violating the internal revenue laws or conniving at the same. See sec. 7623(a).[8] Section 7623(b) was ***125** enacted in response to the ineffectiveness of the prior, discretionary whistleblower program, now codified as section 7623(a).

In 2010, the IRS provided administrative guidance regarding the whistleblower program in Internal Revenue Manual sec. 25.2.2.12 (June 18, 2010).[9] That guidance, in pertinent part, states:

> (1) "Collected proceeds" are the monies the IRS obtains directly from a taxpayer which are based upon the information the whistleblower has provided. Satisfaction of taxpayers' liabilities by reducing a credit balance is not within the scope of collected proceeds.
>
> * * * * * * *
>
> (3) For claims filed after December 20, 2006, awards are paid out of the proceeds collected, including penalties, interest, additions to tax and additional amounts.
>
> * * * * * * *
>
> ***126** (9) Criminal Fines: Criminal fines, which must be deposited into the Victims of Crime Fund, cannot be used for payment of whistleblower awards.

III. Positions of the Parties

A. Respondent's Position

Respondent asserts that the plain language of section 7623 makes clear that only those proceeds assessed and collected under a provision of title 26 may be used to pay a whistleblower award because section 7623 relates solely to violations of Federal tax laws. Consequently, respondent continues, criminal fines and civil forfeitures are not "collected proceeds" for purposes of the Secretary's paying an award under title 26.[10] Respondent further maintains that if criminal fines and forfeitures could be used for payment of the whistleblower award, an "irreconcilable conflict" would be created "between Title 26's whistleblower statute and the provisions of 42 U.S.C. sec. 10601 [regarding criminal fines] and 31 U.S.C. sec. 9703.1[[11] [regarding civil forfeitures] that specify the purposes for which moneys collected under Title 18 in this case may be used."

B. Petitioners' Position

Petitioners also maintain that the plain language of section 7623(b)(1) is clear. Petitioners assert that the entire approximately $74 million collected from the taxpayer is collected proceeds because that amount was the settlement payment resulting from an administrative or judicial action taken by the Secretary and relates to acts committed by the taxpayer in violation of the provisions of title 26, specifically sections 7201 and 7206(1).

***127** IV. Analysis

A. Collected Proceeds Are Not Limited to Amounts Collected Under Title 26.

[1] The language of section 7623(b)(1) is plain. And "[w]here * * * the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.' " United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) (quoting Caminetti v. United States, 242 U.S. 470, 485, 37 S.Ct. 192, 61 L.Ed. 442 (1917)). We therefore must "give effect to the will of Congress, and where its will has been expressed in reasonably plain terms, 'that language must ordinarily be regarded as conclusive.' " Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 570, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982) (quoting Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980)).

[2] **[3]** Section 7623(b)(1) is straightforward and written in expansive terms, namely, where, using information provided by the whistleblower, the Secretary proceeds with an administrative or judicial action regarding underpayments of tax or any action regarding the violation of, or conniving to violate, the internal revenue laws, the whistleblower is entitled to an award based on a percentage of the collected proceeds resulting from the Secretary's action (as well any related actions) or from any settlement in response to such action. The term at the center of the dispute herein, i.e. "collected proceeds", is not statutorily defined. We therefore must rely on the canons of statutory construction that: (1) when words used in a statute are not specifically defined, courts generally give the words their plain or ordinary meaning, FCC v. AT&T, Inc., 562 U.S. 397, 403, 131 S.Ct. 1177, 179 L.Ed.2d 132 (2011), and (2) words in a statute must be read in their context, with a view to their place in the overall statutory scheme, Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989). Moreover, we are mindful that reliance on a statute's context is a "subtle business, calling for great wariness lest what professes to be mere rendering becomes creation and attempted interpretation of legislation becomes legislation itself." Palmer v. Massachusetts, 308 U.S. 79, 83, 60 S.Ct. 34, 84 L.Ed. 93 (1939).

[4] With these canons in mind, we turn to the meaning of "collected proceeds". "Proceeds", as the Supreme Court explained, is "a word of great generality." Indeed, the Supreme Court noted that "[p]roceeds are not necessarily ***128** money." Phelps v. Harris, 101 U.S. 370, 380, 25 L.Ed. 855 1879; see Whistleblower 22716-13W v. Commissioner, 146 T.C. ——, —— (slip op. at 22) (Mar. 14, 2016). Our Court has stated that "[t]he general dictionary definition of 'proceeds' encompasses 'what is produced by or derived from something (as a sale, investment, levy, business) by way of total revenue: the total amount brought in' ". Anderson v. Commissioner, 123 T.C. 219, 232 (2004) (quoting Webster's Third New International Dictionary 1807 (1974)), aff'd, 137 Fed.Appx. 373 (1st Cir. 2005). And the Oxford English Dictionary defines "proceeds" as "[t]hat which proceeds, is derived, or results from something; that which is obtained or gained by any transaction; produce, outcome, profit." 12 Oxford English Dictionary 544 (2d ed. 1989). The definition of "collect" is similarly expansive: "[t]o gather together into one place or group; to gather, get together." 3 Oxford English Dictionary 476.

We find instructive the decision by the Court of the Appeals for the Eighth Circuit in United States v. S. Half of Lot 7 & Lot 8, 910 F.2d 488 (8th Cir. 1990) (en banc). Therein, the Court of Appeals had to interpret 18 U.S.C. sec. 1955(d), which provides that any property, including money, used in an illegal gambling operation may be seized and forfeited to the United States. The plaintiffs owned real property that was seized by the United States. They argued that only personal property could be seized because the statute did not provide specifically that real property could be forfeited. Disagreeing with the plaintiffs, the Court of Appeals held that the term "any property" is to be given its plain meaning and that the addition of the phrase "including money" does not limit the breadth of the term "any property".[12] The Court of Appeals, quoting the Supreme Court, stated:

> We believe "Congress could not have chosen ... broader words to define the scope of what was to be forfeited." United States v. Monsanto, 491 U.S. 600, [607], 109 S.Ct. 2657, 105 L.Ed.2d 512 * * * (1989). The words in question here are commonly understood, and "Congress' failure to supplement [section 1955(d)'s] comprehensive phrase —'any property'—with an exclamatory 'and we even mean [real property]' does not lessen the force of the statute's plain language." ***129** Id. at * * * [609] (emphasis omitted). * * * [S. Half of Lot 7 & Lot 8, 910 F.2d at 490.]

We are leery of arbitrarily limiting the meaning of an expansive and general term such as "collected proceeds". In drafting section 7623(b)(1), Congress could have provided that the whistleblower's award is to be based on taxes and other amounts assessed and collected by the IRS under title 26. But it did not. Instead, Congress chose to use a sweeping term "collected proceeds" as the basis of the award. The context of the statute in which the term "collected proceeds" is used reinforces our conclusion. Congress revealed its intent that the mandatory whistleblower program be an expansive rewards program by including in section 7623(b)(1) other broad and sweeping terms such as "any administrative or judicial action", "any related actions", and "any settlement in response to such action."

Respondent would have us narrow the definition of collected proceeds, despite the term's expansive ordinary meaning. Respondent would limit collected proceeds to those moneys assessed and collected under the provisions of title 26. Respondent claims the phrase "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws", as used in section 7623(a)(2), is essentially synonymous with the phrase "detecting underpayments of tax", as used in section 7623(a)(1), and that both phrases refer to taxes assessed and collected under a provision of title 26. Consequently, according to respondent, only amounts assessed and collected under a provision of title 26 may be used in funding the award to a whistleblower.

[5] In making this argument, respondent notes that the Code mentions "internal revenue laws" in a number of instances. See, e.g., sec. 6301 ("The Secretary shall collect the taxes imposed by the internal revenue laws."); sec. 6065 ("Except as otherwise provided by the Secretary, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws * * * shall contain or be verified by a written declaration that it is made under penalties of perjury."); sec. 1400S(e) (authorizing the Secretary to "make such adjustments in the application of the internal revenue laws as may be necessary to ensure that taxpayers do not lose any deduction or credit or experience a change of filing status" by reason of exigencies caused by ***130** various hurricanes). Respondent also invites our attention to the caption of section 7212, "Attempts to Interfere with Administration of Internal Revenue Laws", and points out that subsection (a) of section 7212 makes it a crime to block an official acting "under this title".

We do not accept respondent's position that "collected proceeds" are limited to title 26 collections. If Congress had wanted to limit collected proceeds to title 26 collections, it could, and would, have done so. Moreover, we disagree that internal revenue laws are limited to laws codified in title 26. To the contrary, none of the provisions cited by respondent state, or even imply, that internal revenue laws are limited to those laws codified in title 26.[13]

There are numerous instances where internal revenue laws are found outside title 26. One instance relates to relief from employment tax obligations. So called "section 530 relief" from employment tax does not refer to section 530 of the Code (which governs Coverdell education savings accounts), but rather to section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. at 2885. Another instance: Although section 6212 is the Code provision relating to notices of deficiency, it is section 3463(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. at 767, which provides that "[t]he Secretary * * * shall include on each notice of deficiency under section 6212 * * * the date determined * * * as the last day on which the taxpayer may file a petition with the Tax Court." And perhaps the most telling instance: The very provisions establishing the Whistleblower Office are found outside the Code. See Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, div. A, sec. 406(b), 120 Stat. at 2959-2960.[14]

***131** The Code itself refers to laws outside title 26 as internal revenue laws. As an example, section 6531 provides periods of limitation on criminal prosecutions:

> SEC. 6531. PERIODS OF LIMITATION ON CRIMINAL PROSECUTIONS.
>
> No person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal revenue laws unless the indictment is found or the information instituted within 3 years next after the commission of the offense, except that the period of limitation shall be 6 years—
>
> * * * * * * *
>
> (8) for offenses arising under section 371 of Title 18 of the United States Code, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax or the payment thereof.

We find the reference in section 6531(8) to 18 U.S.C. sec. 371 to be especially illuminating inasmuch as the targeted taxpayer pleaded guilty to conspiracy to defraud the IRS, file false Federal income tax returns, and evade Federal income tax, in violation of 18 U.S.C. sec. 371.[15] Finally, the phrase "internal revenue laws" dates from the earliest version of the whistleblower statute enacted in 1867. At that time, the modern title 26 did not exist; internal revenue laws meant all revenue laws. We think it erroneous to impose a post facto restriction on the meaning of the phrase not intended by Congress when it enacted the legislation. In sum, the phrase "internal revenue laws" is not limited to those laws codified in title 26.

Respondent further argues that the term "collected proceeds", as used in section 7623(b)(1), pertains solely to taxes and related payments because the list of items deemed to be collected proceeds is set forth in a parenthetical: "collected proceeds (including penalties, interest, additions to tax, and ***132** additional amounts)". Respondent asserts that "the terms penalties, addition to tax, and additional amounts have specific meanings under Title 26 that do not extend beyond the definition of 'tax'." Respondent bases his argument on section 6665(a)(2), which provides that "any reference in this title to 'tax' imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter", as well as on section 6671(a), which provides that "[t]he penalties and liabilities provided by this subchapter * * * shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to 'tax' imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter." Respondent argues:

> Neither section 7623 nor its legislative history [respondent refers to the legislative history of sec. 7623(a)] provides a basis to conclude that Congress intended the terms penalties, additions to tax, and additional amounts in section 7623 to have meaning different than that set forth in section 6665. Penalties, additions to tax, and additional amounts under section 7623(b) pertain to amounts assessed under Title 26 that increase the total amount of tax liability. More broadly, these terms have a well-established meaning under Subtitle F of the Code—they are, in fact, the title of Chapter 68 and refer to those penalties, additions to tax, and additional amounts.

In making this argument, respondent ignores the fact that the first word in the parenthetical listing those items deemed to be collected proceeds is "including". And the Code itself provides that "[t]he terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined." Sec. 7701(c); see also Wnuck v. Commissioner, 136 T.C. 498, 506 (2011) ("Anyone fluent in English knows that the word 'includes' cannot be assumed to mean 'includes only'."); Dunaway v. Commissioner, 124 T.C. 80, 91-92 (2005) (quoting Cannon v. Nicholas, 80 F.2d 934, 936 (10th Cir. 1935)). By using the word "including", Congress clearly intended the list of items deemed to be collected proceeds to be nonexhaustive. Moreover, the list of items deemed to be collected proceeds includes the word "penalties". In several places the Code interposes the word "fine" with the word "penalties". See, e.g., sec. 7201 ("Any person who willfully attempts in any manner to evade or defeat ***133** any tax * * * shall, in addition to other penalties provided by law * * * be fined not more than $100,000 [.]"); sec. 162(f) ("No deduction shall be allowed under subsection (a) for any fine or similar penalty paid to a government for the violation of any law."). Finally, we note that the list of items deemed to be collected proceeds does not include "tax", yet respondent conceded that the restitution payment (i.e., a tax) qualifies as collected proceeds. [16] By making this concession, respondent appears to concede concomitantly that the universe of "collected proceeds" is greater than the items deemed to be collected proceeds listed in the parenthetical.

Our holding in this matter is not in conflict with our holding in Whistleblower 22716-13W v. Commissioner, 146 T.C. ——, wherein the Court examined the $2 million threshold requirement of section 7623(b)(5)(B). See supra note 7. Section 7623(b)(5)(B) provides that for a whistleblower to qualify for the mandatory whistleblower award, "the tax, penalties, interest, additions to tax, and additional amounts in dispute [must] exceed $2,000,000." In Whistleblower 22176-13W, the whistleblower provided information to the Government that resulted in the collection of a small tax restitution payment and Foreign Bank and Financial Accounts (FBAR) civil penalties under 31 U.S.C. sec. 5321(a) in an amount exceeding $2 million. The IRS Whistleblower Office denied the whistleblower's claim for an award on the basis that (1) the Government had obtained complete information about the taxpayer's activities from another source and (2) the whistleblower's claim did not meet the $2 million threshold of section 7623(b)(5)(B) because FBAR penalties do not constitute "tax, penalties, interest, additions to tax, * * * [or] additional amounts". In arguing his case before us, the whistleblower asserted that FBAR penalties constituted an "additional amount" as used in section 7623(b)(5)(B).

***134** We rejected the whistleblower's assertion. In interpreting what constitutes "additional amounts" we held that the phrase "additional amounts" as it appears in the series in section 7623(b)(5)(B), i.e., "tax, penalties, interest, additions to tax, and additional amounts", was a term of art. We noted that the phrase "additional amounts" when used in a series that also includes "tax" and either "additions to tax" or "additions to the tax" appeared nearly 40 times in title 26, and when the words were tied together, as they are in section 7623(b)(5)(B), they had a specific technical meaning. We stated we repeatedly have held that the phrase "additional amounts", which the whistleblower sought to extend to FBAR penalties, "is a term of art that refers exclusively to the civil penalties enumerated in chapter 68, subchapter A" of title 26 which are assessed, collected, and paid in the same manner as taxes. Whistleblower 22716-13W v. Commissioner, 146 T.C. at —— (slip op. at 19).

In reaching our holding, we determined that the wording in the threshold requirement of section 7623(b)(5)(B) ("if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000") is different from that of section 7623(b)(1), which provides for an award of a percentage of the collected proceeds ("including penalties, interest, additions to tax, and additional amounts"). After acknowledging that "the Supreme Court observed long ago that the word 'proceeds' is 'of great generality' * * * Phelps v. Harris, 101 U.S. 370, 380, 25 L.Ed. 855 1880", we explicitly rejected the whistleblower's argument that we should read the phrase "collected proceeds" into section 7623(b)(5)(B), stating: "Congress could have employed, but did not employ, the term 'collected proceeds' when drafting the $2,000,000 monetary threshold." Whistleblower 22716-13W v. Commissioner, 146 T.C. at —— (slip op. at 22). We observed that the word "including" was not used in section 7623(b)(5)(B) and that "Congress explicitly and unambiguously provided that a whistleblower is eligible for a non-discretionary award only 'if the tax, penalties, interest, additions to tax, and additional amounts in dispute' exceed $2,000,000." Id. Moreover, we explicitly declined to entertain the Commissioner's arguments that collected proceeds are limited to amounts collected under title 26 and that because FBAR penalties are paid under title 31, they do not constitute collected proceeds. Id. at —— n.6 (slip op. at 14).

***135** In sum, we herein hold that the phrase "collected proceeds" is sweeping in scope and is not limited to amounts assessed and collected under title 26. To paraphrase the Court of Appeals: Congress' not supplementing the comprehensive phrase "collected proceeds" with an exclamatory "and we mean all proceeds collected" does not lessen the force of the statute's plain language.

B. Section 7623(b)(1) Uses Collected Proceeds to Calculate the Amount of the Award.

As has been discussed supra, section 7623 governs two distinct whistleblower programs: Section 7623(a) governs the longstanding discretionary whistleblower program, and section 7623(b) governs the mandatory whistleblower program at issue in these cases. These two programs provide awards to whistleblowers via two subtly different mechanisms.

Section 7623(a) provides that in cases where an award is not otherwise provided by law, if the Secretary in his discretion makes an award, "[a]ny amount * * * shall be paid from the proceeds of amounts collected by reason of the information provided, and any amount so collected shall be available for such payments." The mandate of section 7623(a) is twofold. First, because the statute gives the Secretary discretion in determining not just whether to make an award, but also the amount of the award to be made, subsection (a) limits the amount of the award to the proceeds collected as a consequence of the whistleblower's information. Second, the statute explicitly provides that all of the proceeds collected are available for funding the award, thus emphasizing that the whistleblower may receive an award based on all the proceeds collected as a result of the whistleblower's information. In other words, section 7623(a) ensures that the award cannot exceed the amount of the proceeds collected, but with the proviso that all of the proceeds collected are to be available to fund the award.

Section 7623(b) is different. Unlike subsection (a), which requires that an award "shall be paid from" a specific funding source, subsection (b) sets forth how to calculate the whistleblower's award. Paragraph (1) directs that the whistleblower "shall * * * receive as an award at least 15 percent but not more than 30 percent of the collected proceeds ***136** * * * resulting from the action (including any related actions) or from any settlement in response to such action."

[6] **[7]** The difference in wording between subsections (a) and (b) of section 7623 is striking. Section 7623(a) explicitly provides that the whistleblower award is to be paid from the proceeds collected. In contrast, subsection(b)(1) provides that the whistleblower award is calculated by using a percentage of the collected proceeds. Had Congress sought to require that the section 7623(b) award payment be drawn from the collected proceeds, it could and would have done so, such as by incorporating the wording of subsection (a). But it did not. And we are mindful that when "Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." Russello v. United States, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983) (quoting United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972)); see Whistleblower 22716-13W v. Commissioner, 146 T.C. at —— (slip op. at 23). We therefore hold that the collected proceeds are to be used only for purposes of calculating the amount of the award to be given to the whistleblower.

C. Criminal Fines Are Collected Proceeds.

As previously noted, both the discretionary and mandatory whistleblower awards program require the Secretary to proceed with an administrative or judicial action which relates to, inter alia, the detection and bringing to trial and punishment of persons guilty of violating the internal revenue laws or conniving at the same. See sec. 7623(a) and (b)(1). The phrase "punishment * * * [of] persons guilty of violating the internal revenue laws or conniving at the same" has throughout the existence of the statute meant punishment of criminal tax violations. See supra note 8. In these cases the taxpayer pleaded guilty to conspiring to evade tax and file false statements under 18 U.S.C. sec. 371, which section 6531(8) refers to as an internal revenue law.

[8] Paragraph (1) of section 7623(b) includes penalties as collected proceeds. And as we noted supra p. 20, 104 S.Ct. 296, we are mindful that (1) title 26 often treats a fine as a subset within the purview of a penalty, and (2) title 26 provides for fines levied as punishment. See, e.g., secs. 7201, 7212, 7217. In these cases the Secretary, through the IRS' criminal enforcement ***137** unit, took administrative action[17] in response to information provided by petitioners. That action ultimately resulted in the taxpayer's entering into a plea agreement and, inter alia, agreeing to pay a criminal fine.

Respondent acknowledges that "[i]n 1996 Congress amended section 7623 to add 'detecting underpayments of tax,' to clarify that information pertaining to civil as well as criminal violations of the internal revenue laws constitutes a basis for a whistleblower award." Thus, respondent acknowledges that since the whistleblower statute was first enacted in 1867, almost a century and a half ago, whistleblowers could receive an award for information relating to criminal tax violations. Respondent's admission is at loggerheads with his fundamental position in these cases that criminal fines do not constitute collected proceeds because they were not assessed and collected under title 26.[18]

As an alternative argument, respondent asserts that a criminal fine collected by the Government cannot be considered collected proceeds because (1) pursuant to 42 U.S.C. sec. 10601[19] all criminal fines collected from persons convicted of offenses against the United States, with certain exceptions not herein applicable, are to be deposited in the Crime Victims Fund; (2) criminal fines are paid by the taxpayer directly to the imposing court, which in turn deposits them into the Crime Victims Fund; and (3) at no time are criminal ***138** fines available to the Secretary, thus making it impossible for him to use the fines to pay a whistleblower award.

Respondent's argument arises from a fundamental misinterpretation of the plain language of the statute. Section 7623(b)(1) does not refer to, or require, the availability of funds to be used in making an award. As we noted supra section IV.B., section 7623(b)(1) establishes the manner in which the Secretary calculates the award to be made to a whistleblower who qualifies for the mandatory award program. The statute explicitly instructs the Secretary to pay the whistleblower who qualifies for the mandatory award program an award of 15% to 30% of the collected proceeds. We have already explained that "collected proceeds" is a broadly defined term: It encompasses "the total amount brought in" by the Government. See Anderson v. Commissioner, 123 T.C. at 232. On the other hand, the discretionary award program of subsection (a) requires the Secretary to pay the whistleblower award "from the proceeds; of amounts collected by reason of the information provided" by the whistleblower, presumably to prevent the amount of the award from exceeding the amount of the proceeds collected; but in doing so the statute explicitly makes all such proceeds collected available for use in making the award. Seemingly, respondent desires the Court to impose some, but not all, of the rules of the discretionary whistleblower award program of section 7623(a) on the mandatory whistleblower award program of section

7623(b).[20] This we will not do. The mandatory award program of subsection (b) is separate and distinct from the discretionary award program of subsection (a).

We thus hold that criminal fines constitute collected proceeds for purposes of an award under section 7623(b)(1).

D. Civil Forfeitures Are Collected Proceeds.

[9] The taxpayer agreed to (1) relinquish claims to approximately $16.2 million in moneys previously forfeited and (2) forfeit approximately $15.8 million representing gross fees it received from U.S. taxpayers. See supra p. 5. These forfeitures ***139** resulted from an administrative action with respect to the laundering of proceeds, which, in turn, arose from a conspiracy to violate sections 7201(tax evasion) and 7206 (fraudulent/false tax returns). Within the context of section 7623(b)(1), we are of the opinion that a forfeiture is similar to a criminal fine.

Respondent argues that the amounts forfeited by the taxpayer are not collected proceeds because they were not collected as a result of a violation of the tax laws under title 26. But as we held supra, internal revenue laws are not limited to laws codified in title 26. Laundering proceeds gained from the filing of false returns and tax evasion is a violation of internal revenue laws.

Respondent asserts that forfeited moneys do not constitute collected proceeds because they are required to be deposited into the Department of the Treasury Forfeiture Fund, governed by 31 U.S.C. sec. 9703(a).[21] This assertion is similar to that advanced by respondent with respect to the criminal fine; we reject it.

Respondent next argues that the discretionary whistleblower awards program governed by section 7623(a) prevents the inclusion of forfeited moneys as part of the collected proceeds. Respondent bases this argument on the flush language of subsection (a), which provides that the Secretary may make a discretionary whistleblower award only "in cases where such expenses are not otherwise provided for by law" and a separate awards program exists for civil forfeitures in 31 U.S.C. sec. 9703(d)(2). As we stated previously, this argument is flawed because section 7623(a) relates to discretionary whistleblower awards, whereas the type of award involved in these cases relates to a mandatory whistleblower award authorized by section 7623(b)(1). See Whistleblower 22716-13W v. Commissioner, 146 T.C. at —— (slip op. at 22-23).

We thus hold that civil forfeitures constitute collected proceeds for purposes of an award under section 7623(b)(1).

V. Conclusion

Section 7623(b)(1) uses plain language. The words and terms in question are commonly understood. The term for amounts used to calculate the award is "collected proceeds". ***140** The term "collected proceeds" means all proceeds collected by the Government from the taxpayer. The term is broad and sweeping; it is not limited to amounts assessed and collected under title 26.

To reflect the aforesaid, and on the bases of (1) respondent's acknowledgment that petitioners are entitled to an award under section 7623(b) for information brought to the Secretary's attention; (2) the parties' agreement that the aforesaid award should be 24% of the proceeds collected from the taxpayer; (3) the parties' agreement that the taxpayer paid the Government $74,131,694 in tax restitution, a criminal fine, and civil forfeitures; (4) the parties' agreement that the taxpayer's $20,000,001 restitution payment constitutes collected proceeds for purposes of an award under section 7623(b); and (5) the holdings we herein make, namely that the criminal fine of $22,050,000 and the civil forfeitures of $32,081,693 are collected proceeds for purposes of an award under section 7623(b), we conclude that petitioners are entitled to a $17,791,607 (24% x $74,131,694) award under section 7623(b).

Appropriate decisions will be entered for petitioners.

All Citations

147 T.C. No. 4, 147 T.C. 121, Tax Ct. Rep. (CCH) 60,664, Tax Ct. Rep. Dec. (RIA) 147.4

Footnotes

* This Opinion supplements our previously filed Opinion, Whistleblower 21276-13W v. Commissioner, 144 T.C. 290 (2015).

[1] The names of petitioners' counsel have been omitted in furtherance of protecting petitioners' identities.

[2] Unless otherwise indicated, all section references are to the Internal Revenue Code (Code or title 26). All dollar amounts are rounded to the nearest dollar.

[3] Title 18 U.S.C. sec. 371 (2012) provides:

> If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.
>
> If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.

The underlying crimes within the conspiracy charge were (1) tax evasion in violation of sec. 7201 and (2) fraudulent declarations made under penalties of perjury in violation of sec. 7206(1).

[4] The criminal fine was imposed by a Federal court pursuant to 18 U.S.C. sec. 3571 as a result of the taxpayer's guilty plea to conspiring to defraud the IRS, file false Federal income tax returns, and evade Federal income taxes in violation of 18 U.S.C. sec. 371. Title 18 U.S.C. sec. 3571(a) provides that a defendant who has been found guilty of an offense may be sentenced to pay a fine. As relevant in these cases an organization may be fined the amount specified in the law setting forth the offense, 18 U.S.C. sec. 3571(c)(1); $500,000 for a felony, 18 U.S.C. sec. 3571(c)(3); or if the defendant derived pecuniary gain from the offense, or if the offense results in pecuniary loss to a person other than the defendant, a fine of not more than the greater of twice the gross gain or twice the gross loss, 18 U.S.C. sec. 3571(d).

[5] The money was forfeited pursuant to 18 U.S.C. sec. 981(a)(1)(A), which provides for a forfeiture of property involved in a financial transaction (money laundering) with the intent to engage in conduct constituting a violation of sec. 7201 (tax evasion) or sec. 7206 (fraud/filing false returns).

[6] The relinquishment was from a prior civil forfeiture pursuant to 18 U.S.C. sec. 981(a)(1)(A).

[7] See Whistleblower 22716-13W v. Commissioner, 146 T.C. —— (Mar. 14, 2016), for an analysis of sec. 7623(b)(5).

[8] Sec. 7623(a) provides:

> SEC. 7623(a). In General.—The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums as he deems necessary for—
>
> (1) detecting underpayments of tax, or
>
> (2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same,
>
> in cases where such expenses are not otherwise provided for by law. Any amount payable under the preceding sentence shall be paid from the proceeds of amounts collected by reason of the information provided, and any amount so collected shall be available for such payments.

The sec. 7623(a) discretionary awards program derives from legislation enacted in 1867 that authorizes the Secretary “to pay such sums * * * as may in his judgment be deemed necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same.” Act of Mar. 2, 1867, ch. 169 sec. 7, 14 Stat. 471, 473; see Whistleblower 22716-13W v. Commissioner, 146 T.C. at —— (slip op. at 7-8). In 1996 the statute was amended to clarify that providing the Government with information detecting underpayments of tax qualified for an award. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, sec. 1209(a), 110 Stat. at 1473. The legislative history states that “[t]he bill clarifies that rewards may be paid for information relating to civil violations, as well as criminal violations. The bill also provides that the rewards are to be paid out of the proceeds of amounts (other than interest) collected by reason of the information provided.” H.R. Rept. No. 104-506, at 51 (1996), 1996-3 C.B. 49, 99.

[9] The Secretary promulgated regulations with respect to sec. 7623(b) applicable to whistleblower information submitted on or after Aug. 12, 2014, and to claims for awards under sec. 7623(b) that are open as of Aug. 12, 2014. Secs. 301.7623-2(f), 301.7623-4(e), Proced. & Admin. Regs. The Whistleblower Office denied each petitioner's claim for an award on or about Aug. 13, 2013, and the parties agree that the regulations do not apply in these cases.

[10] Respondent concedes that the tax restitution payment made by the taxpayer qualifies as collected proceeds (even though the restitution was made pursuant to 18 U.S.C. sec. 3556) because it was assessed as a tax and collected by the IRS under sec. 6201(a)(4).

[11] Respondent appears to refer to 31 U.S.C. sec. 9703(a) (redesignated 31 U.S.C. sec. 9705, by the Justice for Victims of Trafficking Act of 2015, Pub. L. No. 114-22, sec. 105(c)(1)(A), 129 Stat. at 237).

[12] The Court of Appeals also noted that legislative history generally cannot overcome the plain words and meaning of a statute. United States v. S. Half of Lot 7 & Lot 8, 910 F.2d 488, 490 (8th Cir. 1990) (citing Ex parte Collett, 337 U.S. 55, 61 (1949)).

[13] Indeed, the IRS itself acknowledges that tax laws may be found outside title 26. In a Chief Counsel Memorandum discussing whistleblower matters, dated April 23, 2012, the IRS, citing IRM pt. 4.10.12.1.2(3) (Nov. 9, 2007), stated: "Title 26 of the United States Code, reproduced separately as the Internal Revenue Code (Code), contains most of the Federal tax law."

[14] We doubt that respondent would agree with the contention that an individual who threatened a Whistleblower Office official would not be in violation of sec. 7212 because the statute governing the activities of the Whistleblower Office is not codified under title 26.

[15] Ours is not the only court to note that tax laws and related laws may be found beyond those codified in title 26. The District Court for the Northern District of California in Hom v. United States, 2013 WL 5442960 (N.D. Cal. Sept. 30, 2013) aff'd, 645 Fed.Appx. 583, 2016 WL 1161577 (9th Cir. Mar. 24, 2016), stated: "[T]he issue here is whether [31 U.S.C.] Section 5314 is either an internal revenue law or related statute (either designation would make the disclosure [of taxpayer information under sec. 6103] permissible). The United States argues that [31 U.S.C.] Section 5314 is a 'related statute' under Section 6103 (Dkt. No. 13 at 6). This is correct. Congress intended for [31 U.S.C.] Section 5314 to fall under 'tax administration.' "

[16] Respondent conceded that the tax restitution payment constitutes collected proceeds because it was assessed under sec. 6201(a)(4). Sec. 6201(a)(4) was enacted as part of the Firearms Excise Tax Improvement Act of 2010, Pub. L. No. 111-237, sec. 3(a), 124 Stat. at 2497-2498, effective for restitution ordered after Aug. 16, 2010. Under respondent's logic, if the whistleblowers in this matter had provided information to the Government before Aug. 17, 2010, they would not be entitled to any award.

[17] Although inapplicable in these cases, see supra note 9, sec. 301.7623-2(a)(2), Proced. & Admin. Regs., includes criminal investigations in its definition of administrative action. "[T]he term administrative action means all or a portion of an Internal Revenue Service (IRS) civil or criminal proceeding against any person that may result in collected proceeds * * * including, for example * * * an examination, * * * or a criminal investigation."

[18] As stated supra note 8, in 1996 sec. 7623 was amended to clarify that an award could be made for information relating to the detection of a civil tax underpayment as well as detection of a criminal tax violation. Thus, the IRS has turned itself around. The implication of the amendment is that before 1996, the IRS denied whistleblower awards for reporting civil tax deficiencies on the basis that the statute authorized awards only for the reporting of criminal tax violations. Now respondent asserts that an award may be made only for the reporting of civil tax deficiencies.

[19] Enacted by the Act of Oct. 12, 1984, Pub. L. No. 98-473, sec. 1402, 98 Stat. at 2170-2171.

[20] Respondent would have us impose the rule that awards must be paid from proceeds collected, but not make all such proceeds available for such payment.

[21] See supra note 11.

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951 F.2d 1466
United States Court of Appeals,
Sixth Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
David A. STURMAN (90–3147); Ralph L. Levine (90–3148); Reuben Sturman (90–3151); and Melvin Kaminsky (90–3750), Defendants–Appellants.

Nos. 90–3147, 90–3148, 90–3151 and 90–3750.
|
Argued Aug. 5, 1991.
|
Decided Oct. 24, 1991.
|
Rehearing and Rehearing En Banc Denied Jan. 8, 1992.

Synopsis

Defendants were convicted in the United States District Court for the Northern District of Ohio, George W. White, J., of conspiring to defraud the United States, and one defendant was convicted additionally of attempted tax evasion, filing false income tax returns, wilfully failing to maintain records and file reports, and endeavoring to obstruct justice. Defendants appealed. The Court of Appeals, Kennedy, Circuit Judge, held that: (1) defendants were properly charged with conspiracy to defraud the United States rather than conspiracy to commit specific offense against the United States; (2) evidence was sufficient to support challenged convictions; (3) foreign depositions were properly admitted; and (4) foreign bank records were properly admitted.

Affirmed.

Attorneys and Law Firms

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Jeremy A. Rosenbaum, J. Michael Murray (argued and briefed), Berkman, Gordon, Murray & Palda, Cleveland, Ohio, for defendant-appellant Reuben Sturman.

Before KENNEDY and MILBURN, Circuit Judges, and WILHOIT, District Judge. [*]

KENNEDY, Circuit Judge.

I. STATEMENT OF FACTS

On June 25, 1987, the defendants were charged with one count of conspiring to defraud the United States by impeding governmental functions. Reuben Sturman was also indicted on counts of attempted tax evasion, filing false income tax returns, willfully failing to maintain records and file reports, and one count of endeavoring to obstruct justice. Following their conviction, Reuben Sturman was sentenced to 10 years imprisonment, fined approximately $2.5 million, and ordered to pay prosecution costs. The other defendants were sentenced to shorter terms and fined lesser amounts.

Reuben Sturman engaged in the production, sale, and distribution of sexually explicit books and tapes. Some of the individual businesses ran “peep booths” which played sexually explicit videos. David Sturman, Reuben Sturman's son, was responsible for his father's businesses in the San Francisco area. Ralph Levine ran the businesses in Nevada and Melvin Kaminsky managed Reuben Sturman's principal business, Sovereign News Company.

The defendants, led by Reuben Sturman, created 150 domestic corporations beginning in the 1960s. Reuben Sturman also formed five foreign corporations in countries following strict “corporate secrecy” policies. The testimony of numerous witnesses revealed that the named shareholders and nominees in these corporations were often fictitious. In other cases, real people were listed as shareholders, but their names and signatures had been used without their knowledge or permission. The prosecution proved that, in fact, Reuben Sturman was the beneficial owner of most of the corporations.

The defendants used the corporations to conceal income. They transferred money between corporations in ways that made tracing income and expenses difficult. The defendants also skimmed money from some of the adult entertainment businesses. This money was then used to pay personal expenses or was transferred and deposited in Swiss bank accounts. These bank accounts ***1472** were opened in 1974, as stated by Reuben Sturman, to "conceal his money" and "avoid taxes." (Testimony of Walter Butti, Alfred Graf and James Olsafsky.) The transfers to Switzerland were accomplished through a series of transactions involving both the foreign and domestic corporations.

Reuben Sturman took a variety of steps to conceal his activities from the authorities. A federal investigation in 1975 forced him to begin hiding documents. In 1979, following the issuance of subpoenas calling for various records, Reuben Sturman destroyed or hid many of the requested records. He took similar actions in response to a 1982 grand jury subpoena.

Tax records filed during the period of the conspiracy contained numerous false statements and inaccuracies. Reuben Sturman failed to report his ownership in the domestic and foreign corporations or his signature authority over foreign bank accounts. His tax returns for 1978–1982 underreported $2,735,713 in individual income. The other defendants also failed to report their signature authority in foreign accounts.

II. DENIAL OF DEFENDANTS' MOTIONS TO DISMISS COUNT I

All defendants filed motions to dismiss Count I which charged that the defendants,

> did unlawfully, knowingly and willfully conspire, combine, confederate and agree together and with each other to defraud the United States of America by hampering, hindering, impeding, impairing, obstructing and defeating the lawful Governmental functions of the Internal Revenue Service of the Treasury Department of the United States in the ascertainment, computation, assessment and collection of income taxes [in violation of 18 U.S.C. § 371.]

Defendants based their motions on this Court's decision in *United States v. Minarik,* 875 F.2d 1186 (6th Cir.1989), which held that conspiracy to commit an offense and conspiracy to defraud, under 18 U.S.C. § 371, were two separate crimes. The District Court denied the defendants' motions holding that *Minarik* was inapplicable to the conspiracy charged in this case. We agree.

Count I of the indictment is based on 18 U.S.C. § 371 (1984) which states,

> [i]f two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

Count I charges the defendants under the defraud clause of the statute. This type of conspiracy is generally known as a "Klein" conspiracy. *See United States v. Klein,* 247 F.2d 908 (2d Cir.1957), *cert. denied,* 355 U.S. 924, 78 S.Ct. 365, 2 L.Ed.2d 354 (1958). In *Klein,* several persons were charged with defrauding the United States by impeding and obstructing the lawful functions of the Treasury Department and concealing the nature of their business activities and source of income. As in this case, "the indictment [was] framed to make a general charge of impeding and obstructing the Treasury Department ... [with more specific allegations] as particular instances, rather than as substitute and complete allegations of the substantive crime itself." *Klein,* 247 F.2d at 916. The conspiracy in *Klein* also involved a large number of domestic and foreign corporations, and multiple violations of the tax laws.

[1] In *Minarik,* 875 F.2d at 1186, this Court addressed the two clauses of the conspiracy statute. One of the defendants in that case, Aline Campbell, had been issued three tax assessments for a total demand of $108,788.15. Campbell responded that she did not owe a tax. Shortly after the tax assessment, Campbell, together with her friend Robert Minarik, arranged for the sale of a house Campbell owned. The $47,500 payment was made in the form of seven checks for $4,900 and one check for $3,732.18. The buyer assumed a mortgage for the balance. When Campbell cashed two of the checks at the same bank, the IRS was contacted. The IRS agents ***1473** obtained a warrant to search Campbell's car because she had attempted to avoid the Bank Secrecy Act which requires the filing of an IRS report for any transaction over $10,000. The defendants were charged with conspiring to defraud the government by concealing the nature of and income from Campbell's business affairs in violation of 18 U.S.C. § 371. The indictment did not make clear what function of the Treasury Department the defendants were impeding and the government changed its theory of the case throughout the indictment process and trial. The defendants could have been charged properly under section 7206(4) of the Internal Revenue Code which makes it a felony to conceal any goods or commodities on which a tax or levy has been imposed.

This Court held that defendants could not be charged under the defraud clause but convicted on evidence which supports the offense clause. In *Minarik,* the Court interpreted section 371 finding:

> the "offense" and "defraud" clauses as applied to the facts of this case are mutually exclusive, and the facts proved constitute only a conspiracy under the offense clause to violate 26 U.S.C. § 7206(4)....

875 F.2d at 1187. The Court concluded that when Congress creates a specific offense out of conduct which was previously criminalized only if it took the shape of a conspiracy to defraud the United States, the court should require that a criminal conspiracy regarding that conduct be brought exclusively under the offense clause. *Id.* at 1194. Thus, if the offense clause covers an act or offense, a person cannot alternatively be convicted under the broad defraud clause. This rule comes into effect most often when a Congressional statute closely defines the duties a defendant is accused of violating. The Court reasoned that requiring an indictment to charge a defendant with conspiracy to commit a specific crime reduces the uncertainty in a case by defining up front the alleged crime.

[2] Defendants here argue that the conduct alleged in Count I amounted to a violation of either 26 U.S.C. §§ 7206(1) or 7206(4) and that the conspiracy should have been charged under the offense clause of section 371. We disagree. The conspiracy alleged and proven here was broader than a violation of a specific statute.

This Court, in *Minarik,* noted that the holding in the case referred to the offense and defraud clauses "as applied to the facts in this case." 875 F.2d at 1187. The facts in *Minarik* and this case are distinguishable. Reuben Sturman set up a complex system of foreign and domestic organizations, transactions among the corporations, and foreign bank accounts to prevent the IRS from performing its auditing and assessment functions. Evidence shows that he committed a wide variety of income tax violations and engaged in numerous acts to conceal income. This large conspiracy involved many events which were intended to make the IRS impotent. No provision of the Tax Code covers the totality and scope of the conspiracy. This was not a conspiracy to violate specific provisions of the Tax Code but one to prevent the IRS from ever being able to enforce the Code against the defendants. Only the defraud clause can adequately cover all the nuances of a conspiracy of the magnitude this case addresses. As the Supreme Court had held with respect to specific violations within a conspiracy, "[t]he fact that the events include the filing of false statements does not, in and of itself, make the conspiracy-to-defraud clause of § 371 unavailable to the prosecution." *Dennis v. United States,* 384 U.S. 855, 863–64, 86 S.Ct. 1840, 1845–46, 16 L.Ed.2d 973 (1966). In this case, the prosecution was entitled to indict the defendants under the defraud clause.[1] ***1474** The broad nature of the conspiracy, and the associated violation of several statutes, distinguishes this case from *Minarik.* In this case, the alleged conduct violates several statutes. A "conspiracy to defraud" charge most clearly covers the conduct when viewed in its entirety.

The chief concern of this Court in *Minarik* was that the government, by constantly changing the prosecution theory, never adequately informed the defendant of the charges against him. In this case, no such changing theories have emerged. The prosecution has presented the case clearly and no confusion as to the charges is evident.

III. INSUFFICIENT EVIDENCE CLAIMS OF DAVID STURMAN AND RALPH LEVINE

A. David A. Sturman

David Sturman asserts that the prosecution produced insufficient evidence to support his conviction. He specifically points to a lack of proof evidencing his participation in a conspiracy or of the formation of a willful conspiracy.

[3] [4] [5] A conviction withstands a sufficiency of evidence challenge if

> after viewing the evidence in the light most favorable to the government and drawing all reasonable inferences in the government's favor, the evidence is sufficient to justify a reasonable juror's conclusion that each element of the offense has been established beyond a reasonable doubt....

United States v. Poulos, 895 F.2d 1113, 1117 (6th Cir.1990) (citations omitted). When attempting to prove an individual's participation in a conspiracy, the prosecution must first establish that a conspiracy existed. This Court stated the elements necessary for proof of conspiracy under 18 U.S.C. § 371 in *United States v. Meyers,* 646 F.2d 1142 (6th Cir.1981):

> The essential elements of conspiracy are: (1) that the conspiracy described in the indictment was willfully formed, and was existing at or about the time alleged; (2) that the accused willfully became a member of the conspiracy; (3) that one of the conspirators thereafter knowingly committed at least one of the overt acts charged in the indictment, at or about the time and place alleged; and (4) that such overt act was knowingly done in furtherance of some object or purpose of the conspiracy as charged.

Id. at 1143–44. The existence of a conspiracy can be inferred from circumstantial evidence. *United States v. Levinson,* 405 F.2d 971 (6th Cir.1968), *cert. denied,* 395 U.S. 958, 89 S.Ct. 2097, 23 L.Ed.2d 744 (1969). Once a conspiracy has been established, the prosecution need only produce slight evidence to implicate the defendant. *Poulos,* 895 F.2d at 1117.

[6] Extensive evidence was submitted at trial to establish the existence of a conspiracy. Evidence against David Sturman included his admission that he had opened two Swiss bank accounts under assumed names, his signature authority over 20 additional accounts under the names of various fictitious persons, his directorship at one of the corporations used to channel money from other businesses, and his failure to report his signature authority over Swiss accounts as required by law. All of these activities were interrelated to his father's overall activities. His father's secretary and accountant were also active in the overall scheme. This evidence is adequate to prove the existence of a conspiracy. The testimony of various witnesses, the signature cards with David Sturman's name, and his own admissions implicate the defendant. The jury reasonably could have inferred from the evidence that David Sturman knew of the conspiracy, willfully became a member of the conspiracy, and participated in the concealment of assets from the IRS. This Court finds that a reasonable jury could find the evidence adequate to implicate the defendant and support his conviction and therefore affirms the District Court findings.

B. Ralph L. Levine

[7] Levine argues there is insufficient evidence of any agreement on his part to ***1475** become a member of the conspiracy, and that even if he did so agree, it was to a different conspiracy then the one alleged. For this Court to sustain a conviction of conspiracy,

> the defendant must know the purpose of the conspiracy, but not necessarily the full scope thereof, the detailed plans, operation, membership, or even the purpose of other members in the conspiracy.

United States v. Shermetaro, 625 F.2d 104, 108 (6th Cir.1980). Further, the Court is bound by "all reasonable inferences and credibility choices in support of the jury's verdict." *United States v. Hughes,* 895 F.2d 1135, 1140 (6th Cir.1990) (quoting *United States v. Stull,* 743 F.2d 439, 442 (6th Cir.1984)).

As Levine concedes, Reuben Sturman conspired to defraud the government by creating numerous and complex means of concealing assets and income. Levine, who acted as a partner to Sturman, ran the Nevada businesses. An employee, Jack Marcum, testified that at least $70,000 in cash from the Nevada businesses went unrecorded every month. Levine failed to report the existence or use of this money and therefore furthered the purpose of the conspiracy. His signature authority and power of attorney on Swiss accounts, his failure to report such authority, and the signing of aliases on the signature cards provides further evidence from which the jury could imply willing membership. Levine argues that any finding that he participated in the conspiracy can only be based on inference piled on inference in violation of *Direct Sales Co. v. United States,* 319 U.S. 703, 711, 63 S.Ct. 1265, 1269, 87 L.Ed. 1674 (1943). This Court finds the evidence presented adequate to find participation in a conspiracy even without multiplying inferences. A reasonable jury could find the evidence sufficient to convict the defendant.

IV. SINGLE VERSUS MULTIPLE CONSPIRACIES AND JOINDER OF CLAIMS

Levine and David Sturman both contend that the evidence establishes the existence of multiple conspiracies rather than only one large conspiracy. Levine also asserts that the District Court abused its discretion when it denied his motion for severance. The motion, based on Federal Rules of Criminal Procedure 14, claimed prejudice by the joinder of defendants at trial. Defendants have failed to preserve either of these issues.

[8] **[9]** At the end of trial, both Levine and David Sturman requested jury instructions on multiple conspiracies. The district judge declined to give the multiple conspiracy instruction and several other instructions requested by the defense. After the jury was instructed, Reuben Sturman's attorney, J. Michael Murray, raised a general objection "to the failure with respect to any of the jury instructions that have not been included." He then mentioned several specific instructions, by number, which he believed expressed a correct statement of law and were necessary to present a balanced statement of the case to the jury and potential defenses. Mr. Murray did not mention, even by number, the instruction addressing multiple conspiracies and gave no distinct reasons for objecting to the court's failure to include the multiple conspiracy instruction.

A general objection to district court jury instructions is insufficient to preserve a specific claim. Fed.R.Crim.P. 30 states:

> No party may assign as error any portion of the charge or omission therefrom unless that party objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which that party objects and the grounds of the objection.

This rule clearly indicates that a specific objection must be made with regard to charge requests. *See United States v. Friedman,* 854 F.2d 535, 555 (2d Cir.1988), *cert. denied,* 490 U.S. 1004, 109 S.Ct. 1637, 104 L.Ed.2d 153 (1989); *United States v. Martinez,* 776 F.2d 1481, 1484 (10th Cir.1985) (holding that the objection "both instructions fit this case and should be given" is inadequate to preserve issue). The defendants in this case have failed to preserve ***1476** the issue of multiple conspiracies for appeal.

[10] Levine's contention that the District Court abused its discretion by denying his motion for severance is also without merit. Levine made several motions based on Rule 14 of the Federal Rules of Criminal Procedure. Rule 14 allows the trial court to grant a severance if it appears that a defendant is prejudiced by a joinder of offenses or defendants. Levine argued that the evidence against the co-defendants unfairly accrued to him and that no cautionary instruction could eradicate that accrual.

Levine has failed to preserve this claim for appeal. This Court has held that "a severance motion will be deemed waived if it is not renewed at the end of the evidence." *United States v. Swift,* 809 F.2d 320, 323 (6th Cir.1987). Although Levine argued that he was entitled to a judgment of acquittal under Federal Rule of Criminal Procedure 29 because of the prosecution's failure to prove one conspiracy, he did not renew his motion for severance.

[11] Even if Levine had preserved this claim, it is without merit. The Supreme Court articulated a test for denial of severance motions in *Kotteakos v. United States,* 328 U.S. 750, 66 S.Ct. 1239, 90 L.Ed. 1557 (1946). Succinctly, the test is whether the error had substantial influence on the judgment. *Id.* at 765, 66 S.Ct. at 1248. A denial of a severance motion is reversed only if there is abuse of discretion by the trial court. *United States v. Bibby,* 752 F.2d 1116 (6th Cir.1985), *cert. denied,* 475 U.S. 1010, 106 S.Ct. 1183, 89 L.Ed.2d 300 (1986). No abuse of discretion is apparent in this case. The District Court made repeated instructions to the jury to consider the evidence against each defendant separately. A jury is presumed capable of sorting and considering evidence separately. *Swift,* 809 F.2d at 323. In addition, much of the evidence in the trial would have been admissible if Levine had a separate trial. This Court finds no basis for reversing the District Court's denial of severance.

V. WILLFULNESS ELEMENT OF COUNTS XII–XV

[12] Counts XII–XV charged Reuben Sturman with willfully failing to maintain records and file reports as required by 31 U.S.C. § 5314 (1982). The statute governs records and reports on foreign financial agency transactions. The government based these counts on Reuben Sturman's failure to file Form 90–22.1. This form must be filed by any person who has an interest in or signature over a foreign bank account with a balance in excess of a set dollar amount. Reuben Sturman objects to his conviction on these counts because he believes that the prosecution failed to show that he was aware of the Form 90–22.1 filing requirements.

In *Cheek v. United States,* 498 U.S. 192, 111 S.Ct. 604, 610, 112 L.Ed.2d 617 (1991), the Supreme Court established that the test for statutory willfulness is "voluntary, intentional violation of a known legal duty." Willfulness may be proven through inference from conduct meant to conceal or mislead sources of income or other financial information. *Spies v. United States,* 317 U.S. 492, 499, 63 S.Ct. 364, 368, 87 L.Ed. 418 (1943).[2] Other circuit courts have concluded that willfulness can be inferred from a conscious effort to avoid learning about reporting requirements. *United States v. Bank of New England, N.A.,* 821 F.2d 844, 855 (1st Cir.), *cert. denied,* 484 U.S. 943, 108 S.Ct. 328, 98 L.Ed.2d 356 (1987).

The evidence in this case establishes that Reuben Sturman did take actions to conceal his assets from the federal government. He concealed his signature authority, his interests in various transactions, and his interest in corporations transferring cash to foreign banks. This conduct could be adequate for the jury to infer willfulness ***1477** on the part of the defendant. In addition, the defendant did admit knowledge of and failure to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return. This section of the return refers taxpayers to a booklet that further outlines their responsibilities for reporting foreign bank transactions. This booklet discusses the duty to file Form 90–22.1. These resources indicate that the defendant could have learned of the additional requirements quite easily. It is reasonable to assume that a person who has foreign bank accounts would read the information specified by the government in tax forms. Evidence of acts to conceal income and financial information, combined with the defendant's failure to pursue knowledge of further reporting requirements as suggested on Schedule B, provide a sufficient basis to establish willfulness on the part of the defendant.

VI. OBJECTIONS TO PROSECUTORIAL SUMMATION

[13] Defendant Levine contends that statements by the prosecutor in his rebuttal argument deprived him of a fair trial and that the District Court abused its discretion when it denied his motion for mistrial based on the statements. Levine's attorney argued in summation that the prosecution had failed to produce any evidence which linked Levine to the purchase, sale, transfer of funds into or out of Swiss accounts. In response, the prosecution referred to cashiers checks from Nevada banks which had been deposited in Switzerland. The inference was that these checks established that money from sales in Nevada, where Levine managed Sturman's businesses, had been moved into foreign banks. Levine asserts that since no direct or concrete evidence was produced to link him with those foreign bank transactions, the prosecutor's remarks were prejudicial and improperly suggested an unsupported inference.

Alleged prosecutorial prejudicial or biased remarks will warrant reversal only if the comments have "so infected the trial with unfairness as to make the resulting conviction a denial of due process." *United States v. Moreno,* 899 F.2d 465, 468 (6th Cir.1990) (quoting *Darden v. Wainwright,* 477 U.S. 168, 181, 106 S.Ct. 2464, 2471, 91 L.Ed.2d 144 (1986)). In this case, evidence did exist that suggested Levine had participated in the skimming and transfer of money from United States corporations to Swiss accounts. This evidence included Levine's signature on signature cards and the testimony of various witnesses. This evidence is adequate to support any inference by the jury that deposits to the Swiss accounts from Nevada reflects proceeds from the skimming of income in which Levine was involved. In addition, the jury was instructed that the arguments of the attorneys should be dismissed to the extent they were unsupported by the evidence. This Court finds Levine's guilt supported by the evidence and that the prosecution's summary argument did not "infect[ ] the trial with unfairness."

VII. ALLEGED BIAS OF A JUROR

[14] Levine contends that he has been denied the right to a fair trial because the District Court failed to accord the defendant a hearing based on the defendant's claims of juror bias. This Court has held that,

> [s]ince the trial judge is in the best position to determine the nature and extent of alleged jury misconduct, his decision on the scope of proceedings necessary to discover misconduct is reviewed only for an abuse of discretion.

United States v. Shackleford, 777 F.2d 1141, 1145 (6th Cir.1985), *cert. denied,* 476 U.S. 1119, 106 S.Ct. 1981, 90 L.Ed.2d 663 (1986). The Supreme Court, in *Remmer v. United States,* 347 U.S. 227, 230, 74 S.Ct. 450, 451, 98 L.Ed. 654 (1954), required a hearing in cases of jury bias to "determine the circumstances, the impact thereof upon the juror, and whether or not it was prejudicial, in a hearing with all interested parties permitted to participate." [3]

***1478** During the course of this trial, Juror Olenik approached Judge White with concerns related to Levine's drawing pictures of the jurors during the trial. She advised the judge that some of the other jurors were also uncomfortable. When questioned, several of the jurors admitted being anxious over the drawings and their appropriateness. The judge assured the jurors that drawings by the defendants were permitted. He also told Juror Olenik that the drawings did not resemble any of the jurors. The judge asked each juror whether the incident would have any impact on their ability to remain fair and impartial. All the jurors responded negatively. Although the judge asked the jurors the questions originally requested by defense counsel, he denied defense requests for additional questioning. He did not allow the defense attorneys to ask any questions directly to the jury.

This Court has articulated four points to be considered when determining jury impartiality. *United States v. Zelinka,* 862 F.2d 92 (6th Cir.1988). First, a hearing must be held. Second, the defendant bears the burden of proving bias. Third, no presumption of prejudice arises from the "contact." And finally, fourth, juror testimony at the hearing to determine juror bias is not inherently suspect. Although no case since *Remmer* has addressed the right of the defense to question jurors, such questioning would normally be important to the defense in its effort to prove bias. However, when the questioning of the jurors occurs during the trial it is preferable it be done by the judge. Jurors may resent being questioned directly by counsel.

Even if direct questioning of the jurors by the defense is required by *Remmer,* the absence of such questioning in this case is harmless error. Each juror was asked separately what had occurred and its impact on them. The juror who approached the court about the issue appeared mainly concerned with whether the defendant's drawings were permissible. The court adequately assured the jurors that Levine had done nothing improper. The judge was justified in taking at face value the jurors' assurances of impartiality. This Court finds that any deficiencies in the juror bias hearing were harmless error and the defendant was not entitled to a mistrial.

VIII. ADEQUACY OF 18 U.S.C. § 1503 ALLEGATION

Count XVI of the indictment charged Reuben Sturman with obstruction of justice in violation of 18 U.S.C. § 1503. [4] The count alleged that Reuben Sturman concealed or suppressed documents of various corporations which had been subpoenaed by the grand jury. Reuben Sturman argues that the charge did not provide sufficient information on the specific documents alleged destroyed or the particular corporations or subpoenas involved.

[15] **[16]** The Supreme Court has held that the fifth amendment indictment clause and the sixth amendment notice clause, as protected in Federal Rule of Criminal Procedure 7(c), require an inquiry to determine:

> first, whether the indictment "contains the elements of the offense intended to be charged, 'and sufficiently apprises the defendant of what he must be prepared to meet,' " and, secondly, " 'in case any other proceedings are taken against him for a similar offence, whether the record shows with accuracy to what extent he may plead a former acquittal or conviction.' "

***1479** *Russell v. United States,* 369 U.S. 749, 763–64, 82 S.Ct. 1038, 1046–47, 8 L.Ed.2d 240 (1962) (citations omitted). Furnishing the defendant with a bill of particulars fails to save deficiencies in the indictment. *Id.* at 769–70, 82 S.Ct. at 1050. This Court, when reviewing the sufficiency of an indictment, must ask whether the omission complained of deprives the defendant of one of the protections which the guaranty of a grand jury indictment was meant to ensure. *Id.* at 763, 82 S.Ct. at 1046.

[17] Count XVI of the indictment charges Reuben Sturman with endeavoring to obstruct justice in January 1982 in the United States District Court by destroying, concealing, and suppressing records of various corporations. The indictment clearly establishes the date and manner of the offense as well as the administrative body affected by the actions. This information sets forth all the elements necessary to establish and give a general description of the offense. Any technical deficiencies were harmless error since the indictment sufficiently apprised the defendant of the charges against him to enable him to prepare a response. *See United States v. Weiss,* 491 F.2d 460 (2d Cir.), *cert. denied,* 419 U.S. 833, 95 S.Ct. 58, 42 L.Ed.2d 59 (1974). The District Court correctly dismissed Reuben Sturman's motion to dismiss the charge.

IX. ADMISSION OF JAMES OLSAFSKY'S TESTIMONY

[18] James Olsafsky was the government's key witness with respect to Count XVI of the indictment charging Reuben Sturman with destroying or concealing subpoenaed documents. Olsafsky handled the bookkeeping for fifteen to twenty of the stores owned by Reuben Sturman. Olsafsky testified that he was directed by Reuben Sturman to destroy numerous documents subject to a grand jury subpoena. The documents ordered destroyed included all records of corporations then in existence which contained the name of a living person. Records of defunct corporations were not destroyed. During examination of Olsafsky, the government requested that he flip through the file of a defunct corporation and identify what records he would have destroyed seven years previously if he had been asked by Reuben Sturman. The defense asserts that it is prejudicial error to allow a key witness to speculate on what documents he might have destroyed, and to bolster witness testimony with a demonstration of document destruction. They assert they are denied the right to cross-examine since the testimony was not based in fact.

District court decisions relating to the admission of testimony may not be reversed unless the defendant proves abuse of discretion and specific prejudice. Admissibility of evidence is measured by weighing the probative value of the evidence against its prejudicial value. *United States v. Zipkin,* 729 F.2d 384, 389–90 (6th Cir.1984). The testimony to which Reuben Sturman objects merely serves to identify the types of documents Olsafsky was ordered to destroy. Since Olsafsky did in fact destroy documents, the use of a similar file to identify the type of destroyed documents is based on personal knowledge. The court was within its discretion in permitting the demonstration. Any prejudice would be outweighed by the probative value of Olsafsky's identification of the types of documents Reuben Sturman ordered destroyed.

X. ADMISSION OF EXPERT TESTIMONY

[19] Reuben Sturman objects to the summary testimony of Internal Revenue Agent James Morrow who was involved in the investigation of this case. Reuben Sturman asserts that Morrow's summary testimony was in fact a final argument to the jury, recounting unproven and contested facts. The defendant argues that permitting Morrow's testimony constitutes prejudicial error and requires a reversal of convictions.

Reuben Sturman relies on a Second Circuit case which held that witness credibility is for determination by the jury and that one witness cannot comment on the credibility of another witness. ***1480** *United State v. Scop,* 846 F.2d 135, 142, *modified on reh'g,* 856 F.2d 5

(2d Cir.1988). Agent Morrow, using charts, summarized the evidence and testified that the evidence showed a connection between the defendants, Swiss bank accounts, and a failure to report signature authority and income. Agent Morrow did not comment directly on any specific witness' credibility but rather gave his view of the events. The summary testimony was neither inflammatory nor prejudicial, the District Court properly instructed the jury on the elements of each count charged, and Agent Morrow's testimony and charts aided the jury in organizing the proof presented.

The admission of testimony summarizing evidence has been held to be admissible in income tax prosecutions. *United States v. Lattus,* 512 F.2d 352, 353 (6th Cir.1975). This Court has allowed such testimony in criminal trials when the judge charges the jury as to all the elements necessary for conviction, where the summary is intended to aid the jury in organizing proof, and where the summary is not inflammatory or prejudicially worded. *United States v. Scales,* 594 F.2d 558, 562 (6th Cir.), *cert. denied,* 441 U.S. 946, 99 S.Ct. 2168, 60 L.Ed.2d 1049 (1979). We find that under this standard the District Court properly admitted the testimony.

XI. ADMISSION OF FOREIGN DEPOSITIONS

Reuben and David Sturman both contend that the depositions taken of four Swiss bank officials in Switzerland did not comply with Federal Rule of Criminal Procedure 15. Rule 15(d) provides:

> Subject to such additional conditions as the court shall provide, a deposition shall be taken and filed in the manner provided in civil actions except as otherwise provided in these rules, provided that ... the scope and manner of examination and cross-examination shall be such as would be allowed in the trial itself.

The defendants claim that the admission of the depositions at trial violated their rights to due process, confrontation and effective assistance of counsel.

Depositions of four Swiss bank officials were taken in Switzerland prior to trial. These depositions were presided over by a Swiss magistrate, Benedikt Holdener. Magistrate Holdener had aided the United States in the investigation and prosecution of the defendants. During the depositions, Holdener instructed the defendants to register any objections to the proceeding in writing. He disallowed verbatim transcription. Instead, Holdener dictated a summary of each question and response and noted objections either contemporaneously or required them to be submitted later in writing. Witnesses were given the opportunity to read the summaries and then sign them. During the trial in this case, the English translation of a portion of these depositions was read into the record.

A. Failure to Comply with Fed.R.Crim.P. 15

[20] The District Court overruled the defendants' objections to the foreign depositions finding,

> that the defendants were entitled to be present there, they were entitled to have counsel there, counsel for the government was entitled to have questions read, and it appears to me that counsel for the defendants were entitled to submit questions to the magistrate for answers by the witnesses.

Under a test articulated by the Second Circuit, these procedural safeguards support allowance of the depositions despite variations from United States procedures. The Second Circuit held that a foreign deposition would be admissible,

> unless the manner of examination required by the law of the host nation is so incompatible with our fundamental principles of fairness or so prone to inaccuracy or bias as to render the testimony inherently unreliable....

United States v. Salim, 855 F.2d 944, 953 (2d Cir.1988). Swiss law forbids verbatim transcription so the summary method of establishing the record was the most effective legal method. All defense questions, with just one exception, were submitted to the witnesses so that objections and determinations ***1481** on admissibility could be litigated later.[5] Although the witnesses were not given an oath, defense conceded that each witness was told the penalties for giving false testimony. The Second

Circuit has recognized that an oath may not be given in some foreign countries and that the omission of such an oath does not automatically result in the suppression of the deposition. *See United States v. Casamento,* 887 F.2d 1141, 1172–75 (2d Cir.1989), *cert. denied,* 493 U.S. 1081, 110 S.Ct. 1138, 107 L.Ed.2d 1043 (1990). Cross-examination, acceptance and consideration of objections, and the review of all written testimony by the witnesses ensured that the testimony complied with Rule 15(d) to the extent possible. Depositions taken in foreign countries cannot at all times completely emulate the United States' method of obtaining testimony. Here, all steps were taken to ensure the defendants' rights while respecting the legal rules established in a different country. The District Court achieved substantial compliance with Federal Rule of Criminal Procedure 15.

The same factors which demonstrate substantial compliance with Rule 15 rebut any claims based on due process violations or interference with effective assistance of counsel. The ability of the defendants to cross-examine, and the admission of all defense questions, protected the defendants against the constitutional violations alleged. Defendants have failed to point to any way in which they were prejudiced by the procedures used.

B. Neutrality or Impartiality of the Magistrate

[21] David and Reuben Sturman also object to Magistrate Holdener presiding over the depositions asserting that he was not neutral because of his role in the prosecutions. Holdener himself overruled the objection. Neither Rule 15 nor Federal Rule of Civil Procedure 28(b) address the issue of neutral or impartial magistrates. Instead, these rules accept the necessity of foreign officials presiding over foreign depositions. If the law of Switzerland permits a person to serve as both magistrate and prosecuting attorney, then that practice must be permissible in obtaining depositions for United States litigation provided that the criteria in *Salim* are met. The defendants have failed to establish evidence that Magistrate Holdener's handling of the deposition unfairly prejudiced the defendants or that the testimony could be considered unreliable. The defendants were provided sufficient opportunity to ask questions designed to refute the credibility of the witnesses. The admission into evidence of the depositions did not violate any constitutional rights of the defendants and did not constitute unfair prejudice.

C. Pierre Perrelet's Identification

[22] The defense also objects to Pierre Perrelet's identification of defendant Reuben Sturman. Perrelet was asked to identify his former customer. He responded by stating, “[p]resumably the second gentlemen at the left side of the table in second place who is leaning on a briefcase is a customer of SBC whom I looked after in the past.” This description identified Reuben Sturman. Defense seeks a reversal of Reuben Sturman's convictions since this identification was based on a presumption. From the context in which the word “presumably” was used, it seems sufficiently clear that the witness was identifying the defendant and the “presumably” was merely a euphemism.

XII. DISQUALIFICATION OF DISTRICT JUDGE

[23] Reuben Sturman argues that the district judge in this case was under a duty to *sua sponte* recuse himself because of his bias against the defendants. After pronouncing the sentence and judgment, the judge requested the defendants and their attorneys to approach the bench. He then stated that he had had to separate his feelings about the defendants' business ***1482** from the defendants in imposing the sentence. He concluded, however, by noting that he had tried his best to keep his feelings about the type of business in which the defendants were engaged out of the sentencing and believed he had succeeded. [6]

Reuben Sturman argues that the judge's comments indicate a bias which effected the entire four-month trial and previous years of motions and discretionary rulings. The defendant asserts that because the judge failed to recuse himself at the outset of the case, the convictions in the case must be reversed.

A federal judge is required to recuse himself “in any proceeding in which his impartiality might reasonably be questioned.” 28 U.S.C. § 455(a). This Circuit has determined that whenever a judge's impartiality is questioned, it must be determined whether “a reasonable, objective person, knowing all the circumstances, would not have questioned [the judge's] impartiality.” *Hughes v. United States,* 899 F.2d 1495, 1501 (6th Cir.), *cert. denied,* 111 S.Ct. 508, 112 L.Ed.2d 520 (1990); *see also* H.R.Rep. No. 1453, 93d Cong., 2d Sess. 4, *reprinted in* 1974 U.S.Code Cong. & Admin.News 6351, 6354.

Under the test established in *Hughes,* this Court must look at all the circumstances surrounding the case to determine whether a reasonable person would believe the judge was impartial. Several factors support a finding that Judge White acted impartially during the trial. First, the defendants can point to no decision on the part of the judge that clearly demonstrated bias. The contentions in the appeal that raise abuse of discretion issues have been found to be without merit. Second, the sentences given the defendants, rather than exhibiting bias against the defendants, are substantially below the level requested by the government and appear fair under the circumstances. Third, this Court may take at face value Judge White's assertion that he set his feelings about the defendants' business aside. Judges, whether they are hearing tax evasion cases or vicious murder prosecutions, may have views about the nature and heinousness of the underlying crime. All judges, as part of their decisionmaking process, seek to set these feelings aside. Judge White merely articulated a tension all judges share. This Court holds that the defendants have failed to prove that Judge White's personal beliefs concerning pornography tainted the proceedings. [7]

XIII. VIOLATIONS OF THE MUTUAL ASSISTANCE TREATY

Reuben and David Sturman both raise objections to the use of records obtained from Switzerland under the Treaty Between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters, May 25, 1973, United States–Switzerland, 27 U.S.T. 209, T.I.A.S. 8302. The Treaty ("Treaty") states that Switzerland agrees to provide information and access to bank records in Switzerland only for a specifically defined list of criminal offenses. Reuben Sturman ***1483** asserts that the United States government submitted false information concerning the defendant's connection with organized crime in order to obtain his records under the Treaty. He claims that these submissions and the resultant release of records violated his fourth amendment privacy and fifth amendment due process rights. David Sturman objects to the use of the records obtained under the Treaty provisions in the case against him since the government did not provide evidence to Switzerland concerning David Sturman when they sought the records.

The United States requested assistance from the government in Switzerland in obtaining the bank records of Reuben Sturman. In acquiring these records, the United States government must submit evidence to Switzerland that shows the requested records relate to one of a select list of criminal offenses. The United States government submitted evidence to Switzerland which indicated that Reuben Sturman had some relationship to organized crime. The evidence submitted to Switzerland was never disclosed to Reuben Sturman despite his discovery request. The District Court, after a *in camera* review of the evidence, ruled that the defendant had failed to show the government misrepresented the facts. Both David and Reuben Sturman assert that the records obtained as a result of the United States' action under the Treaty should not be admissible. They further argue that should this evidence be found inadmissible, the convictions based on the evidence should be reversed.

Article 37 of the Treaty provides that,

> [t]he existence of restrictions in this Treaty shall not give rise to a right on the part of any person to take any action in the United States to suppress or exclude any evidence or to obtain other judicial relief in connection with the requests under this Treaty....

Treaty Between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters, May 25, 1973, United States–Switzerland, 27 U.S.T. 209, T.I.A.S. 8302. [8] This language indicates that neither David nor Reuben Sturman have standing to raise a claim under the Treaty. Relying on the decision of the D.C. Circuit Court in *Cardenas v. Smith,* 733 F.2d 909, 917–19 (D.C.Cir.1984), defendants claim that the Treaty cannot deprive them of constitutional rights. *Id.* at 919. [9] Because we find the defendants have not been deprived of their constitutional rights, we do not consider whether they have standing to raise such claims.

A. Fourth Amendment

[24] **[25]** Reuben Sturman maintains that, because of Switzerland's strict banking secrecy laws, he has a reasonable expectation of privacy protected by the fourth amendment. In support of his assertion of an expectation of privacy, he relies on the Swiss penalties of imprisonment or fine for revealing information and on the Treaty's goal of preserving the integrity of Swiss banking law. In essence, the defendant argues a constitutional right created by the statutory rights granted him by a foreign country to records in that country. No such right of privacy in banking ***1484** records is recognized in the United States. *United States v. Miller,* 425 U.S. 435, 96 S.Ct. 1619, 48 L.Ed.2d 71 (1976).

Any privacy right conferred on Reuben Sturman by Switzerland and any remedy given for a violation of that right is limited by the terms of the Treaty. The Treaty clearly indicates that the Swiss government has agreed that an American citizen's right to privacy can be curtailed under certain circumstances. The Treaty also evidences a decision by the Swiss government to limit the remedy available once bank records are released. The Swiss government has limited the right to privacy given by its laws and denied to depositors any expectancy that, if records were disclosed to the United States, they could be suppressed or excluded from evidence. This intent is plainly stated in the language of Article 37 which is part of the law of Switzerland as well as the United States.

Even if Article 37 does not foreclose a fourth amendment claim for suppression of evidence, Reuben Sturman had no reasonable expectation of privacy in the documents for fourth amendment purposes. The Treaty makes any expectation of privacy limited through its terms. If no such expectation exists, then his ability to raise a fourth amendment claim is limited by the holdings of the United States Supreme Court. The Supreme Court has held that there is no privacy interest in the records and documents of third parties. *Rakas v. Illinois,* 439 U.S. 128, 99 S.Ct. 421, 58 L.Ed.2d 387 (1978); *Miller,* 425 U.S. at 435, 96 S.Ct. at 1620. Further, the fourth amendment does not justify exclusion of evidence when the defendant is not the victim of the challenged practices. The supervisory power of the federal courts does not allow it to suppress evidence that has been seized unlawfully from a person not before the court. *United States v. Payner,* 447 U.S. 727, 100 S.Ct. 2439, 65 L.Ed.2d 468 (1980). Thus, since an individual has no privacy interest in his bank records, he cannot make a motion for exclusion once they are obtained. Only the holder of the records, for example the bank, can raise an objection.

B. Due Process Claims

[26] Reuben Sturman asserts that the submission of false statements linking him to organized crime in order to obtain information from a foreign country is the type of governmental misconduct which violates substantive due process. He also claims that he was denied any reasonable opportunity to respond to the charges in the documents submitted to the Swiss government and has thus been denied his procedural due process rights. These claims are without merit.

A review of the submissions to the Swiss government reveals that the documents contain no serious misrepresentations concerning the defendant. The District Court's review of the documents generated the same opinion. Even if misrepresentations were found, a reversal of conviction is not automatic. A federal court's supervisory power allows the court to remedy cases of serious governmental misconduct. *Payner,* 447 U.S. at 727, 100 S.Ct. at 24; *United States v. Gjieli,* 717 F.2d 968 (6th Cir.1983), *cert. denied,* 465 U.S. 1101, 104 S.Ct. 1595, 80 L.Ed.2d 127 (1984). Reversals of convictions using this power should not be granted readily. *Id.* at 978. This Court has held that the reversal of a conviction should be granted only when the following prerequisites are met:

> (1) there must be a constitutional injury which is personal to the complaining defendant, (2) the injury must "harm" the defendant in a legally significant way, (3) there must be an injury to the judicial system, (4) the "remedy" selected by the Court to preserve judicial integrity and deter future misconduct may not exceed established limitations on the court's power, and (5) the remedy selected must be narrowly tailored.

Id. at 978–79.

In *Gjieli,* the government improperly released defendant, Zeff Lulgjuraj, from prison. His release signalled his codefendants that a Bureau of Alcohol, Tobacco and Firearms agent was ready to deliver Lulgjuraj to them. The government officials submitted a false writ to a district judge in ***1485** order to obtain the prisoner's release. One agent posed as a United States Marshal in order to secure custody of the prisoner. Applying the test above, this Court held that the government's misconduct did not entitle the defendants to reversal of their convictions. *Id.* at 979.

In this case, Reuben Sturman has suffered no identifiable constitutional injury. The defendant has no constitutional right to review submissions to the Swiss government made in the course of an investigation. Even if such a right existed, the defendant received adequate protection through the *in camera* review of the documents by the District Court and this Court. As discussed above, no right arises from any expectation of privacy asserted by the defendant. Reuben Sturman also urges that this Court find a deprivation of a liberty interest due to the stigmatization of his name. The documents submitted to the Swiss government have never been released or made public. This Court has held that "in order to establish a protectable liberty interest, the plaintiff must demonstrate ... that the defendants publicly and voluntarily disclosed stigmatizing charges or information...." *Yashon v. Gregory,* 737 F.2d 547, 556 (6th Cir.1984).

Misconduct, if any, committed by the government in this case is not as serious as that committed in *Gjieli* where a reversal of conviction was denied. We find that the defendant has failed to satisfy the test articulated in *Gjieli.*

C. David Sturman

[27] David Sturman obtained a decision from the Swiss Federal Supreme Court which held that no Swiss evidence could be used against him in a case for tax evasion. Notice of Ruling by the Swiss Supreme Court That No Evidence Obtained from Switzerland May be Used Against David Sturman, October 13, 1989. Using this decision, David Sturman objected to the use of the evidence in the District Court. The District Court overruled his objection. We agree. The Swiss Central Authority advised the United States government that the Swiss documents could only be used against the codefendants if they were participants in Reuben Sturman's criminal activities. Article 5 para. 2(b) of the Treaty provides that evidence obtained under the Treaty can be used against persons accused of participating in the criminal activity and accessories. Evidence produced during this trial shows David Sturman's participation in Reuben Sturman's criminal activity. The admission of the Swiss evidence was thus permissible under the Treaty.

XIV. DENIAL OF REUBEN STURMAN'S DISCOVERY REQUEST

A Special Agent of the IRS, Richard N. Rosfelder, who was in charge of the investigation against the defendants, testified at trial about the investigation. Following his testimony, Reuben Sturman requested that the government produce several documents related to the testimony. Specifically, the defendant requested Rosfelder's Special Agent's Report outlining the investigation and suggesting indictment, the submissions to the Swiss government sent with the request for information under the Mutual Assistance Treaty, and the agent's grand jury testimony. The defendant claims that the government failed to produce 99% of the Special Agent's Report, the Swiss submissions, and 100 pages of grand jury testimony. The District Court held that the missing documents did not need to be produced and refused a request to conduct further voir dire of Special Agent Rosfelder to determine the contents of the documents.

A trial court's rulings on matters relating to the production of documents is reviewed under a clearly erroneous standard. *United States v. Nathan,* 816 F.2d 230 (6th Cir.1987). The defendant raises two arguments in support of his contention that the denial of his discovery motion was reversible error.

[28] **[29]** **[30]** First, the defendant claims that the denial of the discovery motion violates the provisions of the Jencks Act. 18 U.S.C. § 3500 (1985). The Jencks Act addresses demands for the production of statements ***1486** and reports of witnesses. Particularly, the statute provides:

> After a witness called by the United States has testified on direct examination, the court shall, on motion of the defendant, order the United States to produce any statement (as hereinafter defined) of the witness in the possession of the United States which relates to the subject matter as to which the witness has testified. [10]

It is clear that the submissions to the Swiss government do not fall under the protections of the Act since they were prepared and signed by government attorneys, were not a verbatim transcript of any statements made by the agent, and were not reviewed for accuracy by the agent. The Special Agent's Report was reviewed by the District Court and certain sections which appeared to be statements of the witness were ordered released to the defendant. The remainder of the document is an internal prosecution report, prepared prior to the events discussed under direct examination, and thus exempt from discovery under the Jencks Act. *United States v. O'Keefe,* 825 F.2d 314, 319 (11th Cir.1987). The defendant also protests the denial of discovery with respect to the redacted portions of the grand jury testimony. The government claims that these portions did not need to be given to the defendant since they did not relate to the direct testimony of the witness and merely summarized documentary evidence and discussed subjects of investigation other than Reuben Sturman. A review of the redacted portions of the testimony reveals that this assessment is accurate.

[31] Second, the defendant raises a protest to the nondisclosure of these documents based on *Brady v. Maryland,* 373 U.S. 83, 83 S.Ct. 1194, 10 L.Ed.2d 215 (1963). The Supreme Court held in *Brady* that the suppression by the prosecution of evidence which is material to either guilt or punishment violates due process. This Court has held that,

> if the government does fail to disclose *Brady* material, the defendant has a constitutional remedy for the nondisclosure *only* if the defendant can show that there is a reasonable probability that "the omission deprived the defendant of a fair trial."

United States v. Presser, 844 F.2d 1275, 1282 (6th Cir.1988) (citation omitted) (emphasis in original). The defendant has failed to show a reasonable probability that he was denied a fair trial. The evidence supporting the defendant's conviction was substantial. No arguments were made which suggest the information withheld contains facts which go directly to the guilt or innocence of the defendants. Both this Court and the District Court, in their *in camera* review, found that they do not. The District Court did not err in denying Reuben Sturman's discovery motion.

XV. THE BANK SECRECY ACT AND SELF–INCRIMINATION

[32] **[33]** Reuben Sturman was under investigation for tax-related violations from 1976 and was under grand jury investigation from 1978. These investigations included the examination of the defendant's foreign bank accounts. Reuben Sturman's indictment listed several counts, associated with The Bank Secrecy Act, which alleged that the defendant had failed to file information related to the foreign accounts during the years he was being investigated. The defendant claims that the Bank Secrecy Act, which requires a person to file certain information if they have over a minimum amount of money in foreign accounts, is directed at persons suspect of criminal activities and promotes self-incrimination. The defendant asserts that the Act is therefore unconstitutional and that ***1487** the trial court erred in denying his motion to dismiss and motion for judgment of acquittal on the counts related to the Act.

The Supreme Court has held that taxpayers cannot assert a violation of their rights against compulsory self-incrimination when they refuse to answer questions on a tax return for fear authorities will discover illegal activity. *United States v. Sullivan,* 274 U.S. 259, 260, 47 S.Ct. 607, 607, 71 L.Ed. 1037 (1927). *Sullivan* implies that any objections to specific questions will be considered only if the individual files a completed return and raises the objections in the return. A defendant's fear of self-incrimination cannot serve as a defense to a failure to complete the information called for on his tax return unless he raised an objection when he filed.

Even if *Sullivan* were not applicable to this situation, the defendant's claim is still without merit. The defendant bases his claim on a line of cases which have found various reporting requirements in violation of the privilege against compulsory self-incrimination when specific conditions are met. *Marchetti v. United States,* 390 U.S. 39, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968); *Grosso v. United States,* 390 U.S. 62, 88 S.Ct. 716, 19 L.Ed.2d 906 (1968); *Haynes v. United States,* 390 U.S. 85, 88 S.Ct. 722, 19 L.Ed.2d 923 (1968).[11] The Supreme Court held in these cases that statutes violate the right against compulsory self-incrimination when (1) they are directed against a "selective group inherently suspect of criminal activity"; (2) requirements are imposed in an "area permeated with criminal statutes"; and (3) reporting requirements would have placed the subject in real danger of self-incrimination. *See Marchetti,* 390 U.S. at 47, 88 S.Ct. at 702; *Grosso,* 390 U.S. at 64, 88 S.Ct. at 711. The Bank Secrecy Act applies to all persons making foreign deposits, most of whom do so with legally obtained funds. The requirement is imposed in the banking regulatory field which is not infused with criminal statutes. In addition, the disclosures do not subject the defendant to a real danger of self-incrimination since the source of the funds is not disclosed. It is not evident from the information provided whether the money in the account came from a legitimate adult entertainment business or from a scheme to skim money from a business. Thus, the defendant has failed to show that the Bank Secrecy Act violated any individual right *Marchetti* and *Grosso* seek to protect.

XVI. DOUBLE JEOPARDY

[34] Reuben Sturman received consecutive fines for Counts VII–XI, charging him with making and subscribing a false tax return in violation of 26 U.S.C. § 7206(1), and Counts II–VI, charging him with attempting to evade income taxes in violation of 26 U.S.C. § 7201. Relying on several cases from other circuit courts,[12] the defendant argues that filing a false tax return under section 7206(1) is a lesser included offense under attempted income tax evasion in violation of section 7201. In cases of lesser included offenses, consecutive sentences are double jeopardy since the offender cannot be tried and convicted under both statutes. At least one court, however, has recognized that the cases cited by the defendant address only cases where the proof of tax evasion necessarily proves the preparation and filing of a fraudulent return. *United States v. Franks,* 723 F.2d 1482, 1487 (10th Cir.1983), *cert. denied,* 469 U.S. 817, 105 S.Ct. 85, 83 L.Ed.2d 32 (1984). The Tenth Circuit found that a misrepresentation of foreign bank account information is distinct from understating income on a tax return. Proving that a taxpayer violated ***1488** section 7206(1) by misrepresenting her interest in or signature authority on a foreign account does not necessarily prove tax evasion. When the proofs on the charges are separate, the sentencing may be consecutive. *Id.* at 1487. We adopt the reasoning of the Tenth Circuit and allow the sentence to stand.

XVII. REFUSAL TO GIVE JURY INSTRUCTIONS

Reuben Sturman objects to the trial court's rejection of nine jury instructions requested by the defendant. Defendant seeks a reversal of his convictions due to the jury instruction errors. The defendant's objections are without merit.

[35] The first requested jury instruction whose denial the defendant protests would have informed the jury that the activities of the defendants were not illegal unless the activities furthered a conspiracy to impede the IRS. A jury instruction read by the court instructed the jury that a conviction of the defendants on Count I was only possible if the government showed that the "means or methods described in the indictment were agreed upon to be used in an effort to ... accomplish ... the conspiracy." This instruction adequately covers the same ground as the requested instruction.

[36] Defendant's requested jury instructions numbered 9, 10, 13, 14, and 15 set forth the defendant's argument that if the government had proved evasion of corporate, as opposed to individual income, then he was entitled to acquittal. The defendant asserts that the failure to present the requested instructions resulted in the jury only being presented with the prosecution's theory of the case. These instructions were addressed at Counts II–VI and Counts VII–XI. The defendant has waived his right to object to the court's refusal to give instructions 14 and 15 by failing to present distinct and clear objections with regard to those instructions.

[37] The defendant's theory of the case as presented in requested instructions 9, 10, and 13 makes an incorrect statement of law. The requested instructions call on the jury to distinguish between income of the defendant and income accruing to the corporations. In this case, all the Swiss accounts were set up in the name of individuals. This Court, in *Davis v. United States,* 226 F.2d 331 (6th Cir.1955), *cert. denied,* 350 U.S. 965, 76 S.Ct. 432, 100 L.Ed. 838 (1956), held that the unexplained transfer of funds to an individual's account constituted income to the individual. The government was not required to prove what use was made of the funds. The defense failed to prove that any of the funds were used to the benefit of any corporation.

The defendant next objects to the District Court's rejection of his suggested instructions 7 and 8 which addressed his reading of *Minarik,* 875 F.2d at 1186. This Court has found that the District Court properly allowed Count I and that *Minarik* did not apply in this case. Thus, no error resulted from the District Court's failure to give instructions 7 and 8.

[38] The final objection raised in connection with jury instructions concerns defendant's requested instruction 17. This instruction, which sought to define when a false statement is knowingly made, was requested in relation to Counts VII–XI which charged the defendant with willfully filing fraudulent tax returns. The instruction stated that in order to establish a knowingly made false statement the defendant must knowingly make a statement and know that the statement is false. The instruction was designed to present defense's assertion that failure to answer a question did not constitute a knowingly made false statement. It is a crime for any person to willfully make "any return, statement ... which he does not believe to be true and correct as to every material matter." 26 U.S.C. § 7206(1). The District Court properly instructed the jury that the government had to prove that the defendant willfully made a false statement "as to a material matter alleged in the indictment." This instruction covered the issue presented by requested instruction 17. This Court finds no error on the part of the ***1489** District Court with regard to jury instructions.

XVIII. ADMISSION INTO EVIDENCE OF FOREIGN BANK RECORDS

Volumes of business records from seven foreign banks were presented at trial. These records were "certified" by twelve affidavits or certificates of authenticity. This practice, adopted by Congress in 18 U.S.C. § 3505, dispenses with the necessity of calling a live witness to establish authenticity.

Section 3505 allows the admission of foreign records, and prevents their exclusion as hearsay, provided that a foreign certification attests to certain facts.[13] A foreign certification serves to authenticate the records. Reuben Sturman asserts that there was error in the admission and maintenance of records the prosecution received from Switzerland. He also objects to the admission of the foreign bank records urging that section 3505 is unconstitutional because it deprives him of his right to confrontation.

[39] The certificates at issue indicated that the person signing the certificates was acting in the capacity of custodian of the records, that the records were made or received in the regular course of business, and that the records were part of a regular business practice that made or received the documents at the time, or within a reasonable time thereafter, of the recorded event. These attestations satisfy most of the provisions of section 3505. The certificate fails to state that the "record was made ... by (or from information transmitted by) a person with knowledge of those matters." 18 U.S.C. § 3505(a)(1)(A). Reuben Sturman contends that this foundational element must be established. This Court, when interpreting similar language in Federal Rules of Evidence 803(6),[14] has held that a witness need only have knowledge of the recordkeeping procedures. *United States v. Hathaway,* 798 F.2d 902 (6th Cir.1986). In this case, a bank official, who would necessarily have some knowledge of the bank's recordkeeping procedures, provided the certification.

[40] The defendant also protests that the certificates were not physically attached to the records being authenticated and that the certifications did not identify the specific records they authenticate. Neither of these assertions is valid. Section 3505 contains no requirement that the certificate be attached to the authenticated record. Each certificate was associated with a transmittal record that listed the account and record of accounts being produced. The certifications incorporated these transmittal letters.

The defendant also raises the following arguments: (1) that the "legal advisor" who signed the certification was not a "custodian" under the requirement of section 3505; (2) that section 3505 does not refer to records "received" which the certification includes in its description of the records; and (3) that the certification states that it was the regular course of business to make "documents of this kind" rather than the specific record being authenticated. After a careful consideration of these issues, this Court find the claims to be without merit.

[41] ***1490** Reuben Sturman also alleges that section 3505 deprives him of his sixth amendment right of confrontation. We disagree. The confrontation clause does not establish an absolute exclusion of all hearsay. Testimony of an unavailable witness is permissible provided it contains an "indicia of reliability." *United States v. Miller,* 830 F.2d 1073 (9th Cir.1987), *cert. denied,* 485 U.S. 1033, 108 S.Ct. 1592, 99 L.Ed.2d 907 (1988) (quoting *Ohio v. Roberts,* 448 U.S. 56, 63, 100 S.Ct. 2531, 2537, 65 L.Ed.2d 597 (1980)). The Supreme Court in *Bourjaily v. United States,* 483 U.S. 171, 182–83, 107 S.Ct. 2775, 2782–83, 97 L.Ed.2d 144 (1987), has held that "[b]ecause 'hearsay rules and the Confrontation Clause are generally designed to protect similar values,' ... no independent inquiry into reliability is required when the evidence 'falls within a firmly rooted hearsay exception.' " (quoting *Roberts,* 448 U.S. at 66, 100 S.Ct. at 2539) (citations omitted). Section 3505 establishes an exception to the hearsay rule for foreign business documents. This exception ensures that the requirements of the Confrontation Clause are automatically satisfied.

[42] [43] Finally, the defendant claims that the prosecution failed to satisfy the foundational requirements of Federal Rules of Evidence 602 and 901. Rule 602 requires the introduction of evidence which supports a finding that a witness has personal knowledge of the matter on which they are to testify. Rule 901 requires authentication and identification prior to the admissibility of any evidence. The admissibility of foreign records is a question that may be determined by the court before trial. Fed.R.Evid. 104(a); 18 U.S.C. § 3505(b); *United States v. Tedder,* 801 F.2d 1437, 1448 (4th Cir.1986), *cert. denied,* 480 U.S. 938, 107 S.Ct. 1585, 94 L.Ed.2d 775 (1987). The District Court held a pre-trial hearing on November 6 and 16, 1987 to determine the admissibility of the challenged records. There was no necessity of repeating this hearing before the jury. In addition, the prosecution did have Special Agent Rosfelder testify regarding the receipt, custody, and certification of the records. The defense was given an opportunity at that time to cross-examine the witness.

Special Agent Rosfelder admitted during his testimony that he did not have custody of the records at all times and therefore lacked personal knowledge regarding some of the details of the receipt and maintenance of the records. Even if the court did commit error by allowing Rosfelder to testify on an issue of which he did not have personal knowledge, the error is harmless. Special Agent Rosfelder's testimony was sought as the result of challenges to the certification of the records. Since we find the certificates to be adequate, the testimony was unnecessary.

CONCLUSION

Accordingly, the decision of the District Court is AFFIRMED as to all defendants.

All Citations

951 F.2d 1466, 34 Fed. R. Evid. Serv. 704

Footnotes

[*] The Honorable Henry R. Wilhoit, Jr., United States District Court for the Eastern District of Kentucky, sitting by designation.

[1] The government's brief cites four cases in which the Sixth Circuit has affirmed convictions based on the defraud clause. These defendants could also have been charged based on the offense clause. These decisions lend support to limiting *Minarik* to its facts. *See United States v. Jerkins,* 871 F.2d 598 (6th Cir.1989); *United States v. Shermetaro,* 625 F.2d 104 (6th Cir.1980); *United States v. Fruehauf Corp.,* 577 F.2d 1038 (6th Cir.), *cert. denied,* 439 U.S. 953, 99 S.Ct. 349, 58 L.Ed.2d 344 (1978); *United States v. Levinson,* 405 F.2d 971 (6th Cir.1968), *cert. denied,* 395 U.S. 958, 89 S.Ct. 2097, 23 L.Ed.2d 744 (1969).

[2] The defendant claims that *Spies* is irrelevant since it deals with specific charges of tax evasion rather than conspiracy to defraud the government. We find that the case relevant. *Spies* did involve an indictment which contained a single felony charge of willfully attempting to defeat and evade a tax. However, willful failure to file a return and willful failure to pay taxes were cited as means to the end. 317 U.S. at 494, 63 S.Ct. at 366.

[3] *Remmer* involved a case of jury tampering by outside influences. After the completion of the trial, it was revealed that a juror had been approached by someone who suggested it would be profitable to bring in a verdict favorable to the petitioner. The judge had ordered an investigation at the time the juror had reported the incident, decided the offer had been made in jest, and never notified the defense of the incident. The defense learned of the occurrence after the trial in the newspaper. 347 U.S. at 228, 74 S.Ct. at 450.

[4] 18 U.S.C. § 1503 (1984) states, in relevant part, that whoever,

> corruptly or by threats or force, or by any threatening letter or communication, influences, obstructs, or impedes, or endeavors to influence, obstruct, or impede, the due administration of justice, shall be fined not more than $5,000 or imprisoned not more than five years, or both.

5 It should be noted that only Reuben Sturman exercised his cross-examination rights. The other defendants are presumed to have waived their rights to cross-examination. The one question rejected by Holdener concerned the salary of one of the witnesses.

6 The transcription of the judge's comments reads in part:

> I have gone out of my way, very frankly, as a judge to separate in my mind the business that the defendants are in from what they are charged with.

. . . . .

> However, it is this Court's feeling that even thought [sic] the defendants are suffering and have gone through an ordeal, I can't help but think that having seen many movies that depicted certain scenes, that probably the gentleman involved in selling, first of all, it runs through my mind that somebody has to be paid to appear in those scenes.
>
> Quite frankly, I have to believe that some people who have acted in those scenes have gone through some tremendous pressures of their own.

. . . . .

> I had to say that. I have tried my best to, and I think I have in keeping that from involving the sentence in this case. I have tried to limit it to the tax matters in this case and the conspiracy that was alleged and the other charges in this case which have nothing to do with—indirectly it may with the businesses—but should not involve my thinking in the sentences.

7 No motion for recusal was filed with the District Court. Indeed, defense counsel complimented the district judge at this same sentencing hearing on his fairness in presiding over the case.

8 The Technical Analysis of Article 37 goes further adding,

> [e]nforcement of the provisions of the Treaty is a matter for the Contracting parties, and does not give rise to any right on the part of defendants ... to obtain judicial relief....

Technical Analysis of the Treaty Between the United States and Switzerland on Mutual Assistance in Criminal Matters, *reprinted in* Message from the President transmitting the Treaty with the Swiss Confederation on Mutual Assistance in Criminal Matters, 94th Cong., 2d Sess. 34 (1976).

9 The *Cardenas* case involved an appeal by a nonresident alien seeking redress in United States Courts for the seizure of Swiss accounts in which plaintiff had an interest. The United States government had encouraged the Swiss government to seize the accounts. The plaintiff claimed that the seizure violated her rights under the fourth and fifth amendments as well as various statutory and Treaty related obligations. The D.C. Circuit recognized that Article 37 precluded any claims arising under the Treaty. The court found, however, that there was no evidence that the Treaty intended to preclude judicial review of the statutory and constitutional claims. The court reversed the lower court's decision to dismiss the complaint so that the statutory and constitutional claims could be heard. 733 F.2d at 911–19.

10 The statute defines the term statement as

> (1) a written statement made by said witness and signed or otherwise adopted or approved by him;
>
> (2) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital of an oral statement made by said witness and recorded contemporaneously with the making of such oral statement; or
>
> (3) a statement, however taken or recorded, or a transcription thereof, if any, made by said witness to a grand jury.

18 U.S.C. § 3500(e).

11 These cases dealt with an occupational tax related to wagers. Under the statute, persons registering as wagers had to keep on their persons stamps showing the payment of tax, maintain daily wagering records, and keep their books open for inspection. These persons were also liable for an occupational tax. The petitioners in these cases argued that the registration and tax requirements violated their rights against self-incrimination. Based on the criteria discussed above, the court found for the petitioners.

12 *United States v. Citron,* 783 F.2d 307, 312 (2d Cir.1986), *following remand,* 853 F.2d 1055 (2d Cir.1988); *United States v. Pulawa,* 532 F.2d 1301, 1302 (9th Cir.1976); *United States v. Slutsky,* 487 F.2d 832, 845 (2d Cir.), *cert. denied,* 416 U.S. 937, 94 S.Ct. 1937, 40 L.Ed.2d 287 (1974).

13 18 U.S.C. § 3505 reads in relevant part:

(a)(1) In a criminal proceeding in a court of the United States, a foreign record of regularly conducted activity, or a copy of such record, shall not be excluded as evidence by the hearsay rule if a foreign certification attests that—

> (A) such record was made, at or near the time of the occurrence of the matters set forth, by (or from information transmitted by) a person with knowledge of those matters;
> (B) such record was kept in the course of regularly conducted business activity;
> (C) the business activity made such a record as a regular practice; and
> (D) if such record is not the original, such record is a duplicate of the original;
> unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness.
> ....

[14] Fed.R.Evid. 803(6) list evidence which may not be excluded by the hearsay rule. Subdivision 6 addresses records of regularly conducted activity. Such records must be “made at or near the time by, or from information transmitted by, a person with knowledge....”

End of Document

2017 WL 2483213
United States District Court,
W.D. Washington,
at Seattle.

UNITED STATES of America, Plaintiff,
v.
Jeffrey P. POMERANTZ, Defendant.

CASE NO. C16-0689JLR
|
Signed 06/08/2017

Attorneys and Law Firms

Paul T. Butler, US Dept. of Justice, Washington, DC, for Plaintiff.

Jeffrey P. Pomerantz, pro se.

ORDER

JAMES L. ROBART, United States District Judge

I. INTRODUCTION

***1** Before the court is Defendant Jeffrey P. Pomerantz's motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(3) for improper venue and Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim. (Mot. (Dkt. # 9).) In the alternative, Mr. Pomerantz moves to transfer venue to the United States District Court for the District of Columbia pursuant to 28 U.S.C. § 1404(a). (*Id.*) Plaintiff United States of America ("the Government") opposes Mr. Pomerantz's motion. (Resp. (Dkt. # 11).) Mr. Pomerantz also provides a declaration, which the court considers when addressing the issues relating to venue. (Pomerantz Decl. (Dkt. # 13-1).) The court has considered the parties' submissions, the relevant portions of the record, and the applicable law. Considering itself fully advised, [1] the court DENIES the motion to transfer and GRANTS the motion to dismiss for failure to state a claim with leave to amend.

II. BACKGROUND

On May 13, 2016, the Government filed this suit to reduce to judgment civil penalties assessed against Mr. Pomerantz for his alleged failure to disclose foreign bank accounts in his 2007 through 2009 annual taxes. (Compl. (Dkt. # 1) at 2.) When the Government filed its complaint, the alleged civil penalties and interest totaled $860,300.35. (*Id.*) Mr. Pomerantz is a dual citizen of the United States and Canada who resides in Canada (*id.*), and he was allegedly required to file certain tax forms because of his interests in foreign bank accounts (*id.* ¶¶ 22, 36, 44). Mr. Pomerantz, who is proceeding *pro se*, moves to dismiss this case for improper venue under Federal Rule of Civil Procedure 12(b)(3) and for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6). [2] (*See* Mot.) Alternatively, Mr. Pomerantz seeks to transfer this action to the District of Columbia. (*Id.*)

III. ANALYSIS

A. Venue

Mr. Pomerantz moves to dismiss this case for improper venue pursuant to Federal Rule of Civil Procedure 12(b)(3). (*Id.* at 1.) Dismissal for improper venue is only proper when venue is "wrong" or "improper." Fed. R. Civ. P. 12(b)(3); *Atl. Marine Constr. Co. v. U.S. Dist. Court*, ––– U.S. ––––, 134 S. Ct. 568, 577 (2013). The federal venue statute provides that "[a] defendant not resident in the United States may be sued in any judicial district." 28 U.S.C. § 1391(c)(3); *see also Brunette Mach. Works, Ltd. v. Kockum Indus., Inc.*, 406 U.S. 706, 714 (1972) (affirming that the provision in Section 1391 governing venue over a foreign defendant "is properly regarded not as a venue restriction at all, but rather as a declaration of the long-established rule that suits against aliens are wholly outside the operation of all the federal venue laws, general and special"). Mr. Pomerantz concedes that he is not a resident of the United States. (Pomerantz Decl. ¶ 1.) Therefore, venue is proper in any judicial district, including the Western District of Washington, and the court denies the motion to dismiss for improper venue.

***2** In the alternative, Mr. Pomerantz moves to transfer venue to the United States District Court for the District of Columbia under 28 U.S.C. § 1404(a), chiefly because his counsel of choice is admitted to practice before that court. (*See* Mot. at 8.) Section 1404 grants judges discretion to transfer a case to another district, even though venue is proper in the current forum. *See Jones v. GNC*

Franchising, Inc., 211 F.3d 495, 498 (9th Cir. 2000). The purposes of Section 1404(a) are to prevent wasted "time, energy, and money and to protect litigants, witnesses, and the public against unnecessary inconvenience and expense." *Van Dusen v. Barrack*, 376 U.S. 612, 616 (1964).

1. Legal Standard

The court must "adjudicate motions for transfer [of venue] according to an individualized, case-by-case consideration of convenience and fairness." *Jones*, 211 F.3d at 498. As the movant, Mr. Pomerantz bears the burden of showing transfer is appropriate. *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 255-56 (1981). In determining whether to transfer venue pursuant to Section 1404(a), the Ninth Circuit articulated several factors that the court should consider: "(1) the location where the relevant agreements were negotiated and executed, (2) the district that is most familiar with the governing law, (3) the plaintiff's choice of forum, (4) the respective parties' contacts with the forum, (5) the contacts relating to the plaintiff's cause of action in the chosen forum, (6) the differences in the costs of litigation in the two forums, (7) the availability of compulsory process to compel attendance of unwilling non-party witnesses, and (8) the ease of access to sources of proof." *Jones*, 211 F.3d at 498-99.

2. Factors Related to Location

The first factor—the location where the underlying agreement was negotiated or concluded—is neutral because there are no agreements between the parties. (*See generally* Compl.) The second factor—the district most familiar with the governing law—is also neutral. Neither party argues that federal courts in Washington or the District of Columbia have superior familiarity with the federal law, and federal district courts are presumed to be equally capable of applying federal law. *See Cargill Inc. v. Prudential Ins. Co. of Am.*, 920 F. Supp. 144, 148 (D. Colo. 1996).

The fifth factor—the contacts between the Government's claims and the chosen forum—is also neutral. *See Jones*, 211 F.3d at 498. The acts or omissions that allegedly give rise to the claim took place when Mr. Pomerantz failed to file the contested tax forms from his residence in Canada. (Resp. at 7.) Neither party asserts any relationship between the cause of action and the Western District of Washington or the District of Columbia. (*See generally* Mot.; Resp.)

3. Factors Related to the Parties

The third factor—the plaintiff's choice of forum—favors denying the motion to transfer. As the plaintiff in this action, the Government's choice of forum generally receives deference under Section 1404(a). *Decker Coal Co. v. Commonwealth Edison Co.*, 805 F.2d 834, 843 (9th Cir. 1986). The court balances this deference against the extent of the plaintiff's and defendant's contacts with the forum, "including those relating to his cause of action." *See Pac. Car & Foundry Co. v. Pence*, 403 F.2d 949, 954 (9th Cir. 1968.) "If the operative facts have not occurred within the forum of original selection and that forum has no particular interest in the parties or the subject matter, the plaintiff's choice is only entitled to minimal consideration." *Id.* None of the operative facts occurred in the Western District of Washington, and this forum does not have any particular interest in the parties or the subject matter. (*See generally* Compl.) Neither the assessment of the FBAR penalties nor the hearings related to it occurred in Washington. (*See id.*; Resp. at 7.) Thus, this factor weighs only slightly against transfer of venue.

***3** Likewise, the fourth factor—the parties' contacts with the forum—supports denying the motion to transfer. The Government asserts that Mr. Pomerantz has had frequent contact with the Western District of Washington (*see* Resp. at 7), whereas Mr. Pomerantz contends that he does not "regularly or frequently cross into th[at] district," only for short visits "every 2-3 months" (Pomerantz Decl. ¶ 9). Mr. Pomerantz does not identify any personal contacts with the District of Columbia, but he notes that his counsel of choice is a member of the District of Columbia bar. (Mot. at 4; *see also* Pomerantz Decl. ¶ 10 (stating that Mr. Pomerantz "cannot afford counsel and ha[s] no access to counsel licensed to practice before this court").) On balance, the court concludes that this factor weighs against transfer because the relevant contacts under *Jones* are the contacts between the parties, the witnesses, and the potential fora, not the parties' representatives. *See* 28 U.S.C. § 1404 (listing interests to be considered as those of "parties and witnesses").

4. Factors Related to Litigation

The sixth factor—differences in litigation costs—is also neutral. Mr. Pomerantz declares that he "cannot afford counsel" and has "no access to counsel licensed to practice in the Western District of Washington." (Pomerantz Decl.

¶ 10.) Mr. Pomerantz further asserts that he "has no connection with anyone in Washington [S]tate to act as his counsel and doesn't feel that anyone there would be more qualified than his choice of representative." (Mot. at 4.)

The conveniences to be considered when determining whether transfer is warranted are those of the "parties and witnesses." 28 U.S.C. § 1404. Generally, convenience of counsel may not be considered as part of the Section 1404(a) analysis. *See, e.g.*, *In re Volkswagen AG*, 371 F.3d 201, 206 (5th Cir. 2004) (holding that the district court's "consideration of location of counsel as a factor to be considered in determining the propriety of a motion to transfer venue was an abuse of discretion").

A minority of courts have considered convenience of counsel a proper consideration when deciding whether to transfer a case, as a derivative of the parties' interests in litigation costs. *See Mobil Oil Corp. v. W. R. Grace & Co.*, 334 F. Supp. 117, 124 n.5 (S.D. Tex. 1971) ("The cost of counsel's transportation and time in route must be borne by the parties. Therefore this factor directly bears upon the convenience of the parties and costs of litigation"). However, Mr. Pomerantz does not assert that his chosen counsel will incur additional costs if this case remains in the Western District of Washington. (*See generally* Mot.) Mr. Pomerantz instead argues that his chosen counsel cannot practice in this court at all because his preferred counsel is not admitted to practice in this court and cannot be admitted *pro hac vice* because "he has no connection with anyone who may be willing to act as local counsel." (*See id.* at 4.) The court finds this argument unpersuasive.

Before the District Court for the District of Hawaii, a plaintiff asserted that his counsel of choice resided in Hawaii, and if the court granted the defendant's motion to transfer, the plaintiff would likely be unable "to find another attorney to represent [him] in New York." *Berry v. Deutsche Bank Tr. Co. Americas*, No. 07-00172 SOM/LEK, 2007 WL 2363366, at *8 (D. Haw. Aug. 13, 2007). The court gave this argument no weight, reaffirming that "courts have not considered the location of the parties' counsel as a factor for transfer." *Id.* (citing *Kawamoto v. CB Richard Ellis, Inc.*, 225 F. Supp. 2d 1209, 1215-16 (D. Haw. 2002)); *see also* 15 Wright & Miller, Federal Practice & Procedure § 3850 (4th ed. 2017) (stating the general rule that the location of counsel is not a factor to considered on a motion to transfer venue). Thus, this court does not consider the location of Mr. Pomerantz's counsel as a factor for transfer. As neither party has alleged any other basis for increased litigation costs in either forum, the sixth factor is neutral.

***4** The seventh and eighth factors—the ease of access to sources of proof and witnesses—are also neutral. Mr. Pomerantz identifies no witnesses or evidence that are more easily accessed from the District of Columbia than from the Western District of Washington. (*See generally* Mot.)

5. Weighing the Factors

The only non-neutral factors are the plaintiff's choice of forum and the parties' contact with the forum, and each weighs against transferring venue. *See supra* §§ III.A.2-4. Accordingly, the court denies Mr. Pomerantz's motion to transfer.

B. Failure to State a Claim

In his motion to dismiss, Mr. Pomerantz asserts that the Government fails to plead sufficient facts to support the reasonable inference that he "willfully" failed to file a required report regarding foreign bank accounts in 2007, 2008, and 2009. [3] (Mot. at 8.) The Government responds by identifying allegations that it contends suggest Mr. Pomerantz was either willfully ignorant of the reporting requirement or had actual knowledge of the reporting requirement and his duty to comply with it. (Resp. at 4.)

1. Legal Standard

When considering a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the court construes the complaint in the light most favorable to the nonmoving party. *Livid Holdings, Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005). The court must accept all well-pleaded facts as true and draw all reasonable inferences in favor of the plaintiff. *Wyler Summit P'ship v. Turner Broad. Sys., Inc.*, 135 F.3d 658, 661 (9th Cir. 1998). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). A court may dismiss a complaint as a matter of law if it lacks a cognizable legal theory or states insufficient facts under a cognizable legal theory. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990); *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 534 (9th Cir. 1984).

The court need not accept as true a legal conclusion presented as a factual allegation. *Iqbal*, 556 U.S. at 678. Although Rule 8 does not require "detailed factual allegations," it demands more than "an unadorned, the-defendant-unlawfully-harmed-me accusation." *Id.* (citing *Twombly*, 550 U.S. at 555). A pleading that offers only "labels and conclusions or a formulaic recitation of the elements of a cause of action" will not survive a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6). *Id.*

2. The Government's Claim

The Government seeks to reduce to an enforceable judgment a civil penalty assessed against Mr. Pomerantz by a delegate of the Secretary of the Treasury. (Compl. at 1); 31 U.S.C. § 5321(a)(5). Section 5321(a)(5) permits the Secretary of Treasury to "commence a civil action to recover a civil penalty," but it does not indicate the elements of such an action. *See United States v. McBride*, 908 F. Supp. 2d 1186, 1201 (D. Utah 2012). Courts have concluded the validity of the underlying civil penalty is one element of an action to reduce a penalty to judgment. *See United States v. Williams*, No. 1:09-CV-437, 2010 WL 3473311, at *1 (E.D. Va. Sept. 1, 2010), *rev'd on other grounds*, 489 Fed.Appx. 655 (4th Cir. 2012). In *United States v. Williams*, the District Court for the Eastern District of Virginia concluded that a court should review the assessment of the underlying penalty *de novo*, and the amount of the penalty under an arbitrary and capricious standard. *Id.*; *accord McBride*, 908 F. Supp. 2d at 1201 (applying a *de novo* standard to whether the underlying penalty was a valid debt); *Moore v. United States*, No. C13-2063RAJ, 2015 WL 1510007, at *7 (W.D. Wash. Apr. 1, 2015) (same). Thus, in order to state a claim to reduce a civil penalty to a judgment, the Government must allege sufficient facts to support a reasonable inference that (1) the government assessed a civil penalty, and (2) the penalty was valid. To adequately allege that the penalty was valid, the Government must allege facts supporting each element of the underlying penalty. *See United States v. Toth*, No. 15-CV-13367-ADB, 2017 WL 1703936, at *4 (D. Mass. May 2, 2017) (using the elements of C.F.R. § 1010.350 as elements of an action to reduce to judgment a civil FBAR penalty in ruling on a motion to dismiss).

***5** The civil penalties that the Government seeks to reduce to a judgment result from Mr. Pomerantz's alleged failure to file Treasury Form TD F 90-22.1 (an "FBAR Form"), which reports foreign bank and financial accounts. (Compl. at 1.) A duty to file an FBAR form arises if: (1) a "U.S. Person";[4] (2) has a direct financial interest in, an indirect financial interest in, signatory authority over, or some other type of authority over one or more financial accounts located in a foreign country; and (3) the aggregate value of such account or accounts was greater than $10,000.00 at any time during the calendar year at issue. 31 U.S.C. § 5314; *see also* 31 C.F.R. § 1010.350. Additionally, because the Government assessed a penalty greater than $10,000.00 for each alleged failure to file (Compl. ¶¶ 24, 46, 48), Mr. Pomerantz's failure to file must have been willful, 31 U.S.C. § 5321. Thus, in order to state a claim the Government must plead facts supporting the reasonable inferences that (1) Mr. Pomerantz was a "U.S. Person," who (2) had an interest in or authority over the subject foreign accounts, which (3) had an aggregate value of $10,000.00 or more, and (4) that he willfully failed to file an FBAR Form for the accounts. Mr. Pomerantz contends that the Government fails to adequately allege his "interest in or authority" over foreign accounts and willful failure to file.[5]

a. Interest or Authority over Foreign Financial Accounts

The "interest or authority" element may be met by showing that the taxpayer: (1) had a direct financial interest in a foreign account, (2) had an indirect financial interest in a foreign account, or (3) served as a signatory or had other authority over a foreign account. 31 C.F.R. § 1010.350(b). The Government alleges two sets of foreign accounts provide the basis for the penalties assessed: (1) Mr. Pomerantz's personal accounts located in Canada (the "CIBC Accounts"), and (2) Mr. Pomerantz's accounts in Switzerland (the "Grand Turk Oppenheim Accounts," the "2003 Oppenheim Portfolio Accounts," and the "2007 Oppenheim Portfolio Accounts" (collectively, the "Chafford Limited Accounts")).[6] (Compl. ¶¶ 5-13.)

The Government alleges that the CIBC Accounts are located in Canada and that Mr. Pomerantz had a direct financial interest in them. (*Id.* ¶ 5.) The Government further alleges that Mr. Pomerantz formed a corporation named Chafford Limited, in whose name the Chafford Limited Accounts were opened, and that Mr. Pomerantz "retained full powers to exercise any and all rights to act on behalf of" Chafford Limited. (*Id.* ¶ 6.) These allegations plausibly support the inferences that Mr. Pomerantz had a "financial interest" in the CIBC Accounts and an "other financial interest" in the Chafford Limited Accounts, and that both sets of accounts were foreign. *See* 31 C.F.R. § 1010.31(e)(ii)(2).

b. Willful Failure to File

Because the civil penalties exceed the statutory limit for a non-willful failure to file an FBAR Form, the Government must allege facts supporting the inference that Mr. Pomerantz acted "willfully" in his failure to file. *See* 31 U.S.C. § 5321(a)(5)(c). Generally, a "willful" failure for purposes of the Bank Secrecy Act is "an intentional violation of a known legal duty to report." *Ratzlaf v. United States*, 510 U.S. 135, 154 n.5 (1994); *see also United States v. Zwerner,* No. 13-22082-CIV, 2014 WL 11878430, at *3, n.3 (S.D. Fla. Apr. 29, 2014) (adopting the *Ratzlaf* definition for civil FBAR penalties); *accord* IRS CCA 200603026, 2006 WL 148700 at *1-2 (Jan. 20, 2006) (An IRS chief counsel advisory opinion addressing in part the definition of "willful" FBAR reporting violations.).

***6** The Government alleges that Mr. Pomerantz's failure to timely file FBAR Forms "was willful within the meaning of 31 U.S.C. § 5321(a)(5)," implying that Mr. Pomerantz had either constructive or actual knowledge of the reporting duty. (*Id.* ¶¶ 23, 37, 45.) However, these allegations are precisely the "threadbare recitals of the elements of a cause of action, supported by mere conclusory statements" that are insufficient to state a claim. *Iqbal*, 556 U.S. 662, 678, (2009) (citing*Twombly*, 550 U.S. at 555). They do not plausibly support the inference that Mr. Pomerantz knew of the reporting duty. Instead, the Government must allege sufficient facts to plausibly support the inference that Mr. Pomerantz knew—actually or constructively—of the reporting requirement. *United States v. Williams*, 489 Fed.Appx. 655, 659 (4th Cir. 2012).

i. Actual Knowledge

Actual knowledge of the duty to report may be inferred from a course of conduct that demonstrates a conscious attempt to conceal the failure to report. *See United States v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1991) (citing *Spies v. United States*, 317 U.S. 492, 499 (1943)). The Government alleges that the company Mr. Pomerantz used to open the Swiss accounts—Chafford Limited —"conducted no active business, but was a shell entity used to hold and manage [Mr.] Pomerantz' personal investments." (Compl. ¶¶ 6-7.)

Similar allegations, combined with the taxpayer's failure to pursue knowledge of further reporting requirements, sufficiently supported a finding of "willfulness" in *Sturman. See* 951 F.2d at 1476-77. The court can plausibly infer an intent to evade the foreign bank account reporting requirement based on the creation of foreign bank accounts in the name of a shell company. *See id.* Thus, with regard to the Chafford Limited Accounts, the Government has adequately pleaded facts supporting the inference that Mr. Pomerantz knew of his duty to report.

However, Mr. Pomerantz opened the CIBC Accounts in his own name. (Compl. ¶ 5.) The accounts were opened prior to January 1, 2001, well before the allegedly "duplicitous" actions occurred. (*Id.*) The Government makes no allegations that Mr. Pomerantz took steps to conceal or mislead sources of income by opening the CIBC Accounts, and since the accounts were created well before the allegedly "duplicitous" actions occurred, the court cannot infer a confiscatory intent with regard to the CIBC Accounts. (*See id.*) The court declines to infer from Mr. Pomerantz's creation of the Chafford Limited Accounts knowledge of the duty to file FBAR Forms for the CIBC Accounts. The Government has not provided the court with any authority in which a court inferred from obfuscating conduct with no connection to a particular account an intent to evade a reporting obligation for that account, and the court finds such an inference implausible. (*See generally* Resp.) Thus, with regard to the CIBC Accounts, the Government makes only speculative and conclusory allegations regarding Mr. Pomerantz's actual knowledge.

ii. Constructive Knowledge

Knowledge of the duty to report may be actual or constructive. *Williams*, 489 Fed.Appx. at 659. Taxpayers who are willfully ignorant of the reporting requirement are treated as if they knew of the requirement, under the theory of constructive knowledge. *Id.* The Government alleges that Mr. Pomerantz "failed to report income deposited into, and/or received from, the foreign accounts." (Compl. ¶¶ 22, 36, 44.) The Government argues that the court can reasonably infer from this allegation that Mr. Pomerantz was willfully ignorant of the FBAR reporting obligation. (Resp. at 4.)

However, the cases the Government cites in support of this argument have found "willful ignorance" of the FBAR reporting duty because the government showed that the taxpayer was on inquiry notice of the duty due to specific language on a Schedule B tax form, which directs filers to the FBAR filing instructions and requirements. *See Williams*, 2010 WL 3473311, at *4 (imputing knowledge of the FBAR reporting requirement to a taxpayer who completed a Schedule B form); *McBride*, 908 F. Supp. 2d at 1197-98 (same); *Sturman*, 951 F.2d at 1476 (imputing knowledge of the FBAR reporting requirement to a taxpayer who was "aware of" the Schedule B form's contents).

***7** Here, in contrast, the Government does not allege that Mr. Pomerantz filled out a Schedule B Form or was otherwise aware of its contents and instructions regarding the FBAR reporting requirement. (*See generally* Compl.) Nor has the Government alleged any other basis to infer willful ignorance. (*Id.*) Accordingly, the court cannot reasonably infer that Mr. Pomerantz was willfully ignorant of the FBAR duty to report.

Based on the foregoing analysis, the court concludes that the Government fails to sufficiently plead that any failure of the duty to report with regard to the CIBC Accounts was willful. The court cannot disaggregate the amount of the penalty that resulted from the failure to report the CIBC accounts from the failure to report the Chafford Limited Accounts. Because the CIBC Accounts were part of the basis for levying each of the penalties that the Government seeks to reduce to judgment, the court accordingly dismisses the entire complaint as to all three penalties. (Compl. ¶¶ 24, 46, 48.)

C. Leave to Amend

As a general rule, when a court grants a motion to dismiss, the court should dismiss the complaint with leave to amend. *See Eminence Capital, LLC v. Aspeon, Inc.*, 316 F.3d 1048, 1051-52 (9th Cir. 2003) (citing Fed. R. Civ. P. 15(a)). The policy favoring amendment is to be applied with "extreme liberality." *Id.* at 1051. In determining whether dismissal with leave to amend is appropriate, courts consider such factors as undue delay, bad faith or dilatory motive, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowing the amendment, and futility of amendment.*Foman v. Davis*, 371 U.S. 178, 182 (1962).

Mr. Pomerantz does not argue that any prejudice, undue delay, bad faith, or dilatory motive should preclude leave to amend, and the court discerns no such circumstances. (*See generally* Mot; Reply (Dkt. # 13).) The court also concludes that amendment would not be futile at this stage of the proceedings. The court therefore grants the Government leave to amend its complaint within 21 days of the entry of this order. If the Government fails to file an amended complaint by that deadline, the court will dismiss the complaint with prejudice.

IV. CONCLUSION

The court DENIES Mr. Pomerantz's motion to transfer but GRANTS his motion to dismiss for failure to state a claim (Dkt. # 9) and GRANTS the Government leave to amend its complaint. The Government's amended complaint, if any, must be filed and served no later than twenty-one (21) days from the entry of this order.

All Citations

Slip Copy, 2017 WL 2483213, 119 A.F.T.R.2d 2017-2113

Footnotes

[1] Neither party has requested oral argument, and the court deems it unnecessary to the disposition of this motion. *See* Local Rules W.D. Wash. LCR 7(b)(4).

[2] Mr. Pomerantz phrases his argument regarding venue in a way that suggests he may attempt to challenge the court's personal jurisdiction over him. (*See* Mot. at 5.) However, he has waived that defense by failing to affirmatively raise it. *See* Fed. R. Civ. P. 12(h)(1)(A); *see also Am. Ass'n of Naturopathic Physicians v. Hayhurst*, 227 F.3d 1104, 1007 (9th

Cir. 2000) (holding that a *pro se* defendant waived the defense of lack of personal jurisdiction by omitting it from a Rule 12 motion to dismiss for insufficient process).

3 Mr. Pomerantz provides a declaration supporting his motion to dismiss. (*See generally* Pomerantz Decl.) If, in a motion to dismiss for failure to state a claim, a court is presented with matters outside the pleadings and does not exclude them, the court must treat the motion as one for summary judgment. Fed. R. Civ. P. 12(d). The court therefore excludes Mr. Pomerantz's declaration from its consideration of the motion to dismiss for failure to state a claim and does not convert the motion to one for summary judgment.

4 “U.S. Person” is a term of art that includes U.S. citizens. *See* 31 C.F.R. § 1010.350. Mr. Pomerantz does not contest that he was a “U.S. Person” during the relevant time and declares that he is a U.S. citizen. (*See* Mot.; Pomerantz Decl. ¶ 1.)

5 Mr. Pomerantz does not contest the Government's allegation that the aggregate amount was greater than $10,000.00. (*See generally* Mot.)

6 The Government also alleges facts regarding “Tofino Accounts.” (*See* Compl. ¶¶ 24, 46, 48.) However, because the Government does not allege that any of the 2007, 2008, and 2009 penalties were based on the Tofino Accounts, the court does not address the Tofino Accounts herein. (*See generally id.*)

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United States District Court,
W.D. Tennessee,
Eastern Division.

David W. NANCE and Priscilla
Lynn Nance, Plaintiffs,
v.
UNITED STATES of America, Defendant.

No. 12–1064.
|
April 11, 2013.

Attorneys and Law Firms

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Christopher James Williamson, U.S. Department of Justice, Washington, DC, for Defendant.

ORDER DENYING DEFENDANT'S MOTION TO DISMISS AMENDED COMPLAINT

J. DANIEL BREEN, District Judge.

INTRODUCTION

***1** This matter was initially brought by the Plaintiffs, David W. Nance and Priscilla Lynn Nance (the “Nances”), on March 9, 2012 against the United States of America (sometimes referred to herein as the “Government”). (D.E.1.) On August 29, 2012, they filed an amended complaint, seeking a refund of tax penalties. (D.E.20.) Before the Court is the Defendant's motion to dismiss the amended complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. (D.E.25.)

STANDARD OF REVIEW

The Rule permits a court to dismiss a complaint for “failure to state a claim upon which relief can be granted.” Fed.R.Civ.P. 12(b)(6). “When a court is presented with a Rule 12(b)(6) motion, it may consider the [c]omplaint and any exhibits attached thereto, public records, items appearing in the record of the case and exhibits attached to defendant's motion to dismiss so long as they are referred to in the [c]omplaint and are central to the claims contained therein.” *Bassett v. Nat'l Collegiate Athletic Ass'n,* 528 F.3d 426, 430 (6th Cir.2008). “[T]he district court must construe the complaint in the light most favorable to the plaintiff and must accept all the factual allegations contained in the complaint as true.” *Paige v. Coyner,* 614 F.3d 273, 277 (6th Cir.2010) (citing *Lambert v. Hartman,* 517 F.3d 433, 439 (6th Cir.2008)). “In order to survive a Rule 12(b)(6) motion to dismiss, [a plaintiff's] complaint need contain only ‘enough facts to state a claim to relief that is plausible on its face.’ “ *Id.* (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)).

FACTS ALLEGED

The Plaintiffs have alleged the following facts. The Nances reside in Milan, Tennessee and own and operate Nance Tool & Die, Inc ., a Tennessee corporation. Their attorney, Robert Bly, of Knoxville, Tennessee, who held himself out as an experienced tax adviser, informed the Plaintiffs that they could minimize income subject to federal taxation by forming offshore corporations domiciled in the Bahamas. To that end, he assisted them in forming Bahamian-domiciled Philco Investments, Ltd. (“Philco”), of which Mr. Nance was principal shareholder. Thereafter, Nance transferred funds from Nance Tool & Die's corporate account to Philco's bank account in Nassau. On Bly's advice, Plaintiffs also incorporated Luxum International, Ltd. in the Bahamas and a trust in Costa Rica. At the time, Bly assured the Plaintiffs their investments were proper.

In late 1999, however, counsel contacted the Nances to inform them that the offshore transactions may “no longer” be valid from a tax standpoint. Consequently, they ceased all their Bahamian and Costa Rican operations and deposits. Bly did not instruct Plaintiffs to remove funds from the offshore accounts, make reports to any agency, including the Internal Revenue Service (“IRS” or the “Service”), or take any other action.

On November 25, 2003, the IRS issued Letter 3679 to the Plaintiffs, advising that they were under examination by the agency in connection with their offshore financial arrangements. They were invited to participate in the

Voluntary Compliance Initiative, a program under which they could minimize their exposure to penalties by providing certain information to the Government. If they complied, a civil fraud penalty would only be imposed for the "major" year. For any other year, only a delinquency or accuracy-related penalty would be assessed. The letter further stated that "[a]dditionally, we will not impose information return civil penalties for failure to comply with [Internal Revenue Code ("IRC")] sections ... 6048 [which requires reporting with respect to foreign trusts], if you file delinquent or amended information returns." (D.E. 20–1 at 1.) The letter provided that

> ***2** civil penalties for violations involving Reports of Foreign Bank and Financial Accounts (FBAR) will be imposed for *only* one year and we may resolve the FBAR penalty for less than the statutory amount based on the facts and circumstances of your case. Except for the FBAR penalty in one year, to which you will be expected to agree, civil penalties will not be imposed for failure to file an FBAR, for filing a false FBAR, or failing to keep records you are required to keep, if you file delinquent or amended FBARs.

(*Id.*). Letter 3679 instructed that, in order to participate in the program, Plaintiffs had to advise the IRS within thirty days of the date of the letter of their intention to participate. All required materials were to be submitted within 150 days. The agency contact person was listed therein as Elysia A. Wilcox.

After consulting with an attorney [1] and their accountant, the Nances opted to participate in the initiative. On December 8, 2003, they provided a Form 2848 to their accountant, Tom Shelton, permitting him to discuss their tax issues with the IRS. The Nances submitted the same form to their current attorney, Frank Stockdale Carney, on March 18, 2004. The form included power to discuss issues related to their income taxes and civil penalties for tax years 1996 through 2003. By letter dated March 24, 2004, Carney advised Wilcox that he was working with the Plaintiffs on a response to her letter and enclosed a copy of the Form 2848. In a subsequent correspondence dated April 9, 2004, Carney informed Wilcox of the facts and circumstances of Plaintiffs' offshore transactions and sought to begin the process of filing the necessary documents to be in compliance with the initiative. In the early summer of 2004, Carney contacted Janet Cunningham, the revenue agent assigned to the Nances' case, stating:

> As you and I discussed, there may be some informational returns, such as reports in IRC section[ ] ... 6048, that should have been filed in the past in connection with the foreign bank accounts. At this time, the Nances no longer maintain any of the foreign bank accounts. You mentioned that in your review you would determine whether these informational returns are now moot and we do not need to file those, or whether you want us to file any of those applicable returns. As I confirmed, if you feel you need us to file the applicable informational returns, please let me know and we will prepare those returns.

(*Id.* at 33.) Plaintiffs worked diligently to determine whether information reported for years 1997 through 2000 was correct and voluntarily filed amended returns based on professional advice received in 2003 and 2004 and at the request of the IRS. As part of the Voluntary Compliance Initiative, the Nances worked with the Service to formulate a Closing Agreement. Carney met with Cunningham on July 2, 2004, during which they discussed the remaining and amended returns that would be required. Carney took notes at the meeting that reflected his clients would need to file a Form 3520–A for the years 1997 through 2004, and that 2004 would be the final return. In a November 4, 2004 letter to Cunningham, Carney submitted, among other things, a Form 3520–A for the years 1997 through 2003. He stated therein that the submission was "[i]n response to [her] request at [their] last conference for additional information and reporting returns ..." (*Id.* at 35.) Otherwise, the Nances would have been required, pursuant to the 2003 Form 3520–A's filing instructions, to mail the form to the IRS Center located in Philadelphia, Pennsylvania.

***3** On February 23, 2006, Plaintiffs executed a Closing Agreement with the IRS, pursuant to which they filed Forms 3520, 3520–A, 5472 and TDF 99–22.1 for the years 1999 through 2002. Under the terms of the Closing Agreement, Plaintiffs paid $1,245,396.52 in taxes due and $446,344.50 in penalties for 1999, along with interest. The Closing Agreement was signed by the Commissioner of Internal Revenue on April 12, 2006. The document provided in part that "[t]his agreement is final and conclusive except ... if it relates to a tax period ending after the date of this agreement, it is subject to any law, enacted after the agreement date, that applies to that tax period." (*Id.* at 9.)

On September 11, 2006, the Service issued Notice Number CP15 to the Plaintiffs, assessing an additional penalty in the amount of $156,478.00 for the 2003 tax year based on their failure to timely file the Form 3520–A due March 15, 2004. In subsequent notices, numbered CP503 and CP504, dated October 16, 2006 and November 20, 2006, respectively, the Nances were advised of interest added to the penalty, bringing the total balance to $158,897.00. Plaintiffs filed a Request for Penalty Waiver with the Taxpayer Advocate on June 1, 2007, citing reasonable cause for late filing of Form 3520–A. The request was denied on June 26, 2007.

On August 8, 2007, the Nances filed a Written Protest Appeal, requesting reconsideration of the determination based on reasonable cause. A conference was held with an appeals officer on March 11, 2008. The appeal was denied on October 20, 2009. A month later, the Plaintiffs filed a claim for credit for the period ending December 31, 2003, which the IRS disallowed on March 29, 2010.

The Plaintiffs submit that they are entitled to relief on the following grounds:

> (a) The penalty assessed against Plaintiffs by Defendant is improper because Plaintiffs filed Forms 3520, 3520–A, 5472 and TD 99–22.1 for tax years 1999–2002 after receiving notice regarding the Voluntary Compliance Initiative dated November 25, 2003; however, Plaintiffs received a late filing fee for 2003 Form 3520–A.
>
> (b) The 2003 Form 3520–A return was filed with the understanding that it was part and parcel of a Voluntary Compliance Initiative under which the Plaintiffs over a couple of years worked with an assigned Revenue Officer to determine what returns were required, to file such returns, and to pay back taxes associated with foreign bank accounts.
>
> (c) The Letter 3679 and the Voluntary Compliance Initiative had assured the Plaintiffs that a civil fraud penalty and a civil penalty for failing to file an FBAR would be assessed for only one year, and the Plaintiffs paid such penalties for 1999 as stated in the Closing Agreement. Letter 3679 further assured Plaintiffs that the offer contained therein pertained to years ending after December 31, 1998.
>
> (d) The Closing Agreement, executed by the Plaintiffs and the Commissioner, included the penalties assessed with respect to tax year ending December 31, 1999 and further stated that it was conclusive as to all tax periods except "if it relates to a tax period ending after the date of this agreement" and such Closing Agreement was last executed by the Commissioner on April 12, 2006.
>
> ***4** (e) Plaintiff's attorney, Mr. Carney, first contacted Ms. Elysia A. Wilcox by letter dated March 24, 2004, about the Plaintiffs' participation in the Voluntary Compliance Initiative, which was within the 150–day period permitted by Letter 3679.
>
> (f) Mr. Carney's and the Plaintiffs' understanding was that the Service would determine what, if any, information returns and amended returns were required and would notify Mr. Carney and the Plaintiffs, at which time the Plaintiffs would file such returns. In fact, Plaintiffs filed such returns upon the instruction of the Service's agent, including returns for 2003, in finalizing the Voluntary Compliance Initiative. All information returns, including the 2003 Form 3520–A, were mailed as one single packet to the agent to conclude the Voluntary Compliance Initiative.
>
> (g) Under the Plaintiffs' reasonable reliance on Letter 3679, the Closing Agreement, and the Voluntary Compliance Initiative, no assessment should ever have been made for 2003 because the Plaintiffs' understanding was that any penalties for late filing of all necessary information returns related to the Plaintiffs' offshore transactions were covered by such Letter 3679, the Closing Agreement, and the Voluntary Compliance Initiative.
>
> (h) Alternatively, the Plaintiffs should be granted the requested relief because they had reasonable cause for failing to timely file the 2003 Form 3520–A, which was not due to willful neglect.

(D.E. 20 at 13–15.)

ASSERTIONS OF THE PARTIES AND ANALYSIS

The Government first submits that the tax period ending December 31, 2003 and, by extension, the 2003 Form 3520–A, the late filing of which was the basis for the penalty at issue, was not, as Plaintiffs claim, part of any agreement between the Nances and the IRS. Under 26 U.S.C. § 7121, the Service "is authorized to enter into an agreement in writing with any person relating to the liability of such person ... in respect of any internal revenue tax for any taxable period." 26 U.S.C. § 7121(a). Closing agreements under the statute are "final and conclusive," except on a showing of "fraud or malfeasance, or misrepresentation of a material fact[.]" 26 U.S .C. § 7121(b). Accordingly, "closing agreements are binding on the parties as to the matters agreed upon and may not be modified or disregarded in any proceeding unless there is a showing of fraud, malfeasance, or misrepresentation of a material fact." *In re Spendthrift Farm, Inc.,* 931 F.2d 405, 407 (6th Cir.1991); *see also In re Crowell,* 258 B.R. 885, 888 (E.D.Tenn.2001) (same), *aff'd,* 305 F.3d 474 (6th Cir.2002).

Closing agreements under § 7121(a) "are contracts and generally are interpreted under ordinary contract principles." *Roach v. United States,* 106 F.3d 720, 723 (6th Cir.1997). "An ambiguous closing agreement will be interpreted in accord with the surrounding circumstances." *Id.* "[I]f the essential terms of an agreement are deemed unambiguous, a court will not look beyond the four corners of the document to determine the parties' intent." *Rink v. Comm'r of Internal Revenue,* 47 F.3d 168, 171 (6th Cir.1995).

***5** The Defendant points out that the Closing Agreement entered into by the Plaintiffs referred only to the tax years 1997 through December 31, 2002 and that, while the Nances could have requested inclusion of the 2003 tax year within the agreement's terms, they did not do so. Although they do not dispute that the Closing Agreement did not specifically mention 2003 returns, the Plaintiffs insist that, at a minimum, there is some ambiguity as to whether it applied only to years 1997 through 2002 or to all tax years other than those ending after the date of the agreement. Thus, they submit that the Court is permitted to consider parol evidence—in this case, the parties' conduct and Letter 3679—in construing the Closing Agreement.

Even if the Court agreed with the Government that the 2003 Form 3520–A filing did not fall within the ambit of the Closing Agreement, 26 U.S.C. § 6677, which provides for the imposition of penalties for failure to file information with respect to foreign trusts and under which the penalty here was assessed, states that "[n]o penalty shall be imposed ... on any failure which is shown to be due to reasonable cause or not due to willful neglect." 26 U.S.C. § 6677(d). "Reasonable cause" requires the taxpayer to demonstrate that he "exercised ordinary business care and prudence but nevertheless was unable to file the return within the prescribed time." *United States v. Boyle,* 469 U.S. 241, 246, 105 S.Ct. 687, 690, 83 L.Ed.2d 622 (1985) (internal quotation marks omitted). "Willful neglect" is defined in this context as "conscious, intentional failure or reckless indifference." *Id.* at 245, 105 S.Ct. at 690. The taxpayer is charged with the "heavy burden" of showing both reasonable cause and absence of willful neglect. [2] *Id.,* 105 S.Ct. at 689–90; *Shafmaster v. United States,* 707 F.3d 130, 137 (1st Cir.2013).

In attempting to meet their burden, the Nances argue that (1) Bly did not indicate to them that they needed to report any transactions to the IRS or take other action in connection with prior offshore transactions, advice upon which they relied, and that (2), upon receipt of Letter 3679 and knowledge of filing requirements relating to the offshore transactions, Plaintiffs immediately sought advice from their accountant and new attorney, who opened a dialogue with the IRS, which constituted the exercise of ordinary business care. The Government discounts the first of the proffered bases, contending that Plaintiffs could not have relied upon advice regarding when a 2003 tax form should have been filed when Bly ceased representing them in 1999. However, it is not clear from the record before the Court when Bly's representation ceased. Further, "[a]lthough relying on an expert for the ministerial task of filing a tax return does not constitute reasonable cause, relying on an expert's advice concerning substantive questions of tax law, such as whether a liability exists in the first instance, may constitute reasonable cause." *Estate of Liftin v. United States,* 101 Fed. Cl. 604, 608 (Fed.Cl.2011) (citing *Boyle,* 469 U.S. at 250, 105 S.Ct. 687) (internal quotation marks omitted); *see also McMahan v. Comm'r of Internal Revenue,* 114 F.3d 366, 369 (2d Cir.1997) ("reliance on a mistaken legal opinion of a competent tax adviser—a lawyer or accountant—that it was unnecessary to file a return constitutes reasonable cause"). The Nances may be able to prove facts demonstrating that they relied in good faith on Bly's failure to advise them of the need to file a Form 3520–A for tax year 2003 and that they did not otherwise know during the period of his representation that such a filing was required.

***6** When they received Letter 3679, Plaintiffs became aware of their obligation to make certain filings with the Service. As noted above, their subsequent counsel, Mr. Carney, met with revenue officer Cunningham in July 2004, four months after the Form 3520–A's March 2004 due date. According to the amended complaint, "Mr. Carney and Ms. Cunningham discussed the remaining returns and amended returns that would be required. Mr. Carney took notes from such meeting, noting that the Plaintiffs would need to file a Form 3520–A for the years 1997 through 2004 (stating that 2004 would be the final return)." (D.E. 20 ¶ 42.) Carney provided the form to Cunningham directly pursuant to her request in November 2004.

"Reasonable cause may exist when a taxpayer files a return after the due date, but does so in reliance on an expert's erroneous advice." *Estate of Liftin,* 101 Fed. Cl. at 608. Reliance on the erroneous advice of an IRS officer or employee may also constitute reasonable cause. *See McMahan,* 114 F.3d at 369; *Tesoriero v. Comm'r of Internal Revenue,* No. 18959–10, 2012 WL 3964976, at *4 (U.S. Tax Ct., Sept. 11, 2012). Viewing the facts alleged in the light most favorable to the Plaintiffs, the Court finds they have stated a plausible claim that their failure to timely file the 2003 Form 3520–A was due to reasonable cause, based on Mr. Carney's communications with Ms. Cunningham.

CONCLUSION

For the reasons set forth herein, the Defendant's motion to dismiss is DENIED.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2013 WL 1500987, 111 A.F.T.R.2d 2013-1616, 2013-1 USTC P 50,278

Footnotes

[1] The amended complaint does not indicate whether this individual was Bly, Frank Stockdale Carney, *see infra,* or someone else.

[2] The Government does not argue that the Nances' failure to file the form at issue was the result of willful neglect and nothing currently in the record raises an inference thereof. Thus, for purposes of the instant motion, the Court will assume Plaintiffs did not willfully neglect their tax liability and will focus on whether they have passed muster under Rule 12(b)(6) on the issue of reasonable cause.

End of Document

148 T.C. No. 21
United States Tax Court.

Ian D. SMITH, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 25605–15W
|
Filed June 7, 2017

Synopsis

Background: Petitioner brought whistleblower action, seeking to recover award after target corporate taxpayer paid income tax deficiency of over $14 million. Parties cross-moved for summary judgment.

Holdings: The Tax Court, Gerber, J., held that:

[1] in matter of first impression, term "amounts in dispute," as used in whistleblower provisions, included tax deficiencies, penalties, interest, additions to tax and additional amounts in dispute because of examinations commenced on account of whistleblower claim, and

[2] petitioner met statutory threshold "amount in dispute" required to recover whistleblower award.

Ordered accordingly.

Attorneys and Law Firms

Thomas C. Pliske and Shine Lin, for petitioner.

Richard L. Hatfield, for respondent.

P, a whistleblower, provided information to R. Using P's information, R commenced examinations of a taxpayer that led to the assessment and collection of almost $20 million. R determined that slightly less than $2 million of the collected proceeds was collected using the information P provided. R further determined that because less than $2 million was based on P's information, the $2 million threshold for application of the nondiscretionary award regime of I.R.C. sec. 7623(b) had not been met. Accordingly, R made a discretionary whistleblower award under I.R.C. sec. 7623(a). P argues that the "amounts in dispute" referenced in I.R.C. sec. 7623(b)(5)(B) is almost $20 million and that the threshold for use of the nondiscretionary award of I.R.C. sec. 7623(b) has been met.

OPINION

GERBER, Judge:

***1** This whistleblower award case, brought pursuant to section 7623(b)(4), [1] is before the Court on the parties' cross-motions for summary judgment. The seminal legal issue, one of first impression, concerns the interpretation of the phrase "amounts in dispute" in section 7623(b)(5)(B) for purposes of determining whether the $2 million threshold was met requiring payment of a whistleblower award under section 7623(b).

Background [2]

Petitioner filed a Form 211, Application for Award for Original Information, that respondent received on August 4, 2008. On the Form 211 petitioner alleged that a business was exchanging its products or services for gift certificates and that these barter transactions were not included as part of the business' income. Petitioner also contended that customers' gift certificates were given to the business' employees as compensation and that the value of the gift certificates was not treated as includible in the employees' income (i.e., not included on Forms W–2, Wage and Tax Statement). This information was based on petitioner's personal experience. In a September 4, 2008 letter, respondent acknowledged receipt of the Form 211, assigned a number to petitioner's application, and advised that the claim would be evaluated.

Using petitioner's whistleblower information, respondent, early in 2009, initiated both an employment tax and an income tax examination of the business entity that petitioner had identified. As a result of the employment tax examination, on January 4, 2012, the business agreed to employment tax liabilities for various taxable quarters from 2006 through 2009 in the aggregate amount of $3,094,188.12. On the same date the business also agreed to employment tax penalties for various quarters from 2006 through 2009 in the aggregate amount of $618,837.64. On January 23, 2012, respondent's employment tax revenue agent attributed $496,095, in the aggregate, of employment taxes that were assessed and collected from the subject business directly to the information provided by petitioner's whistleblower claim.

On July 17, 2013, respondent's income tax revenue agent's report proposed business income tax adjustments for “disallowed expenses of barter assets.” The income tax revenue agent noted that the subject business had reported all income from barter activity but that the adjustments resulted from failure to substantiate the barter-related expenses. The amounts of those income adjustments in the report that the income tax revenue agent attributed to the barter deductions for the 2007, 2008, 2009, and 2010 fiscal years were $1,153,327, $1,263,600, $1,130,468, and $1,004,102, respectively. Those adjustments involving the disallowance of barter-related expenses ultimately resulted in the assessment and collection of income tax in the aggregate amount of $1,593,024. The income tax revenue agent also noted that the above amounts were attributable to the information in petitioner's whistleblower claim because the barter accounts had been selected for scrutiny on account of the claim. The total income tax deficiency that was ultimately agreed to and paid by the subject business was $14,543,098, including the $1,593,024 referenced in the income tax revenue agent's report.

***2** Respondent's whistleblower analyst (analyst) in a memorandum to his program manager stated that his “review of the employment tax adjustments supports a determination that the whistleblower information substantially contributed to the actions taken on several general ledger accounts.” The analyst determined that collected proceeds subject to a whistleblower award for the employment taxes totaled $1,777,911.77. That amount exceeded the $595,314 that the employment tax examiner had determined to be attributable to the whistleblower claim. The analyst's more expansive approach included gift certificates and other items that were not specifically tied to the bartering but nonetheless generated employment tax liability as part of the completed audit process initiated by the whistleblower claim.

The analyst, however, stated that

> [his] review of the income tax adjustments and Example 2 in the regulations, leads * * * [him] to the conclusion that the whistleblower submission did not substantially contribute to the income tax adjustments. The only connection between the income tax adjustments and the whistleblower submission is the services choice of general ledger accounts to examine.

The reference to “Example 2” in the analyst's statement refers to Example 2 in section 301.7623–2(b), Proced. & Admin. Regs. He also relied on section 301.7623–2(e)(2), Proced. & Admin. Regs., which contains a definition of “amount in dispute”. In addition, the analyst stated: “The income tax adjustments were made based on a lack of substantiation or business purpose which is a different fact pattern than the one alleged by the whistleblower.” The analyst's conclusion was that the $1,593,024 of income tax collected from the business in connection with barter accounts was not attributable to petitioner's whistleblower claim.

Accordingly, the analyst determined that of the $3,853,345.45 of employment tax, penalty and interest, only a portion, $1,771,911.77, was directly attributable to the whistleblower, resulting in a determination of a discretionary 10% award of $177,191.18 under section 7623(a). The analyst used section 7623(a) because, in his view, the “amount in dispute” was less than the $2 million section 7623(b)(5)(B) threshold so that a mandatory 15% to 30% award under section 7623(b)(1) was not warranted. With respect to the remaining tax, penalties, and interest, $2,081,433.67, the analyst determined that they had no direct relationship to the whistleblower information and therefore resulted in a discretionary 1% award of $20,814.34 under section 7623(a). In the analyst's report in which he determined that the whistleblower's claim did not result in an income tax deficiency, it was also noted that the income tax examination of the subject business generated a $14,543,098 income tax deficiency, which the subject business ultimately agreed to and paid.

In an August 12, 2013, memorandum to his acting program manager, the analyst sought clarification on the determination of the amount to be attributed to the phrase “collected proceeds” and related matters because of the confluence of the employment and income tax deductions in the subject whistleblower's claim. The analyst explained that there was a direct relationship between the whistleblower's claim and the employment tax but not between the whistleblower's claim and the income tax. With respect to the income tax the whistleblower's claim was that the subject business had failed to report the barter transactions in income. The income tax examiner determined that the barter transactions were includible in income but disallowed certain deductions relating to the barter transactions for lack of substantiation, resulting in income tax deficiencies. The analyst questioned whether the income tax deficiencies associated with the bartering accounts of the subject business "are a part of collected proceeds, [and] can the award percentage be different for the employment tax and income tax adjustments?"

***3** On July 27, 2015, respondent issued a Preliminary Award Recommendation Under Section 7623(a) (recommendation). The recommendation followed the analyst's determination that petitioner's total whistleblower award was to be $198,005.52 ($177,191.18 plus $20,814.34). In an August 10, 2015, letter, petitioner's counsel responded to the recommendation disagreeing with the amount of the award. In particular, petitioner's counsel contended that the award percentage should have been between 15% and 30% because the amount in dispute exceed $2 million. Petitioner's counsel raised additional questions concerning interpretation of section 7623.

In a September 4, 2015, Final Decision Under Section 7623(a), respondent advised petitioner that, after considering his counsel's contentions, the amount of the whistleblower award would remain $183,551.11 ($198,005.51 less a 7.3% sequestration reduction) (excluding any award attributable to the income tax). In addition respondent advised that the award amount would be reduced by 7.3% in accord with the Budget Control Act of 2011, as amended by the American Tax Relief Act of 2012, requiring that automatic reductions take place as of March 1, 2013, including awards paid under section 7623.

Discussion

I. Summary Judgment

[1] **[2]** **[3]** Summary judgment is intended to expedite litigation and to avoid unnecessary and expensive trials. Shiosaki v. Commissioner, 61 T.C. 861, 862 (1974). Summary judgment may be granted where the pleadings and other materials show that there is no genuine dispute as to any material fact and that a decision may be rendered as a matter of law. Rule 121(b); Electronic Arts, Inc. v. Commissioner, 118 T.C. 226, 238 (2002). The burden is on the moving party to demonstrate that no genuine dispute as to any material fact remains and that he is entitled to judgment as a matter of law. FPL Grp., Inc. & Subs. v. Commissioner, 116 T.C. 73, 74–75 (2001). The parties filed cross-motions for summary judgment and have shown and stated that there is no genuine dispute as to any material fact.

II. Jurisdiction for Review of Whistleblower Cases

[4] Here we consider the standards for an award and the calculation of the monetary threshold for mandatory awards under section 7623(b). We may exercise our jurisdiction to the extent authorized by Congress. Kasper v. Commissioner, 137 T.C. 37, 40 (2011). In a whistleblower action, we have jurisdiction only with respect to the Commissioner's award determination or denial thereof. Sec. 7623; Cooper v. Commissioner, 135 T.C. 70, 75 (2010). In this case the parties are in agreement as to the information provided to respondent but disagree regarding the term "amounts in dispute" referenced in section 7623(b)(5). That section is the threshold for the mandatory award regime of section 7623(b) and therefore the calculation of the amount of the whistleblower award. Those matters are clearly within the scope of our jurisdiction authorized by Congress in section 7623(b)(4).

III. Statute and Underlying Controversies

Section 7623(a) authorizes the Secretary to pay whistleblower awards and to issue regulations with respect to the application of the enabling statute. The Secretary "is authorized to pay such sums as he deems necessary" from amounts collected in the detection of underpayments of tax. Accordingly, section 7623(a) provides the Secretary with complete discretion to pay sums, limited only to the amounts collected.

Section 7623(b)(1) and (2) specifically provides for less discretionary authority to make awards to whistleblowers and, in pertinent part, contains the following language:

SEC. 7623(b). Awards to Whistleblowers.—

> ***4** (1) In general.—If the Secretary proceeds with any administrative or judicial action described in subsection (a) based on information brought to the Secretary's attention by an individual, such individual shall, subject to paragraph (2), receive as an award at least 15 percent but not more than 30 percent of the collected proceeds. * * * The determination of the amount of such award by the Whistleblower Office shall depend upon the extent to which the individual substantially contributed to such action.
>
> (2) Award in case of less substantial contribution.—
>
>> (A) In general.—In the event * * * the Whistleblower Office determines [the claim] to be based principally on disclosures of specific allegations (other than information provided by the individual described in paragraph (1)) * * * the Whistleblower Office may award such sums as it considers appropriate, but in no case more than 10 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions) or from any settlement in response to such action, taking into account the significance of the individual's information and the role of such individual * * * in contributing to such action.
>>
>> [Emphasis added.]

In summary, section 7623(b)(1) provides that where respondent proceeds with an action using information supplied by an individual, the award shall be at least 15% but not more than 30% of the collected proceeds, depending on the extent to which the information substantially contributed to the collection. Section 7623(b)(2) addresses circumstances where there is a less substantial contribution on the part of a whistleblower and provides respondent, in such circumstances, with discretion to award an amount that does not exceed 10%.

Section 7623(b) is available for whistleblower awards only if the following section 7623(b)(5) thresholds are met:

> (5) Application of this subsection.—This subsection shall apply with respect to any action—
>
>> (A) against any taxpayer, but in the case of an individual, only if such individual's gross income exceeds $200,000 for any taxable year subject to such action, and
>>
>> (B) if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000. [Emphasis added.]

Respondent concluded that the “amounts in dispute” did not exceed $2 million and, accordingly, determined that a discretionary award under section 7623(a) was appropriate. Petitioner contends that respondent incorrectly applied the section 7623(b)(5)(B) threshold to limit the determination of the award to section 7623(a). The main thrust and seminal core of petitioner's argument focuses on the $2 million threshold in section 7623(b)(5)(B) and the phrase “amounts in dispute”. Specifically, petitioner contends, as a matter of first impression, that respondent has read into section 7623(b)(5)(B) a limitation with respect to the $2 million threshold by concluding that “amounts in dispute” include only the amounts of collected proceeds for which the whistleblower provided direct or indirect information.

Under petitioner's interpretation the “amounts in dispute” in this case total $19,989,467.44, which is the combined amount of the employment and income tax deficiencies and penalties in dispute between the taxpayer and respondent because of examinations commenced on account of petitioner's whistleblower claim. Accordingly, under petitioner's interpretation section 7623(b)(1) and (2), rather than section 7623(a), would be applicable and would have resulted in a larger award. Ostensibly, and using the collected amounts attributed by respondent to petitioner's direct information, if section 7623(b)(1) applied, petitioner's award would necessarily be at least 15% of $1,771,911.77, or $265,786.76, as opposed to the 10% amount, $177,191.18, determined by respondent's Whistleblower Office.

***5** Respondent argues that certain common words or phrases in section 7623(b)(1) require him to follow the same quantitative measure in determining the $2 million threshold of section 7623(b)(5)(B). In particular, respondent focuses on the words “any” and “action” in the context of section 7623(b)(1) as follows:

> If the Secretary proceeds with any administrative or judicial action described in subsection (a) based on information brought to

> the Secretary's attention by an individual, such individual shall, subject to paragraph (2), receive an award ... [t]he determination of the amount of such award by the Whistleblower Office shall depend upon the extent to which the individual substantially contributed to such action. [Emphasis added.]

Respondent goes on to contend that section 7623(b)(1) therefore defines the scope of the words "any action" for purposes of section 7623(b), and accordingly governs the use of the phrase "any action" in section 7623(b)(5). Respondent's reliance on the term "action" which appears in section 7623(b)(1), (2), and (5) as the link between those sections is misplaced.

The word "action" is used five times each in subsection (b)(1) and (2) and two times in subsection (b)(5). Subsection (a) is a historical remnant dating back to 1867, and subsection (b) was added by 2006 legislation. Subsection (a) does not contain the word "action", and it provides for a discretionary award for "detecting underpayments of tax, or detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws". Accordingly "action" for purposes of subsection (b) is the detecting of underpayments of tax or violations of tax law without any qualifier as to quantity or amount.

The word "action" is used in subsection (b)(1) and (2) in connection with prescribing percentage limits for awards only from collected proceeds resulting from the action, depending on whether the whistleblower brought information or specific allegations to respondent's attention. Further refinements involve the extent to which the individual substantially contributed to the "action".

Accordingly, the word "action" is being used in that context and does not establish another technical definition or meaning for purposes of section 7623(b) in general. The use of the word "action" in the introductory phrase to section 7623(b)(5), "[t]his subsection shall apply with respect to any action—(emphasis added), is in no manner linked to the concept of "collected proceeds" or substantial contribution. The word "action" is used in subsection (b)(5)(A) in the following context: "against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds $200,000 for any taxable year subject to such action" (emphasis added). Here again, the word "action" is used without specific limitations.

We are unable to accept respondent's contention that the subsection (b)(1) determination of the size or percentage of an award applies only to those portions that were directly or indirectly attributable to the whistleblower's information or that respondent's definition of "amounts in dispute" should be employed to determine whether the $2 million threshold of subsection (b)(5)(B) has been met. The application of respondent's position in this case would lead to anomalous results. Petitioner's whistleblower claim caused the initiation of an examination that resulted in the collection of almost $20 million of tax and penalties, almost $2 million of which was directly or indirectly attributable to petitioner's information. In spite of those results, under respondent's position the provisions of section 7623(b) would not be applicable in this case.

***6** **[5]** The current whistleblower statute was enacted in 2006 to "address perceived problems with the discretionary award regime." Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, div. A, sec. 406, 120 Stat. at 2958; Cooper v. Commissioner, 135 T.C. at 73. Section 7623(b) was enacted to encourage whistleblowers to provide information about the underpayment of tax and violation of tax laws. Lippolis v. Commissioner, 143 T.C. 393, 399 (2014); Cooper v. Commissioner, 135 T.C. at 73. Under the new provisions, a whistleblower generally is entitled to a minimum nondiscretionary award of 15% of the collected proceeds if the Commissioner proceeds with administrative or judicial action using information provided in a whistleblower claim. Cooper v. Commissioner, 135 T.C. at 73–74. The nondiscretionary minimum award is clearly part of the statutory regime to encourage whistleblowers.

In Lippolis, this Court considered whether the $2 million threshold of section 7623(b)(5)(B) is jurisdictional or whether it is to be asserted as an affirmative defense. Lippolis v. Commissioner, 143 T.C. at 396. In reaching the conclusion that it is not jurisdictional, this Court stated: "The phrase 'any action' refers to 'any administrative or judicial action' with which the Secretary 'proceeds' based on information provided by a whistleblower under section 7623." Id. at 395. In that case, the Commissioner assessed and collected $844,746 from the taxpayer and, under section 7623(a), awarded $126,712 (15% of the collected proceeds), and the whistleblower sought to have the award come under section 7623(b). Accordingly, the question arose of whether the section 7623(b)(5)(B) threshold of $2 million had been met. Although this Court in Lippolis specifically did not decide what constitutes the "amounts in dispute", it left for another day the question of whether the $844,746 respondent used to compute the award constituted the entire "amount(s) in dispute".

In Whistleblower 22716–13W v. Commissioner, 146 T.C. 84 (2016), this Court considered whether Foreign Bank and Financial Accounts (FBAR) civil penalties are "additional amounts" described in section 7623(b)(5)(B) to be considered in determining whether the $2 million threshold had been met. This Court held that FBAR civil penalties are not additional amounts that could be counted in determining whether the $2 million threshold has been met. Id. at 85. In that case, the Court did not consider or decide the question before us in petitioner's case, i.e., whether the amount in dispute should include only the amounts that would be subject to the section 7623(b)(1) or (2) award or should include the total amount in dispute between the Commissioner and the taxpayer. Id. at 92.

In Whistleblower 21276–13W v. Commissioner, 147 T.C. 121 (2016), this Court considered whether the term "collected proceeds" as used in section 7623(b)(1) should be construed, as contended by respondent here, as limited to having been collected pursuant to the Internal Revenue Code or whether it should be more broadly defined. In particular, we had to decide whether criminal fines and civil forfeitures are "collected proceeds" for purposes of subsection (b)(1). Id. at 123. In that case, the Commissioner took the limited view that although tax restitution of $20,000,001 constituted "collected proceeds", the remaining $54,131,693 of criminal fines and civil forfeitures did not. Id. In Whistleblower 21276–13W, this Court held that the whistleblower's more expansive view of "collected proceeds" was correct and that it included the $54,131,693 amount along with the $20,000,001, resulting in a $17,791,607 whistleblower award computed at the 24% rate that had been agreed to by the parties. Id. at 140.

***7** We again note that the Commissioner's discretionary authority to pay awards to "whistleblowers" dates back to legislation enacted in 1867. Act of Mar. 2, 1867, ch 169, sec. 7, 14 Stat. at 471, 473; Whistleblower 22716–13W v. Commissioner, 146 T.C. at 88. That discretionary authority became section 7623(a), and it was not subject to judicial review until 2006 when section 7623(b) was added. When Congress added the nondiscretionary award regime with minimum percentages for awards, it also set a monetary threshold that must be met before the mandatory provisions of subsection (b)(1) and (2) come into play. That monetary threshold was established to target large dollar cases.[3] It also appears that the 2006 mandatory award additions to section 7623 were intended to motivate whistleblowers to come forward so that additional collections of tax would occur.

[6] **[7]** In interpreting the term "amounts in dispute" as used in section 7623(b)(5)(B), we begin with the statute. Greyhound Corp. v. Mt. Hood Stages, Inc., 437 U.S. 322, 330 (1978). The phrase "amounts in dispute" is not used in any other context in section 7623, and the parties have not contended that the phrase is a term of art and/or that the phrase had been used in other sections of the Internal Revenue Code. Section 7623(b)(5)(B) is plain and has a clear meaning in the context of section 7623 and its intended congressional purpose. United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989) (citing Caminetti v. United States, 242 U.S. 470, 485 (1917)). Where the statute has been expressed in plain terms, that language should be given effect. Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 570 (1982) (citing Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980)).

The section 7623(b)(5)(B) phrase "amounts in dispute" is not specifically limited to only those amounts directly or indirectly attributable to the whistleblower information. Once the monetary thresholds are met and the Government recovers "collected proceeds" resulting from the action, the mandatory provisions of subsection (b)(1) or (2) apply. See Whistleblower 22716–13W v. Commissioner, 146 T.C. at 89. Conversely, "collected proceeds" as used in subsection (b)(1) is limited by "resulting from the action" whereas "amounts in dispute" as used in subsection (b)(5) is not.

Here section 7623(b)(5) has a clear meaning. Congress intended to limit the nondiscretionary award regime to larger cases. Explicitly, section 7623(b)(5)(A) and (B) "shall apply with respect to any action—against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds $200,000 for any taxable year subject to such action, and * * * if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." The first monetary threshold applies to individuals, and the second applies to all taxpayers. Subsection (b)(5) is intended to make the nondiscretionary award program of subsection (b)(1) and (2) applicable to larger cases. Those where the "amounts in dispute" between the taxpayer and the Commissioner exceed $2 million. Once that threshold is met, then subsection (b)(1) or (2) would apply and award percentages are to be made based on the standards of those subsections.

Section 7623(b)(5) is simply a monetary threshold for application of the less discretionary whistleblower award regime. The $200,000 of gross income threshold must be met where the taxpayer is an individual, and the $2 million amount in dispute must be met for any taxpayer. The factors of section 7623(b)(1) and (2) limiting the award to a particular portion of collected proceeds focuses upon the usefulness of the whistleblower's claim and should not be a refinement of the "amounts in dispute" as used in section 7623(b)(5). The facts of this case are illustrative of that distinction. Petitioner's whistleblower claim regarding the barter and gifts caused respondent to examine those items and related accounts of the taxpayer, resulting in almost $20 million in collected tax revenue. The next statutory step would be to determine what portion of those collected proceeds resulted from the whistleblower's information or claim.

***8** The regulation promulgated with respect to section 7623(b)(5) is section 301.7623–2(e), Proced. & Admin. Regs. Paragraph (e)(2)(i) of the regulation defines "amount in dispute" for purposes of section 7623(b)(5), as follows:

> [T]he term amount in dispute means the greater of the maximum total of tax, penalties, interest, additions to tax, and additional amounts that resulted from the action(s) with which the IRS proceeded based on the information provided, or the maximum total of such amounts that were stated in formal positions taken by the IRS in the action(s). * * *

Respondent's analyst relied on this regulation for determining that the $2 million threshold was not met in this case. The regulation does not support respondent's narrow view that the "amount in dispute" is limited to the portion to which award percentages are applied, as defined in section 7623(b)(1) and (2). The regulation provides instead that the amounts in dispute are the amounts that resulted from the actions with which IRS proceeded based on the whistleblower information. Accordingly, it does not follow that the limiting standards of section 7623(b)(1) and (2) providing for a percentage to be applied to the portion of "collected proceeds" to which the whistleblower's information "substantially contributed" would also apply in determining whether the initial $2 million threshold has been met. Conceptually, section 7623(b)(5) is a threshold to ensure that the less discretionary mandate of subsection (b)(1) is applied to taxpayers with a certain minimum amount of annual income or with a significant amount of tax liability. In effect, respondent has backed into the subsection (b)(1) and (2) limitations to interpret the subsection (b)(5) threshold.

[8] Respondent's analyst also relied on section 301.7623–2(b), Example (2), Proced. & Admin. Regs. That section addresses the concept "proceeds based on" which is an integral part of determining which percentages of section 7623(b)(1) and (2) are to be used to calculate the whistleblower award. All of the examples under section 301.7623–2(b), Proced. & Admin. Regs., are designed as guidance for determining whether whistleblower information was the source or the reason for respondent's pursuit or examination of a taxpayer. In Example 2 the Commissioner pursued a taxpayer using whistleblower information and then, by means of information requests and summonses developed additional information which the example concludes was not information that was proceeded on because of the whistleblower. That example, however was not intended to address the purely mathematical threshold of section 7623(b)(5). In the case before the Court, respondent proceeded using petitioner's information, and the examination resulted in nearly $20 million of tax in dispute, of which almost $2 million was directly or indirectly attributable to petitioner's information. Those circumstances satisfy the purely mathematical threshold of section 7623(b)(5). The next step would be to determine what portions of the proceeds collected were substantially or less substantially attributable to petitioner's information.

Accordingly, the "amount in dispute" for purposes of section 7623(b)(5)(B) in this case was in excess of

$2 million, and respondent's use of the discretionary provisions of section 7623(a) to determine the amount of the whistleblower award was in error.

***9** Petitioner also raised the following issues in his motion for summary judgment: (1) whether “collected proceeds” includes amounts which respondent would not have collected without petitioner's whistleblower claim; (2) whether respondent applied the correct award percentages; and (3) whether respondent has the legal authority to unilaterally reduce an award by sequestration. Because we have decided that respondent's use of section 7623(a) in this case was incorrect, petitioner's motion for summary judgment will be granted in part with respect to the section 7623(b)(5)(B) threshold question. Finally, our holding that respondent should have used section 7623(b) to compute the amount of the award renders petitioner's other concerns or arguments moot until an award has been determined under section 7623(b).

To reflect the foregoing,

An appropriate order will be issued.

All Citations

148 T.C. No. 21, 2017 WL 2472375, Tax Ct. Rep. (CCH) 60,923, Tax Ct. Rep. Dec. (RIA) 148.21

Footnotes

[1] All section references are to the Internal Revenue Code in effect at all relevant times. All Rule references are to the Tax Court Rules of Practice and Procedure.

[2] Respondent in his response to petitioner's motion for summary judgment stated: “In the present case, respondent and petitioner are generally in agreement as to the relevant facts * * * and the proper interpretation of * * * [the statute] presents a pure question of law.”

[3] See Ron West, John H. Skarbnik, & Frank L. Brunetti, “A Primer for Tax Whistleblowers”, Taxes—The Tax Magazine, at 27, 30 (April 2012).

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85 F.3d 906
United States Court of Appeals,
Second Circuit.

UNITED STATES of America, Appellee,
v.
Mark A. SIMON, Defendant–Appellant.

No. 1110, Docket 95–1514.
|
Argued Feb. 28, 1996.
|
Decided May 29, 1996.

Synopsis

Defendant was convicted of structuring financial transactions to avoid reporting requirement, in the United States District Court for the Eastern District of New York, Carol Bagley Amon, J. Appeal was taken. The Court of Appeals, Meskill, Circuit Judge, held that evidence supported determination that defendant intended "something more" than simply to avoid reporting requirement, as required to satisfy intent element of crime, when he made 14 deposits of almost $10,000 (amount requiring report to government by bank) in eight different branches of bank, located in three counties, over seven-day period.

Affirmed.

Winter, Circuit Judge, dissented and filed opinion.

Attorneys and Law Firms

***907** Stephen Robert LaCheen, Philadelphia, PA (Peter Goldberger, Ardmore, PA, of counsel), for Appellant.

Eric Corngold, Assistant United States Attorney (Zachary W. Carter, United States Attorney for the Eastern District of New York, Peter A. Norling, Assistant United States Attorney, Eastern District of New York, Brooklyn, NY, of counsel), for Appellee.

Before: VAN GRAAFEILAND, MESKILL and WINTER, Circuit Judges.

Opinion

MESKILL, Circuit Judge:

This is an appeal from a judgment of conviction by a jury entered August 18, 1995 in the United States District Court for the Eastern District of New York, Amon, *J.* The defendant, Mark Simon, was convicted of structuring cash transactions to evade currency reporting requirements in violation of 31 U.S.C. §§ 5322 and 5324(3).[1] On appeal, Simon contends that the evidence adduced at trial was insufficient to establish knowledge of illegality, as required by *Ratzlaf v. United States,* 510 U.S. 135, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994). Because we conclude that there was sufficient evidence for a jury to infer knowledge of illegality, we affirm the judgment of conviction.

BACKGROUND

Between July 18, 1989 and July 25, 1989, Simon, a licensed stockbroker, deposited more than $130,000 in cash into one account through 14 deposits at eight Citibank branches located throughout Brooklyn, Nassau County and Suffolk County, New York. More specifically, on Tuesday, July 18, 1989, he made two deposits of $9,730 and $9,620, respectively, at Plainview, Long Island and Melville, Long Island Citibank branches. On Wednesday, July 19, 1989, he made two deposits of $9,000 and $8,800, respectively, at Hicksville, Long Island and Garden City, Long Island Citibank branches. On Thursday, July 20, 1989, he made four deposits of $9,900, $9,900, $9,920 and $9,900, respectively, at 13th Avenue, Brooklyn, 18th Avenue, Brooklyn, Shore Parkway, Brooklyn and Plainview, Long Island Citibank branches. ***908** On Monday, July 24, 1989, he made four deposits of $9,900, $9,700, $9,600 and $9,920, respectively, at 13th Avenue, Brooklyn, 18th Avenue, Brooklyn, Shore Parkway, Brooklyn, and Plainview, Long Island Citibank branches. On Tuesday, July 25, 1989, he made two deposits of $9,920 and $5,400, respectively, at Avenue J, Brooklyn and Plainview, Long Island Citibank branches.

Internal Revenue Service Agent Anthony Curieri arrested Simon on March 3, 1992. At trial, Agent Curieri testified that, after Simon signed a waiver of his Fifth Amendment rights, he questioned Simon about the 1989 cash deposits. According to Curieri's testimony, the defendant admitted that "he structured these deposits to conceal the monies from the government and to avoid having, in his words, [the] special $10,000 form filled out." [2]

At trial, the defendant, who did not testify, conceded, through his counsel, that he structured the cash deposits, as described, with the purpose of avoiding the currency reporting requirements. He denied, however, any knowledge that his conduct was illegal. In other words, he conceded knowledge of bank reporting requirements, but denied any knowledge that it was illegal for him to structure transactions with the purpose of avoiding such requirements.

In her charge to the jury, the district judge made it clear that the jury could not convict the defendant unless the jury found beyond a reasonable doubt that the defendant knew that his conduct was illegal. More specifically, she charged the jury as follows:

> The first element of the offense that the government must prove beyond a reasonable doubt is that the defendant knew that Citibank had a duty to report currency transactions in excess of $10,000 and also knew that it was unlawful for the defendant to structure his currency transactions in order to avoid causing such a report to be filed. The act of structuring without knowledge that structuring is unlawful is not a crime.

Similarly, both the prosecution and the defense reminded the jury in summation that the only issue in dispute was whether the defendant knew that his conduct was illegal. The jury convicted.

DISCUSSION

I. *Standard of Review*

[1] **[2]** In reviewing sufficiency of the evidence claims, "we must view the evidence, whether direct or circumstantial, in the light most favorable to the government, crediting every inference that could have been drawn in its favor, ... and we must affirm the conviction so long as, from the inferences reasonably drawn, the jury might fairly have concluded guilt beyond a reasonable doubt." *United States v. Skowronski,* 968 F.2d 242, 247 (2d Cir.1992) (citations omitted). A defendant challenging the sufficiency of evidence bears "a very heavy burden." *United States v. Nusraty,* 867 F.2d 759, 762 (2d Cir.1989) (quoting *United States v. Young,* 745 F.2d 733, 762 (2d Cir.1984), *cert. denied,* 470 U.S. 1084, 105 S.Ct. 1842, 85 L.Ed.2d 142 (1985)). As we have explained before, if " '*any* rational trier of fact could have found the essential elements of the crime,' the conviction must stand." *United States v. Badalamenti,* 794 F.2d 821, 828 (2d Cir.1986) (quoting *Jackson v. Virginia,* 443 U.S. 307, 319, 99 S.Ct. 2781, 2789, 61 L.Ed.2d 560 (1979)).

II. *Sufficiency of the Evidence*

Federal law requires financial institutions to file reports with the Treasury Department of any cash transaction exceeding $10,000. 31 U.S.C. § 5313; 31 C.F.R. § 103.22(a) (1995). Federal law also makes it illegal to structure a transaction for the purpose of evading a financial institution's reporting requirement. 31 U.S.C. § 5324. A person who "willfully" violates the structuring prohibition is subject to criminal prosecution. 31 U.S.C. § 5322.

The Supreme Court recently held that conduct is not "willful" within the meaning of ***909** section 5322 unless the defendant knows that his own conduct is unlawful. *Ratzlaf,* 510 U.S. at ——, 114 S.Ct. at 657. The *Ratzlaf* Court reasoned that because section 5324 itself prohibited *purposeful* structuring and section 5322 authorized prosecution only for *willful* structuring, a prosecution under section 5322 required more than a purpose to circumvent the reporting obligation. *Id.* at ——, 114 S.Ct. at 658. More specifically, the Court reasoned that to avoid rendering the willfulness requirement of section 5322 mere surplusage, section 5322 must be interpreted to require proof that the defendant acted with knowledge that his structuring was unlawful. *Id.* at ——, 114 S.Ct. at 659. Because the district court in *Ratzlaf* had instructed the jury that the government did not have to prove that the defendant acted with knowledge that structuring was unlawful, the Court reversed and remanded for further proceedings consistent with its opinion. *Id.* at ——, 114 S.Ct. at 663. [3]

Thus, "*Ratzlaf* dealt with an abstract jury instruction in yes or no terms; and in its wake, courts and juries must try to answer more concrete questions," *United States v. Hurley,* 63 F.3d 1, 16 (1st Cir.1995), *cert. denied,* 517 U.S. 1105, 116 S.Ct. 1322, 134 L.Ed.2d 474 (1996), such as what type and quantum of proof is sufficient to support a reasonable inference of willfulness. In *Ratzlaf* itself, the dissenters opined that the majority's knowledge requirement would make structuring prosecutions "difficult or impossible." 510 U.S. at ——, 114 S.Ct. at 669 (Blackmun, *J.,* dissenting). The majority responded with the unremarkable suggestion that knowledge of illegality can be inferred from evidence of the defendant's conduct. *Id.* at —— n. 19, 114 S.Ct. at 663 n. 19.

Courts directly and indirectly addressing this issue in the wake of *Ratzlaf* have concluded that general consciousness of illegality, the method of structuring, and the status of the defendant can support a reasonable inference of knowledge of illegality. *See Hurley,* 63 F.3d at 16 (concluding that "the thrust of *Ratzlaf* 's wilfulness requirement is met if persons engaged in depositing broken down amounts are generally conscious that their laundering operation is illegal, even if they do not know the precise requirements of the law."); *United States v. Marder,* 48 F.3d 564, 574 (1st Cir.) (stating that the purchase of approximately $10,000 worth of money orders at "three separate banks suggests that [the] defendant had a purpose beyond evasion of the reporting requirement: concealment of his structuring," tending to prove knowledge of illegality), *cert. denied,* 514 U.S. 1056, 115 S.Ct. 1441, 131 L.Ed.2d 320 (1995); *United States v. Walker,* 25 F.3d 540, 548 n. 8 (7th Cir.) (finding that complex scheme to enlist family members to purchase money orders and cashier's checks in small denominations provided sufficient evidence of knowledge of illegality), *cert. denied,* 513 U.S. 953, 115 S.Ct. 371, 130 L.Ed.2d 323 and 513 U.S. 1009, 115 S.Ct. 531, 130 L.Ed.2d 434 (1994); *United States v. Retos,* 25 F.3d 1220, 1231 (3d Cir.1994) (reversing conviction on improper instruction, but finding that defendant's status provided a sufficient basis to infer knowledge of illegality). However, at least one circuit has criticized such decisions and required evidence of knowledge distinct from the evidence of structuring itself. *United States v. Wynn,* 61 F.3d 921, 928 (D.C.Cir.1995) (disagreeing with *Marder,* 48 F.3d at 574, and *Walker,* 25 F.3d at 548 n. 8). Yet, the *Wynn* Court apparently agreed that the status of the defendant can support an inference of knowledge of illegality. *Id.* (citing *Retos,* 25 F.3d at 1231, with approval).

We recognize that currency structuring is not so "obviously 'evil' or inherently 'bad' " that the act of structuring itself satisfies the willfulness requirement. *See Ratzlaf,* 510 U.S. at ——, 114 S.Ct. at 662. However, we ***910** also recognize that the *method of structuring* can provide circumstantial evidence of willfulness. As the majority noted in *Ratzlaf,* "[a] jury may, of course, find the requisite knowledge on defendant's part by drawing reasonable inferences from the evidence of *defendant's* conduct." *Id.* 655 n. 19, 114 S.Ct. at 663 n. 19 (emphasis added) (citations omitted). And as we have noted repeatedly, a jury may infer "the state of a man's mind from the things he says and does." *United States v. Sweig,* 441 F.2d 114, 117 (2d Cir.), *cert. denied,* 403 U.S. 932, 91 S.Ct. 2256, 29 L.Ed.2d 711 (1971); *see also United States v. Sheiner,* 410 F.2d 337, 340 (2d Cir.), *cert. denied,* 396 U.S. 825, 90 S.Ct. 68, 24 L.Ed.2d 76 (1969).

[3] In other words, when the method of structuring suggests a significant effort not only to avoid the bank reporting requirements but to *conceal* the currency structuring *itself* from the authorities, *Ratzlaf* 's requirement of "something more" is satisfied. 510 U.S. at ——, 114 S.Ct. at 657. Although such conduct may support more than one reasonable inference, the trier of fact may choose between reasonable inferences. In reviewing a claim that the government did not present legally sufficient evidence of willfulness, we need only determine if "*any* rational trier of fact could have found" knowledge of illegality. *Jackson,* 443 U.S. at 319, 99 S.Ct. at 2789.

[4] Moreover, as we have noted in other contexts, "the trier of fact may properly consider the general educational background and expertise of the defendant as bearing on the defendant's ability to form the requisite wilful intent." *United States v. Fletcher,* 928 F.2d 495, 501–02 (2d Cir.) (citations omitted), *cert. denied,* 502 U.S. 815, 112 S.Ct. 67, 116 L.Ed.2d 41 (1991). A jury may infer knowledge of the law from a defendant's education and expertise. *United States v. MacKenzie,* 777 F.2d 811, 818 (2d Cir.1985) ("Defendants' backgrounds (each had a college degree, Roderick in economics and Malcolm in business) also demonstrate the likelihood they knew what the law required."), *cert. denied,* 476 U.S. 1169, 106 S.Ct. 2889, 90 L.Ed.2d 977 (1986).

[5] We conclude that the evidence presented at trial was sufficient to sustain the defendant's conviction for currency structuring. There was sufficient circumstantial evidence for a rational jury to find that the defendant comprehended the unlawfulness of his structuring.

First, and most importantly, we emphasize that this is not a case like *Ratzlaf,* where the court improperly instructed the jury on willfulness. The district court here instructed the jury that the government was required to prove knowledge of illegality. The government and the defense reminded the jury of that requirement.

Second, the defendant's conduct in this case suggests not only knowledge of the reporting requirements and an intent to circumvent those requirements, but knowledge of illegality as well. *Contrast Ratzlaf,* 510 U.S. at ——, 114 S.Ct. at 657 (describing the defendant's efforts in obtaining cashier's checks from at least ten different banks immediately after learning from casino that it would have to file a report if it accepted $100,000 in cash as repayment of gambling debt). Here, the undisputed evidence of the defendant's structuring—of his method of structuring—supports a reasonable inference that the defendant was attempting to conceal not only his deposits, but also his acts of structuring. In other words, a reasonable jury could infer that the extensive efforts undertaken by the defendant in structuring his cash deposits "undoubtedly [were] based on the knowledge that his conduct was unlawful." *Caming v. United States,* 889 F.Supp. 736, 741 (S.D.N.Y.1995).

In structuring his deposits of more than $130,000 in cash, the defendant went to eight different branches of Citibank in Brooklyn, Nassau County and Suffolk County on 14 different occasions over a seven day period. On two separate days, Simon went to four different Citibank branches located throughout two different counties. Simon's decision to make all his deposits in different branches of the same bank rather than in different banks may have been made out of carelessness or convenience or lack of knowledge of how branches assemble information for reporting purposes. The extensive effort Simon ***911** did take in structuring these deposits amply supports a reasonable inference that he was attempting to hide his structuring activities because he knew that his conduct was unlawful.

Finally, we note that this defendant is not an unsophisticated person. He was a licensed stockbroker, and he himself was required, as a stockbroker, to file currency transaction reports with the Treasury Department. *See* 31 U.S.C. § 5315; 31 C.F.R. § 103.11(n)(2) (1995). The jury reasonably could have inferred that this defendant possessed the knowledge and sophistication to understand that his own conduct was unlawful. *Retos,* 25 F.3d at 1231; *see Wynn,* 61 F.3d at 928 (citing *Retos* with approval*).*

To the extent that defense counsel suggests, as he did at trial, that the defendant was attempting to avoid *filling out* the reporting forms himself, *see* n.1, *supra,* the jury logically could reject that explanation, reasoning that the defendant's structuring conduct entailed considerably more effort in time and travel than what is entailed in completing a currency transaction report. To the extent that defense counsel argues that the defendant was merely attempting to avoid scrutiny of his deposits by the IRS, we observe that he would have had a better chance of achieving this objective if he had used different banks or different account names. The defendant's attempts to conceal his activities amply support a reasonable inference that the defendant knew that his own conduct was unlawful. The appellant, in challenging the sufficiency of the evidence, has not borne his "very heavy burden." *Nusraty,* 867 F.2d at 762 (quoting *Young,* 745 F.2d at 762).

CONCLUSION

For the foregoing reasons, the judgment of the district court is affirmed.

WINTER, Circuit Judge, dissenting:

Respectfully, I disagree with my colleagues as to the sufficiency of the evidence that Simon knew that structuring cash deposits to avoid reporting requirements was illegal. I therefore dissent.

The parties and all members of the panel are in agreement that Simon triggered the obligation of Citibank to report cash transactions exceeding $10,000. 31 U.S.C. § 5313; 31 C.F.R. § 103.22(a) (1995). Indeed, Citibank duly reported Simon's transactions. We also agree that Simon knowingly made separate deposits of under $10,000 in an attempt to evade the daily reporting requirements. 31 U.S.C. § 5324. Simon concedes that he wanted to conceal the aggregate size of the transactions from the government. He readily admitted to that purpose when arrested. What is at issue is whether Simon knew that the structuring of deposits to avoid reporting requirements itself was illegal.

The government paints Simon as a sophisticated stockbroker with knowledge of reporting requirements for currency transactions in excess of $10,000. In its view, Simon conceived of a clever scheme to make separate cash deposits of slightly under that amount at different Citibank branches on the days in question. The very nature of the scheme, the government argues, supports an inference of Simon's knowledge that structuring was illegal. *See Ratzlaf v. United States,* 510 U.S. 135, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994).

The scheme was anything but clever, however, and Simon's understanding of the laws regarding the reporting of cash transactions was hardly sophisticated. Simon's fourteen deposits were all made to *a single account in his own name.* For Simon to have expected that daily deposits totalling over $10,000 would not be detected—the government's, and evidently the jury's, view of his purpose—he must have been ignorant of the elementary fact that banks tally all deposits during and at the end of the day in order to determine the balance in an account. In short, the government's position is that Simon's sophistication extended to knowledge of the illegality of structuring but did not include a familiarity with bank statements. Discovery of the fact that he had made cash deposits in excess of $10,000 on each of the days in question was thus as inevitable as the sunset. Indeed, the total of the daily cash deposits was reported by the bank, and the government conceded at oral argument that ***912** the reports were precisely what caused Simon's arrest. Far from being a nascent Professor Moriarty, Simon might as well have faxed his deposit receipts to the United States Attorney.

Simon's status as a licensed stockbroker adds nothing to the proof regarding his knowledge of the laws regulating structuring. The government's evidence was only that financial institutions, including stockbrokers, must file reports concerning cash transactions in excess of $10,000. The government offered no evidence as to whether Simon ever received cash from a client, ever filled out such a report, or ever received training as to pertinent statutory or regulatory requirements. The government's proof, in short, was the law itself.

The government's entire case thus rests on inferences to be drawn from Simon's conduct. What is lacking, however, is an explanation of why someone who knew that structuring deposits was illegal would make several cash deposits on the days in question—on one day totaling over $39,000—into a single account in his own name, whether or not separate branches were used.

Simon's conduct is at least as consistent with the lack of knowledge of the illegality of structuring as with that knowledge. Given that his conduct made his arrest inevitable, it is far more consistent with lack of knowledge. When asked at oral argument how Simon's behavior differed from that of a person lacking knowledge of the illegality of structuring, the government speculated that such a person might make separate deposits at the same branch but at different times during the day. However, such a person might also anticipate that a teller at that branch might recognize the depositor as a repeat customer and ask him to fill out a currency transaction report. Indeed, Simon's post-arrest statement suggested exactly that fear.

My colleagues suggest that the jury could have logically rejected the inference that Simon hoped through his efforts only to avoid having to fill out currency transaction forms himself because structuring "entailed considerably more effort in time and trouble" than filling out the reports. I may misunderstand my colleagues' reasoning, but it seems to me unresponsive. Someone who is ignorant of the illegality of structuring but wants to avoid making a currency transaction report might well spend time and effort in going to different branches to achieve that goal.

I realize that Simon's behavior is more than highly suspicious. He had access to large amounts of cash during very brief periods of time, and the likelihood of some kind of past or future serious criminal activity looms large. However, *Ratzlaf,* in overruling our precedents, requires proof beyond a reasonable doubt that Simon knew that structuring was illegal. The government's proof failed to meet this standard. Simon's conduct, the sole evidence offered to show such knowledge, demonstrates at best a belief that form—deposits just under $10,000 at separate branches—would prevail over substance—the aggregate deposits in one day—for purposes of the currency transaction rules. This is not an unreasonable or uncommon belief given our tax or regulatory laws. For example, splitting a large monetary gift between two tax years alters the tax consequences, as does the use of relatively meaningless trusts for estate purposes.

Finally, it ill behooves the government to seek a conviction based on flimsy inferences regarding a defendant's knowledge of the details of currency reporting and structuring laws. The government has refused to adopt proposals that the requirements of these laws be posted in banks. 53 Fed.Reg. 7,948 (1988); 54 Fed.Reg. 20,398 (1988). Such ignorance is presumably fostered in order to identify the depositors and to put them under surveillance in order to locate the sources of cash. The government's failure to post such requirements is surely no defense. Nevertheless, the lack of such notices undermines any assumption that the details of the laws are widely known.

I respectfully dissent.

All Citations

85 F.3d 906, 77 A.F.T.R.2d 96-2430, 96-2 USTC P 50,358

Footnotes

[1] Subsequent to the conduct which formed the basis of the indictment, Congress recodified § 5324(1)-(3) as § 5324(a)(1)-(3), without substantive change. Congress also added subsection (b) to impose the prohibitions of subsection (a) in the international currency context. *See* Annunzio–Wylie Anti–Money Laundering Act, Pub.L. No. 102–550, tit. XV, § 1525(a), 106 Stat. 4064 (1992) (codified at 31 U.S.C. § 5324). The grand jury indicted Simon on July 14, 1994 under the law in effect at the time of the conduct charged in the indictment. For consistency and clarity, we refer to the codification in effect at the time of the conduct charged in the indictment. *See* 31 U.S.C. § 5324 (1988 & Supp. V 1993). *See also infra* n.3 (discussing 1994 amendment).

[2] Defense counsel pointed out, on cross-examination and on appeal, that the agent's contemporaneous report states that the defendant told him that he structured the deposits "to conceal the monies from the government and *avoid filling out* that $10,000 special form."

[3] *Ratzlaf* overruled Second Circuit precedent, namely, *United States v. Scanio,* 900 F.2d 485 (2d Cir.1990), under which knowledge of the bank reporting obligation and the intent to evade that obligation provided a sufficient basis for conviction. Although Congress subsequently amended the anti-structuring law to conform to the *Scanio* interpretation, *see* Riegle Community Development and Regulatory Improvement Act of 1994, § 411, Pub.L. No. 103–325, 108 Stat. 2160, 2253 (1994) (codified at 31 U.S.C. §§ 5322(a), (b), 5324(c)), *Ratzlaf* governed anti-structuring prosecutions for Simon's conduct, which occurred prior to the amendment. *See also supra* n. 1 (discussing 1992 amendment).

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2010 WL 3473311

This decision was reviewed by West editorial staff and not assigned editorial enhancements.

United States District Court, E.D. Virginia,
Alexandria Division.

UNITED STATES of America, Plaintiff,
v.
J. Bryan WILLIAMS, Defendants.

Civil Action No. 1:09–cv–437.
|
Sept. 1, 2010.

Attorneys and Law Firms

Gerard J. Mene, United States Attorney's Office, Alexandria, VA, for Plaintiff.

David H. Dickieson, Schertler & Onorado, Washington, DC, for Defendants.

Memorandum Opinion

LIAM O'GRADY, District Judge.

I. Background

***1** In this case, the Government seeks to enforce its assessment of two "Report of Foreign Bank and Financial Accounts" ("FBAR") penalties against Defendant J. Bryan Williams for willfully failing to report his interest in two Swiss bank accounts for the tax year 2000 as required by 31 U.S.C. § 5314. Based on the findings of fact and conclusions of law that follow, the Court concludes that the Government falls short of meeting its burden in establishing that Williams willfully failed to disclose assets in a foreign account in violation of 31 U.S.C. § 5314.

II. Procedural Posture

The Government instituted this action by filing its Complaint (Dkt. No. 1) on April 23, 2009. Williams filed his Answer (Dkt. No. 6) on July 10, 2009. After discovery, the Government moved for summary judgment (Dkt. No. 11) on January 6, 2010. By an Order dated March 19, 2010 (Dkt. No. 37), the Court denied the Government's Motion for Summary Judgment, finding that genuine disputes of material facts remained.

The Court held a bench trial on April 26, 2010. In lieu of closing arguments, the Court permitted the parties to file simultaneous post-trial briefs and responses thereto. The parties' briefs have now been received and this matter is ripe for disposition.

III. Jurisdiction

Title 28, § 1345 of the United States Code provides subject matter jurisdiction over this case, as this is a suit "commenced by the United States." Further, the Government states that it has commenced this action at the request of and with the authorization of the Chief Counsel for the IRS and at the direction of the Attorney General, pursuant to 26 U.S.C. § 7401, which states that "No civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Secretary authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced." [1]

IV. Legal Standard

The statute at issue, 31 U.S.C. § 5321(b)(1), permits the Secretary of Treasury to "commence a civil action to recover a civil penalty assessed under subsection (a)...." However, the statute does not indicate the legal standard to be applied by courts in such an action. The Court is aware of no other court which has addressed this issue.

Both parties cite *Eren v. Commissioner,* 180 F.3d 594 (4th Cir.1999) a Fourth Circuit case which discusses the legal standard applicable in a trial before the U.S. Tax Court, for the proposition that the Court's review is "*de novo,* and the general rule is that it is a decision based on the merits of the case and not on any record developed at the administrative level." *Id.* at 597–598.

The Court agrees that a *de novo* standard is appropriate here. Though *Eren* is not wholly on point, the Court looks to the rationale in providing *de novo* review in a trial before the tax court as instructive in this case. Further, in enforcement actions brought by the Government in other contexts, *e.g., U.S. S.E.C. v. Pirate Investor LLC,* 580 F.3d 233, 239 (4th Cir.2009) (§ 10(b) enforcement action under the Securities Exchange Act of 1934); *Hi–Tech Pharm., Inc. v. Crawford,* 544 F.3d 1187, 1191 (11th Cir.2008) (enforcement actions brought under the Federal Food, Drug, and Cosmetic Act); *Reich v. Local 89,* 36 F.3d 1470, 1474 (9th Cir.1994) (Labor–Management Reporting and Disclosure Act of 1959), the Government is required to prove its case by a preponderance of the evidence on the record established at trial. The Court is also persuaded that a *de novo* standard is appropriate given that 31 U .S.C. § 5321 provides for no adjudicatory hearing before an FBAR penalty is assessed. *See United States. v. Healy Tibbitts Const. Co.,* 713 F.2d 1469, 1475 (9th Cir.1983) ("where, as here, the statute *contemplates a full adjudicatory hearing before the agency,* a court trial *de novo* is inappropriate" (emphasis added)); *United States v. Indep. Bulk Transp., Inc.,* 394 F.Supp. 1319 (S.D.N.Y.1975) (same).

V. Findings of Fact Not in Dispute

***2** The following are findings of fact which are not in dispute among the parties and which were established by the evidence submitted at trial:

1. In 1993, Defendant Williams opened two bank accounts at Credit Agricole Indosuez, SA, in the name of ALQI Holdings, Ltd., a British Corporation. Def. Ex. 20.

2. Between 1993 and 2000 Williams deposited more than $7,000,000 in assets in the accounts, earning more than $800,000 in income over that period.

3. Schedule B, Part III of Williams' 2000 income tax return instructed Williams to indicate whether he had an interest in financial accounts in a foreign country by checking "Yes" or "No" in the appropriate box and directed him to Form TCF 90–22.1.

4. On Williams 2000 tax return the box was checked "No."

5. The deadline for filing a TDF 90–22.1 form for the tax year 2000 was June 30, 2001.

6. Williams did not file a TDF 90–22.1 form by June 30, 2001.

7. Williams' tax attorneys and accountants advised him to make a series of complete disclosures to Swiss and U.S. authorities. Tr. at 73; 77–78.

8. In January 2002, Williams disclosed the ALQI accounts to John Manton of the IRS in Washington, D.C. Tr. at 76.

9. On October 15, 2002, Williams disclosed the accounts by filing his income tax return for the tax year 2001. Tr. at 72; Def. Ex. 5.

10. Williams made full disclosure of the ALQI accounts on February 14, 2003, as part of his application to participate in the Offshore Voluntary Compliance Initiative. Tr. at 74–76; Def. Ex. 5.

11. In February 2003, Williams filed Amended Returns for 1999 and 2000 which disclosed details about his ALQI accounts.

12. Thereafter in May 2003, Williams agreed to plead guilty to tax fraud again fully disclosing all information about the ALQI Swiss bank accounts. Tr. at 78.

13. On June 12, 2003, Williams pleaded guilty to one count of conspiracy to defraud the United States and to one count of criminal tax evasion in connection with funds held in the Swiss bank accounts during the years 1993 through 2000. *Id.*

14. On January 18, 2007, Williams filed the TDF 90–22.1 form for all years going back to 1993, including tax year 2000.

VI. Findings of Fact In Dispute

At trial, there were several significant facts in dispute, most significantly being when Williams first met with the Swiss authorities and when the ALQI accounts were frozen. The Government pointed to testimony given by Williams in a related case before the U.S. Tax Court wherein Williams stated the accounts were frozen in 2001 instead of 2000. However, as Defendant notes, the IRS had already stipulated in the Tax Court case that the Swiss account was frozen on November 14, 2000 at the behest of the U.S. Government, a fact that was thereafter confirmed by the IRS Appeals Office. Tr. at 93; Def. Ex. 29. Defendant also asserted that November 14, 2000 is the proper date in its Opposition to the Government's Motion for Summary Judgment. The Government made no attempt to correct the date in its Reply Brief, though the issue became apparent during oral argument on the Motion, and the Court noted that dispute in its March 19, 2010 Order denying the Government's Motion for Summary Judgment.

***3** During his testimony at this trial, Williams adamantly maintained that November 14, 2000 was the actual date the account was frozen, and insisted that he misspoke during his Tax Court testimony, explaining that the date was a collateral issue during the Tax Court proceedings that he had not focused on in preparing for the case. For its part, the Government attempted to disavow its stipulation in the Tax Court by claiming that the stipulation was made in a different jurisdiction by a different set of Government lawyers. Tr. at 43. Upon giving full consideration to all of the evidence, the Court is persuaded by Williams testimony and as such makes the following findings as to facts which were in dispute:

1. In the summer of 2000, Swiss authorities requested a meeting with Williams to interview him with respect to the ALQI accounts. Tr. at 38.

2. Williams subsequently retained Swiss and U.S. attorneys. Tr. at 44.

3. On November 13, 2000, Williams met with Swiss authorities about the ALQI accounts. Tr. at 44.

4. Swiss authorities, acting at the request of the U.S. Government, thereafter froze Williams' ALQI accounts on November 14, 2000. Tr. at 37–38, 93; Def. Ex. 24.

5. Given their November 13, 2000 meeting with Williams and the November 14, 2000 seizure of his assets in the ALQI accounts, Swiss and U.S. authorities were aware of these assets. *Id.*

6. In June of 2001, Williams retained tax attorneys to advise him with respect to his interests at Credit Agricole Indosuez.

7. Despite hiring tax lawyers and accountants, Williams had never been advised of the existence of the TDF 90–22.1 form prior to June 30, 2001, nor had he ever filed the form in previous years with the Department of Treasury. Tr. at 79.

VII. Discussion [2]

Title 31, § 5314 of the U.S.Code requires qualifying individuals to disclose their interests in foreign bank accounts. Section 5314(b) allows the Secretary of Treasury to delegate its authority for enforcement of the section and to prescribe the methods for doing so. The Department of Treasury did so in promulgating the disclosure requirements at issue here, including the requirement to file the TDF 90–22.1 form. *See* 31 C.F.R. § 103.24–27.

Pursuant to the applicable regulation, an individual is required to file Form TDF 90–22.1 if: (1) the individual was a resident or a person doing business in the United States; (2) the individual had a financial account or accounts that exceeded $10,000 during the calendar year; (3) the financial account was in a foreign country; and (4) the U.S. person had a financial interest in the account or signatory or other authority over the foreign financial account. *See* 31 C.F.R. § 103.24; 103.27. Williams does not dispute that he meets the first three of these requirements. [3]

Civil penalties for willful violations of § 5314 are provided in 31 U.S.C. § 5321(a)(5)(B), [4] which allowed for a maximum assessment of $100,000. Section 5321(b)(1) authorizes the Secretary of Treasury to assess these penalties; the Secretary delegated that authority to the IRS in 31 CFR § 103.56(g).

***4** Thus, the crux of this case is whether Williams "willfully" violated any portion of § 5314.

V. "Willful Violations"

While " 'willfully' is a word of many meanings whose construction is often dependent on the context in which it appears," the Supreme Court has clarified that "[w] here willfulness is a statutory condition of civil liability, it is generally taken to cover not only knowing violations of a standard, but reckless ones as well." *Safeco Ins. Co. of Am. v. Burr,* 551 U.S. 47, 57, 127 S.Ct. 2201, 167 L.Ed.2d 1045 (2007) (citations and internal quotations omitted). Importantly, "a single, or even a few, inadvertent errors would not amount to a 'willful' violation. At some point, however, a repeated failure to comply with known regulations can move a [defendant's] conduct from inadvertent neglect into reckless or deliberate disregard (and thus willfulness)...." *Am. Arms Int'l v. Herbert,* 563 F.3d 78, 85 (4th Cir.2009) (citing *RSM, Inc. v. Herbert,* 466 F.3d 316 (4th Cir.2006) (internal citations omitted).

In this case, the Government has failed to prove a "willful" violation. The Court finds that the Government's case does not adequately account for the difference between failing and *willfully* failing to disclose an interest in a foreign bank account.[5] Further, the Government fails to differentiate tax evasion from failing to check the box admitting the existence of a foreign bank account.

ii. Whether Williams Willfully Violated § 5314

Form 1040, Schedule B, Part III instructs a taxpayer to report an interest in a financial account in a foreign country by checking "Yes" or "No" in the appropriate box on Form 1040. Specifically, Schedule B, Part III, Question 7a of Williams' Form 1040 reads:

> At any time during 2000, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions for exceptions and filing requirements for Form TDF 90.22.1.

Def. Ex. 3. It is undisputed that "No" is checked in the box adjoining Question 7a on Williams' Form 1040. *Id.*

The Government argues that Williams' signature on his Form 1040 is *prima facie* evidence that Williams knew the contents of his tax return. *See U.S. v. Dehlinger,* 368 Fed.Appx. 439, 447, 2010 WL 750083 at *7 (4th Cir. March 5, 2010) (citing *United States v. Mohney,* 949 F.2d 1397 (6th Cir.1991)). However, "[a] taxpayer's signature on a return does not in itself prove his knowledge of the contents, but knowledge may be inferred from the signature along with the surrounding facts and circumstances...." *Mohney,* 949 F.2d at 1407.

In this case, upon examination of the surrounding facts and circumstances presented at trial, the Court is not persuaded that Williams was lying about his ignorance to the contents of the Form 1040.

As mentioned, there is no dispute that Williams checked the "No" box indicating that he had no foreign bank accounts and that he failed to submit the requisite TDF 90–22.1 form by June 30, 2001 when it was due. However, these actions occurred after Williams found out that the U.S. and Swiss authorities knew about the ALQI accounts. On November 13, 2000, seven months before he failed to check the correct box, Williams met with the Swiss authorities about the ALQI accounts. At the same time, at the request of the U.S., the Swiss authorities froze the assets in the ALQI accounts.[6] In response to these actions, also in 2000, Williams sought the advice of both Swiss and U.S. counsel. The Court finds that given these facts along with the other testimony given at trial, it clearly follows logically that Williams was aware that the authorities knew about the ALQI accounts by the fall of 2000, significantly before June 30, 2001. The fact that Williams had been notified by Swiss authorities that they were aware of the ALQI accounts and the subsequent freezing of his assets in the account strongly indicate to the Court that Williams lacked any motivation to willfully conceal the accounts from authorities after that point.

***5** Further, Williams' subsequent disclosures throughout 2002 and 2003 corroborate his lack of intent. Though made after the June 30, 2001 deadline, Williams' disclosure of the ALQI accounts to John Manton of the IRS in January 2002 indicates to the Court that Williams continued to believe the assets had already been disclosed. That is, it makes little sense for Williams to disclose the ALQI accounts merely six months after the deadline he supposedly willfully violated. Had the authorities only become aware of the accounts in the intervening six months, Williams' disclosures to Manton may have been viewed in a different light. However, given that Williams believed authorities had been on notice of the accounts since well before the June 30, 2001 deadline, Williams' disclosures to Manton indicate that Williams was not in a mindset to conceal the accounts just six months prior.

The same can be said of Williams' disclosure of the ALQI accounts via his filing of a 2001 tax return. This disclosure is not consistent with a man who knew he had unlawfully concealed his interests in a foreign bank account. Rather, they indicate Williams' consciousness of guilt for evading income taxes, which he never equated with a foreign banking disclosure violation. Similarly, though Williams' February 14, 2003 disclosure in the course of his application to participate in the Offshore Voluntary Compliance Initiative was likely motivated by the possibility of attaining amnesty, the 2003 disclosure is also consistent with an individual who had already been caught avoiding income taxes and was no longer seeking to conceal his assets or income.

The Government argues that Williams' guilty plea should estop him from arguing that he did not willfully violate § 5314 for the tax year 2000. However, the evidence introduced at trial established that the scope of the facts established by Williams' 2003 guilty plea are not as broad as the Government suggests, and there remains a factual incongruence between those facts necessary to his guilty plea to tax evasion and those establishing a willful violation of § 5314. That Williams intentionally failed to report income in an effort to evade income taxes is a separate matter from whether Williams specifically failed to comply with disclosure requirements contained in § 5314 applicable to the ALQI accounts for the year 2000. As Williams put it in his testimony at trial, "I was prosecuted for failing to disclose income. To the best of my knowledge I wasn't prosecuted for failing to check that box." Tr. at 34.

After reviewing the evidence presented at trial, the Court concludes that Williams' testimony that he only focused on the numerical calculations on the Form 1040 and otherwise relied on his accountants to fill out the remainder of the Form is credible, and should be given more weight than the mere fact that Williams checked the "No" box. In sum, the Court finds that Williams' failure to disclose already-frozen assets in a foreign account was not an act undertaken intentionally or in deliberate disregard for the law, but instead constituted an understandable omission given the context in which it occurred. The Government has failed to meet its burden to establish by a preponderance of the evidence that Williams willfully violated § 5314.

VIII. Conclusion

***6** For the foregoing reasons, the Court concludes that the Government failed to meet its burden in establishing Williams' liability under 31 U.S.C. 5321(b). Judgment is hereby entered in favor of Defendant J. Bryan Williams.

An appropriate order shall issue.

All Citations

Not Reported in F.Supp.2d, 2010 WL 3473311, 106 A.F.T.R.2d 2010-6150, 2010-2 USTC P 50,623

Footnotes

[1] In turn, 31 U.S.C. § 7402 provides that "district courts of the United States at the instance of the United States shall have such jurisdiction to make and issue in civil actions, writs and orders of injunction, and ... render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws."

[2] Additional findings of fact appear throughout the Court's conclusions of law as needed.

[3] Williams does dispute whether he had "signatory or other authority" over the account due to its freezing by Swiss authorities, but the issue is rendered moot by the Court's conclusions in the remainder of this Opinion.

[4] As that statute existed prior to amendment in 2004. Willful violations are now addressed in 31 U.S.C. § 5321(a)(5)(C), which provides a different calculation of the maximum available penalty. As discussed in greater detail *infra,* the statute was also amended to expand the scope of the statute to acts falling below the willfulness standard, but those provisions were not in effect for the tax year 2000.

[5] It is worth noting that Congress has since amended 31 U.S.C. § 5321 to allow the government to assess a civil penalty for FBAR violations regardless of whether the violation is willful. *See* 31 U.S.C. § 5321(a)(5), as amended by P.L. 108–357. Further, the statute now provides a "reasonable cause" exception. *See* 31 U .S.C. § 5321(a)(5)(B)(ii). While the issue of Williams' liability under the statute as amended is not before the Court, the Court notes that Congress found it necessary to expand the coverage of § 5321 to address a class of conduct falling short of the "willful" standard solely accounted for under the old statute. Clearly, simply failing to file a Form TDF 90.22.1 was insufficient to subject an individual to liability for a civil penalty under the old statute.

[6] As noted, Williams argues that because the accounts were frozen, it is also debatable whether Williams had "signatory or other authority over" the accounts as required by 31 C.F.R. § 103.24 by June 30, 2001. That question is moot, however, given the remainder of the Court's Opinion.

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2017 WL 4418572
United States District Court,
W.D. Washington,
at Seattle.

UNITED STATES of America, Plaintiff,
v.
Jeffrey P. POMERANTZ, Defendant.

CASE NO. C16-689 MJP
|
Signed 10/05/2017

Attorneys and Law Firms

Paul T. Butler, US Dept. of Justice, Washington, DC, for Plaintiff.

Jeffrey P. Pomerantz, pro se.

ORDER DENYING MOTION TO DISMISS

Marsha J. Pechman, United States District Judge

***1** The Court, having received and reviewed:

1. Defendant's Motion to Dismiss for Failure to State a Claim and/or Lack of Personal Jurisdiction and/or to Strike Amended Complaint (Dkt. No. 19);

2. Plaintiff's Response in Opposition to Defendant's Motion to Dismiss Amended Complaint (Dkt. No. 21);

all attached declarations and exhibits; and relevant portions of the records, rules as follows:

IT IS ORDERED that the motion to dismiss is DENIED.

IT IS FURTHER ORDERED that the motion to strike portions of the amended complaint is DENIED.

Nature of case

The United States brings this action to collect civil penalties assessed against Defendant Jeffrey Pomerantz for failing to timely report his financial interest in foreign bank accounts during the years 2007 through 2009. Defendant allegedly owes $860,300.35 in penalties.

Nature of motion

Mr. Pomerantz brings a motion (1) to dismiss the amended complaint for lack of personal jurisdiction under Federal Rule of Civil Procedure 12(b)(2); or (2) failure to state a claim under Rule 12(b)(6), and; (3) to strike portions of the amended complaint under Rule 12(f). Mr. Pomerantz also argues the amended complaint is barred by the doctrines of res judicata and collateral estoppel.

Background

On May 13, 2016, the United States filed a complaint against Mr. Pomerantz, seeking to collect civil penalties for Defendant's alleged failure to timely file a Treasury Form TD F 90-22.1 (“FBAR Form”) reporting his interest in foreign bank accounts on his annual United States tax filings during the years 2007 through 2009. Mr. Pomerantz is a United States citizen currently residing in British Columbia, Canada. Dkt. # 17 (“Amend. Compl.”), ¶ 2-3; Dkt. # 19 at 2.

The foreign bank accounts at issue in this action include both Mr. Pomerantz's personal accounts—two checking accounts opened with the Canada Imperial Bank of Commerce (“CIBC Accounts”)—and accounts opened by Chafford Limited (five accounts with Sal Oppenheim JR & CIE AG in Switzerland; “Chafford Limited Accounts”). *Id.* ¶¶ 5, 8-10. The Government alleges that Chafford Limited is a corporation formed in the Turks and Caicos Islands that conducted no active business, but was simply a shell company used to hold and manage Mr. Pomerantz's personal investments. Amend. Compl. ¶ 7.

On June 8, 2017, the Government's first complaint was dismissed pursuant to Federal Rule of Civil Procedure 12(b)(6) for failing to state a claim upon which relief can be granted. Dkt. # 16. The Court, the Honorable James L. Robart presiding, held that the Government did not sufficiently allege that Mr. Pomerantz acted “willfully” in his failure to file FBAR Forms regarding his personal, CIBC, checking accounts. In particular, there were no allegations in the original complaint that Mr. Pomerantz had actual or constructive knowledge of the duty to file FBAR Forms for the CIBC accounts, which were opened in Defendant's name, not the name of his company. *Id.* at 14-15.

At the same time, the Court found that the complaint contained sufficient facts to support an inference that Mr. Pomerantz intended to evade the foreign bank account reporting requirement by creating foreign bank accounts in the name of Chafford Limited, an alleged shell company. *Id.* at 14.

***2** On June 23, 2017, the Government filed an amended complaint, alleging the same facts regarding the Chafford Limited accounts, and alleging additional facts in support of the inference that Defendant willfully failed to report his personal CIBC accounts. Mr. Pomerantz now brings a motion (1) to dismiss the amended complaint for lack of personal jurisdiction under Federal Rule of Civil Procedure 12(b)(2); or (2) failure to state a claim under Rule 12(b)(6), and; (3) to strike portions of the amended complaint under Rule 12(f). Mr. Pomerantz also argues the amended complaint is barred by the doctrines of res judicata and collateral estoppel.

Discussion/Analysis

a. Personal Jurisdiction

As an initial matter, Mr. Pomerantz argues that the Court lacks personal jurisdiction over him because he does not have the requisite "minimum contact" with this forum. Dkt. # 19 at 3. However, because Mr. Pomerantz failed to raise lack of personal jurisdiction at the first available opportunity, he has waived the defense. Fed. R. Civ. P. 12(h)(1) (if a party fails to raise a challenge to personal jurisdiction in a preliminary Rule 12 motion or its first responsive pleading, such challenge is waived). As noted in the Court's June 8, 2017 Order granting Mr. Pomerantz's motion to dismiss, Mr. Pomerantz failed to raise the defense of personal jurisdiction in his first Rule 12 motion. Dkt. # 16 at 2 n.2. "Personal jurisdiction ... represents a restriction on judicial power ... as a matter of individual liberty." *Ruhrgas AG v. Marathon Oil Co.*, 526 U.S. 574, 584, 119 S.Ct. 1563, 143 L.Ed.2d 760 (1999). "Therefore, a party may insist that the limitation be observed, or he may forgo that right, effectively consenting to the court's exercise of adjudicatory authority." *Id.*; *see also American Ass'n of Naturopathic Physicians v. Hayhurst*, 227 F.3d 1104, 1106-07 (9th Cir. 2000) ("A fundamental tenet of the Federal Rules of Civil Procedure is that certain defenses under Fed. R. Civ. P. 12 must be raised at the first available opportunity or, if they are not, they are forever waived.").

b. Failure to State a Claim

Mr. Pomerantz next moves to dismiss the amended complaint for failure to state a claim upon which relief can be granted. Dkt. # 19 at 3-5. "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). A claim is plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the conduct alleged." *Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937 (citing *Twombly*, 550 U.S. at 545, 127 S.Ct. 1955). "In sum, for a complaint to survive a motion to dismiss, the non-conclusory 'factual content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief." *Moss v. United States Secret Serv.*, 572 F.3d 962, 969 (9th Cir. 2009).

In this case, to survive the motion to dismiss, the Government is required to plead facts supporting a reasonable inference that (1) Mr. Pomerantz was a "U.S. Person," who (2) had an interest in or authority over the subject foreign accounts, which (3) had an aggregate value of $10,000.00 or more, and (4) that he willfully failed to file an FBAR Form for the accounts. 31 U.S.C. § 5321(a)(5); *see also* 31 C.F.R. § 1010.350; *United States v. Toth*, No. 15-CV-13367-ADB, 2017 WL 1703936, at *4 (D. Mass. May 2, 2017) (using the elements of C.F.R. § 1010.350 as elements of an action to reduce to judgment a civil FBAR penalty).

***3** The first three of these elements were addressed in the Court's June 8, 2017 order. Dkt. # 16. Mr. Pomerantz is a U.S. Citizen, the Court previously held that the Government plausibly alleged Mr. Pomerantz had a "financial interest" in the CIBC Accounts and "other financial interest" in the Chafford Limited Accounts, and both sets of accounts were foreign. *Id.* at 11 n.4, 12-13. The allegations supporting these elements are repeated in the amended complaint. Amend. Compl., ¶¶ 2, 5-11. The Court's previous order also found the allegations regarding the Chafford Limited Accounts—

but not the CIBC Accounts—were sufficient to support an inference that Mr. Pomerantz willfully failed to disclose those accounts. Dkt. # 16 at 14 ("The [C]ourt can plausibly infer an intent to evade the foreign bank account reporting requirement based on the creation of foreign bank accounts in the name of a shell company."). These allegations are also repeated in the amended complaint. Amend. Compl., ¶¶ 6-7.

At issue in the instant motion, therefore, is whether the Government adequately alleged that Mr. Pomerantz acted willfully in failing to disclose income from his CIBC Accounts. Generally, a "willful" failure for purposes of the Bank Secrecy Act is "an intentional violation of a known legal duty to report." *Ratzlaf v. United States*, 510 U.S. 135, 154 n.5, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994); *see also United States v. Zwerner,* No. 13-22082-CIV, 2014 WL 11878430, at *3, n.3 (S.D. Fla. Apr. 29, 2014) (adopting the *Ratzlaf* definition for civil FBAR penalties); *accord* IRS CCA 200603026, 2006 WL 148700 at *1-2 (Jan. 20, 2006) (An IRS chief counsel advisory opinion addressing in part the definition of "willful" FBAR reporting violations.). A willful failure to file an FBAR Form requires proof that "the defendant acted with knowledge that his conduct was unlawful," meaning he intentionally violated "a known legal duty." *Ratzlaf v. United States*, 510 U.S. 135, 137, 114 S.Ct. 655, 126 L.Ed.2d 615 (1994).

In its amended complaint, the Government alleges that Mr. Pomerantz filed timely FBAR Forms, reporting his interest in the CIBC accounts for the years 2001-2002, and again in 2005. Amend. Compl. ¶ 14. This allegation is sufficient to demonstrate that Mr. Pomerantz understood the reporting requirements regarding the CIBC accounts long before 2007, the first year that the Government alleges Mr. Pomerantz willfully failed to report his income in these accounts. The Government's other allegations —that Mr. Pomerantz signed tax returns in the years 2007 through 2009, and reported income from the CIBC accounts when that income was less significant, but failed to report higher maximum account balances—support the inference that Mr. Pomerantz acted with knowledge that his conduct was unlawful. *Id.* ¶¶ 17-19, 26, 42, 52; *United States v. McBride*, 908 F.Supp.2d 1186, 1204 05 (D. Utah 2012)) (inferring willfulness from the taxpayer's signature on his tax returns indicating constructive knowledge of relevant tax statutes); *United States v. Williams*, 489 Fed.Appx. 655, 659 60 (4th Cir. 2012) (finding willful blindness and reckless conduct after a taxpayer had signed his tax return and was on inquiry notice of the FBAR reporting requirement but nonetheless failed to file). The Government's amended complaint therefore pleads sufficient factual content to allow the Court to draw the reasonable inference that the defendant willfully failed to file FBAR Forms for the CIBC Accounts. *See Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937.

While Mr. Pomerantz's main argument for dismissal concerns the sufficiency of the Government's allegations, Mr. Pomerantz also argues that there is insufficient evidentiary support for Plaintiff's allegations. *See, e.g.*, *id.* at 4 ("The amended claim makes claims which are improper and have no evidentiary support...."). However, the issue before the Court on a Rule 12(b)(6) motion " 'is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.' " *Gilligan v. Jamco Dev. Corp.*, 108 F.3d 246, 249 (9th Cir. 1997) (citation omitted). Mr. Pomerantz's arguments regarding the sufficiency of the Government's evidence are not appropriately before the Court at this time.

c. Motion to Strike Under Federal Rule of Civil Procedure 12(f)

***4** Mr. Pomerantz also moves to strike portions of the amended complaint that refer to "an unrelated tax court case" pursuant to Federal Rule of Civil Procedure 12(f). Dkt. # 19 at 7-8. Under Federal Rule of Civil Procedure 12(f), "[t]he court may strike from a pleading an insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). An allegation is impertinent or immaterial if it "ha [s] no possible relationship to the controversy," and scandalous if it "reflect [s] cruelly upon the [other party's] moral character, use[s] repulsive language, or detract[s] from the dignity of the court." *Lawrence v. City of Bethlehem*, No. Civ.A. 97-CV-1824, 1998 WL 964214, at *4, 1998 U.S. Dist. LEXIS 17660, at *11–12 (E.D.Pa. Oct. 30, 1998) (quoting *Khalid Bin Talal Etc. v. E.F. Hutton & Co.*, 720 F.Supp. 671, 686 (N.D. Ill. 1989)). "Motions to strike are disfavored and 'should not be granted unless it is clear that the matter to be stricken could have no possible bearing on the subject matter of the litigation.' " *Harper v. Collection Bureau of Walla Walla, Inc.*, C06-1605-JCC, 2007 WL 4287293, at *3 (W.D. Wash. Dec. 4, 2007) (quoting *Colaprico v. Sun Microsystems, Inc.*, 758 F.Supp. 1335, 1339 (N.D. Cal. 1991)).

The following paragraphs in the amended complaint refer to the tax court case:

> In case number 25058-15 before the United States Tax Court, Pomerantz stipulated to entry of a decision including a tax deficiency and civil fraud penalty under 26 USC § 6663 with respect to his [2007-2009] United States income tax liability.
>
> Both the deficiency and the fraud penalty for the [2007-2009] tax year[s] to which Pomerantz stipulated in the United States Tax Court case were based at least in part on income generated by and/or income deposited into the foreign accounts identified in paragraph 21, above, that were not disclosed on Pomerantz' [2007-2009] income tax return[s].

Amend. Compl. ¶¶ 27-28, 43-44, 53-54.

Mr. Pomerantz argues that the Government has not demonstrated the relevance of the tax case, and therefore included these paragraphs in the pleadings solely to discredit him. *Id.* at 7. The Government counters that Mr. Pomerantz's admission in the tax court case of “fraudulent intent” in failing to report income generated by these accounts is “certainly probative of [his] state of mind.” Dkt. # 21 at 9. The Government has the better argument; Mr. Pomerantz's tax court admissions are directly relevant to the willfulness of his failure to file the FBAR Forms.

Moreover, Mr. Pomerantz has not described any prejudice caused by the offending paragraphs. “[M]otions to strike are rarely granted in the absence of a showing of prejudice to the moving party.” *Moussouris v. Microsoft Corp.*, C15-1483JLR, 2016 WL 4472930, at *3 (W.D. Wash. Mar. 7, 2016) (quoting *Freeman v. Alta Bates Summit Med. Ctr. Campus*, No. C 04-2019 SBA, 2004 WL 2326369, at *2 (N.D. Cal. Oct. 12, 2004)). “This demanding standard leads district courts in the Ninth Circuit to disfavor motions to strike....” *Id.* Given that Mr. Pomerantz's admissions in the tax case are relevant to his state of mind and he has not demonstrated any prejudice, Mr. Pomerantz's Rule 12(f) motion is denied.

d. Res Judicata and Collateral Estoppel

Finally, Mr. Pomerantz argues that the doctrines of res judicata and collateral estoppel apply to bar the Plaintiff's amended complaint because it raises the same claims and issues that were raised in the original complaint filed in this case. Dkt. # 19 at 5. In turn, the Government correctly argues that neither res judicata nor collateral estoppel apply here because both doctrines preclude re-litigating issues that were disposed of in a final judgment, and there has been no final judgment in this matter. Dkt. # 21 at 7; *see also See* Dkt. # 16 (June 8, 2017 Order dismissing complaint and granting leave to amend).

***5** “Res judicata applies as between separate actions, not within the confines of a single action on trial or appeal.” 18 Charles A. Wright & Arthur R. Miller, Fed. Prac. & Proc. Juris. § 4404 (3d ed. 2017). Collateral estoppel “means simply that when an issue of ultimate fact has once been determined by a valid and final judgment, that issue cannot again be litigated between the same parties in any future lawsuit.” *United States v. Romeo*, 114 F.3d 141, 143 (9th Cir. 1997) (quoting *Ashe v. Swenson*, 397 U.S. 436, 443, 90 S.Ct. 1189, 25 L.Ed.2d 469 (1970)).

A dismissal without prejudice is not a final judgment on the merits. *Audette v. Int'l Longshoremen's & Warehousemen's Union*, 195 F.3d 1107, 1113 n. 1 (9th Cir. 1999); *see also Bamgbose v. Delta T Grp., Inc.*, 724 F.Supp.2d 510, 519 (E.D. Pa. 2010) (“Res judicata and collateral estoppel are not triggered when a court decides something without prejudice; rather, they require final judgments.”); *Ahler v. City of New York*, No. 93-0056 (SS), 1993 WL 362404, at *2 (S.D.N.Y. Sept. 13, 1993) (“Dismissal without prejudice averts the possibility of detrimental res judicata and collateral estoppel effects.”). Given that both res judicata and collateral estoppel require a final judgment, and there was no such judgment in this case, Mr. Pomerantz's argument that the amended complaint is barred by these doctrines is wholly without merit.

Conclusion

Ultimately, none of Mr. Pomerantz's arguments in the instant motion are persuasive or supported by the law. Mr. Pomerantz waived his personal jurisdiction defense by failing to raise it in his first Rule 12 motion, the Government pled sufficient facts to support an inference that Mr. Pomerantz willfully failed to file FBAR Forms for his CIBC Accounts, the paragraphs regarding Mr. Pomerantz's tax court case are relevant to this action, and the doctrines of res judicata and collateral estoppel do not bar an amended complaint, especially where the court granted leave to amend. Mr. Pomerantz's motion is therefore DENIED.

The clerk is ordered to provide copies of this order to Defendant and to all counsel.

All Citations

Slip Copy, 2017 WL 4418572, 120 A.F.T.R.2d 2017-6095

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937 F.2d 532
United States Court of Appeals,
Tenth Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
David A. DASHNEY, Defendant–Appellant.

Nos. 90–1136, 90–1220.
|
June 27, 1991.

Synopsis

Following jury trial before the United States District Court for the District of Colorado, Sherman G. Finesilver, Chief Judge, defendant was convicted of two counts of structuring and attempting to structure cash transactions in excess of $10,000 for purpose of avoiding bank filings of currency transaction reports (CTRs). Defendant appealed. The Court of Appeals, Holloway, Chief Judge, held that: (1) Government was not required to prove that defendant had knowledge of prohibition of structuring transactions in criminal statutes, and (2) defendant's conduct in attempting to structure one "cash hoard" to avoid reporting requirements should not have been divided into two charges.

Affirmed in part; reversed in part and remanded.

Attorneys and Law Firms

***533** Jill M. Wichlens, Asst. Federal Public Defender, Denver, Colo. (Michael G. Katz, Federal Public Defender, with her on the brief), for defendant-appellant.

Robert D. Clark, Asst. U.S. Atty., Denver, Colo. (Michael J. Norton, U.S. Atty., with him on the brief), for plaintiff-appellee.

Before HOLLOWAY, Chief Judge, and BARRETT and SEYMOUR, [*] Circuit Judges.

HOLLOWAY, Chief Judge.

I

Defendant-appellant, David Allen Dashney, appeals from his convictions and sentence after a jury trial on two counts of structuring and attempting to structure cash transactions in excess of $10,000.00 for the purpose of avoiding bank filings of currency transaction reports (CTRs), in violation of 31 U.S.C. § 5324(3), 31 U.S.C. § 5322(a), and 18 U.S.C. § 2. [1]

There was evidence tending to show that in December of 1989 Dashney won approximately $92,400, paid out in cash, playing blackjack at the Mirage Hotel in Las Vegas. VIII R. at 354–55; IV R. at 45–46. He was registered under the name David Allen, Allen being his middle name. VIII R. at 346–47; IV R. at 35, 77–78. After winning, Dashney went to Florida to talk to his broker at Dean Witter where he had an account. Dashney told his broker's secretary that he did not want to use a check to deposit his winnings because of the tax consequences. VI R. at 152, 162. Subsequently Dashney discussed with his broker the possibility of depositing cash up to a certain amount without any CTR being filed. *Id.* at 165. The broker had the impression that Dashney thought that he could legally do what he wanted to do. *Id.* at 178. Dashney's broker informed him, however, that the brokerage company could not accept cash deposits in any amount. *Id.* at 167–68.

Soon thereafter Dashney flew to Colorado Springs, Colorado, where he attempted to rent a car, using cash only. This unusual rental attempt was reported to the Sheriff, who sent two officers to investigate. *Id.* at 183–85. The officers asked if they could search Dashney and his bags and were given permission to do so. They counted out $100,000 in his bag. *Id.* at 185. Dashney told them that the money had been won in Las Vegas. *Id.* at 186. Dashney also said that he had not given the money to Dean Witter because he knew if he deposited over $9,999.99 in cash, the broker had to tell federal authorities. *Id.* at 187. Dashney was picked up at the airport by his friend Sandra Jarrett.

On December 14, 1989, Dashney obtained a Colorado driver's license, using Jarrett's address. IV R. at 96–97; VI R. at 235–36. On that same day, he and Jarrett went to ten banks in the Denver area where they attempted to purchase and successfully purchased eleven checks from eight of the banks, each check made out to David Dashney, with no check for over $10,000. IV R. at 96–100; IX R. at 7, 9. Dashney and Jarrett did not purchase checks from two banks contacted.

At FirstBank—Cherry Creek branch, Jarrett began a purchase of a cashier's check for $10,000, made out to Dashney. VI R. at 244. During this transaction the teller told them that if the amount was $10,000 or more, a "large-currency transaction report" would have to be filled out. *Id.* at 241–42. Dashney told the teller that he did not want the CTR filled out because he did ***534** not want to pay taxes on the money. *Id.* at 243. He also told her that no CTR needed to be filed if a cashier's check for $9,999 were purchased. *Id.* at 242. Dashney then had the bank void the first check for $10,000 and issue a cashier's check to him for $9,999.99. *Id.* at 244, 249.

At World Savings—Cherry Creek branch Dashney purchased a cashier's check for $9,999.99, paid for with $100 bills. Dashney said he wanted to purchase ten checks for $10,000. He had the instructions portion of a CTR form in his hand when he approached the teller. *Id.* at 252, 254, 257–58. Dashney indicated to the teller that there was no need to report the money because it had been won in Las Vegas. *Id.* at 257.

At Commercial Federal Savings and Loan—Cherry Creek branch, Dashney raised the issue of CTRs, asking if one was required for a transaction of $10,000 or more. *Id.* at 262. The financial counselor told Dashney that he would definitely file a CTR for $10,000 or over and that it was discretionary as to filing one for lesser transactions. *Id.* at 262. Dashney purchased a bank check for $9,999.99 from the financial counselor and also purchased a cashier's check for $9,999.99 from a teller supervisor. *Id.* at 261, 263. Dashney again mentioned that he had won the money in Las Vegas. *Id.* at 266.

At FirstBank—Green Mountain branch, Dashney purchased a cashier's check for $5,000 from an operations supervisor. *Id.* at 270. Dashney inquired about purchasing a check for $9,999.99 and was informed that the bank would file a CTR for any transaction over $5,000. *Id.* at 271. Jarrett then attempted to purchase a cashier's check for $5,000 with Dashney's money. *Id.* at 273. The supervisor and the bank president decided that the two checks would have to be considered as a single transaction requiring a CTR, but Dashney indicated that he would not provide information for a CTR. *Id.* The second check was voided. *Id.* at 272. Dashney told the supervisor that the money had been won in Las Vegas and that such winnings are exempt from CTR rules. *Id.* at 278.

At Century Bank—Cherry Creek branch, Dashney inquired about a certificate of deposit for over $100,000. *Id.* at 283. He indicated that he was not pleased with the offered rate and would shop around. *Id.* at 283–85. Dashney then asked about purchasing a cashier's check for $100,000 but changed his mind after he was told that a CTR would have to be filed. *Id.* at 285–86, 292. Dashney then asked a vice president if a CTR had to be filed for transactions under $10,000 and was told that one would be filed. V R. at 130. Dashney then showed the instructions portion of a CTR form to the vice president, specifically the paragraph stating that no form need be filled out for transactions under $10,000. *Id.* at 131. The vice president responded that if there was suspicion that multiple transactions might add up to more than $10,000, they had to fill out a CTR. *Id.* Dashney became irritated and left the bank without conducting any transaction. *Id.*

At First National Bank of Lakewood, Dashney asked about purchasing a cashier's check for $10,000 and asked if a CTR would have to be filled out. VI R. at 296, 299. He noted that he had won the money in a casino. After being told that a CTR would be filed for a $10,000 transaction, Dashney pointed out the clause on the CTR form stating that casinos are exempt from CTR requirements. He then purchased a check for $9,999.99. *Id.* at 296–301.

At Capitol Federal Savings—Green Mountain branch, Dashney said he wanted to purchase a $10,000 cashier's check. When he was told that a CTR would have to be filled out for the transaction, he changed his purchase to a $9,999.99 cashier's check. Dashney told the savings counselor that he had won the money in Las Vegas and he showed her a gold watch he had purchased with the money. *Id.* at 305–310.

At Green Mountain Bank, Dashney asked to purchase a $10,000 cashier's check. When he was told that a CTR would be filled out, he objected, stating that only transactions over $10,000 required CTRs. The head teller told Dashney that it was discretionary as to whether ***535** to fill out a CTR for any amount under $10,000. *Id.* at 312. Dashney then told the teller that he had already purchased over ten cashier's checks that day and he held up "in a fan-type motion backs of what looked like checks." *Id.* at 314. A few minutes later, Jarrett attempted to purchase a check for $9,999.99 at another teller's window but no check was obtained. *Id.*

At Cherry Creek National Bank, Dashney asked about purchasing a cashier's check for $30,000. He was told that a CTR would be filed for any transaction over $10,000, whereupon he decided to get a check for $10,000 instead. An unidentified woman accompanying Dashney then purchased a cashier's check for $9,999.99, payable to Dashney. VII R. at 324–25.

At World Savings and Loan—Lakewood Green Mountain branch, Dashney asked about a jumbo certificate, a certificate of deposit for $100,000 or more. VII R. at 337. He appeared unhappy with the offered rate, saying he could get better rates elsewhere. Dashney then purchased a $10,000 association check, similar to a cashier's check. *Id.* at 330–31. Jarrett purchased an association check for $5,000 payable to Dashney. Dashney initiated a discussion about CTRs and he said that one should not be filled out because the transaction was for only $10,000. *Id.* at 332, 333. During the conversation Dashney said that he had started off with $100,000 in cash and he was going from bank to bank purchasing cashier's checks, which he showed to the teller in a stack. *Id.* at 336. The checks purchased by Dashney and Ms. Jarrett on December 14 totaled $99,999.93.

Dashney testified on his own behalf. He stated that he had won the money in Las Vegas, but that he thought that these winnings were reported to the government by the casino. IX R. at 3, 7. Dashney testified that he left the hotel on December 9 with $100,000; he had won $113,000 and had bought an expensive watch there. *Id.* at 3. Dashney testified that he was concerned about "bureaucratic problems" which might arise from having the same money reported to the government again when he bought cashier's checks. *Id.* at 8. He claimed that he had no intention of hiding the money and that he was purchasing cashier's checks only because Dean Witter would not accept cash. *Id.* at 9. Dashney said that several of the prosecution witnesses made incorrect statements in court. *Id.* at 17, 30, 34, 37, 41. A number of the checks were identified by Dashney as having been purchased by him. *Id.* at 44–49. Dashney also admitted that several of the bank employees had discussed CTRs with him. *Id.* at 32–41.

II

Dashney was charged in a two count indictment alleging that he had attempted to and had successfully structured transactions to evade the filing of CTRs, in violation of 31 U.S.C. §§ 5324(3), 5322(a) and 18 U.S.C. § 2.[2] He was convicted following a ***536** jury trial and was sentenced to 24 months' imprisonment pursuant to the Sentencing Guidelines. *See* United States Sentencing Commission, *Guidelines Manual* § 2S1.3 (Nov.1989).[3]

The defendant Dashney filed a motion to dismiss the indictment for vagueness and failure to charge knowledge of illegality. I R. Doc. 6. At a hearing on the motion it was argued more specifically that the indictment did not charge Dashney with knowledge of the antistructuring statute, 31 U.S.C. § 5324. After argument the trial judge denied the motion to dismiss by an oral ruling, rejecting the claim of vagueness. She further held that knowledge of illegality is not required; the defendant would be entitled to an instruction that his acts must be willful, that is, "done voluntarily and intentionally and with the specific intent to do something the law forbids, not because of accident or other innocent reason." II R. at 28–29. The judge said that the statute does contain a scienter element and that the government would have to show that defendant had knowledge that CTRs had to be filed and that the defendant structured his transaction, attempting to evade those reporting requirements. *Id.* at 29.

At a conference where instructions to the jury were discussed, the same issue was again raised by Dashney. His attorney referred to his earlier legal argument that the government must establish knowledge of illegality and the antistructuring statute. VIII R. at 427–29. The trial judge, however, did not instruct that knowledge of illegality was required to be proven by the government, and instead charged, *inter alia,* that the government must prove that the defendant knowingly and willfully structured or attempted to structure a currency transaction; and that the purpose of the structured transaction or attempted structured transaction was to evade the bank's reporting requirement. Instruction No. 12.

The judge further instructed that an act is done willfully if done voluntarily and intentionally, and with specific intent to do something the law forbids, that is to say with bad purpose either to disobey or disregard the law; that to evade or attempt to evade the reporting requirements of 31 U.S.C. § 5313(a) means that the defendant acted voluntarily and intentionally and with the specific intent to knowingly keep financial institutions from having sufficient information to prepare and file the currency transaction report; in other words, the evasion or attempted evasion must be made with the bad purpose of seeking to prevent financial institutions from making a written report of the currency transaction; and that knowingly means that the act or omission was done voluntarily and intentionally, and not because of a mistake or accident. Instruction No. 15. Further she instructed that the crime charged is a serious crime which requires proof of specific intent; that the government must prove that the defendant knowingly did an act which the law forbids, as knowingly was earlier defined, purposely intending to violate the law. Instruction No. 16. The defendant's attorney moved for a judgment of acquittal at the close of all the evidence, and this motion was denied.

Following his convictions and sentencing on Counts 1 and 2, the defendant appealed.

***537** III

[1] Dashney argues three main points on appeal in challenging his convictions on both counts. First, it is claimed that the district court erred in denying Dashney's motion to dismiss the indictment for failure to charge knowledge of illegality. *See* I R. Doc.10. Second, it is claimed that the jury instructions improperly failed to instruct the jury that knowledge of illegality must be proved for conviction under 31 U.S.C. §§ 5322(a) and 5324(3). Third, it is argued that the district court erred in denying Dashney's motion for judgment of acquittal since no evidence was presented that Dashney had knowledge of the illegality of his actions. The gravamen of all of these claims is that for a conviction under 31 U.S.C. §§ 5322(a) and 5324(3), it must be established that the defendant had knowledge of the prohibition of structuring transactions in the criminal statutes.

Although this is the first time such an argument has been made in this circuit under the antistructuring law, a similar contention has been presented and rejected in both the Ninth and Second Circuits. *See United States v. Hoyland,* 914 F.2d 1125, 1128–29 (9th Cir.1990); *United States v. Scanio,* 900 F.2d 485, 489–91 (2d Cir.1990). Dashney, however, says that the argument has never been properly considered in light of the complete legislative history of 31 U.S.C. §§ 5322(a) and 5324(3) and the recent Supreme Court decision in *Cheek v. United States,* 498 U.S. 192, 111 S.Ct. 604, 112 L.Ed.2d 617 (1991).

Section 5324 of Title 31 was part of the Money Laundering Control Act of 1986, which was Title I, Subtitle H of the Anti–Drug Abuse Act of 1986. Pub.L. No. 99–570, 100 Stat. 3207 (1986). There were no Senate or House Reports submitted with the bill as passed, but there were a number of related Congressional reports submitted on proposed versions of the various portions of the final bill. 1986 U.S.Code Cong. & Ad.News 5393. [4]

Dashney primarily relies on two reports—one by the House Committee on the Judiciary and one by the House Committee on Banking, Finance and Urban Affairs. The report from the House Committee on the Judiciary contained a proposal, not adopted, to change "willfully" to "knowingly" in § 5322. *See* H.R.Rep. No. 855, 99th Cong., 2d Sess. 7, 27 (1986) (hereinafter Judiciary Committee Report). The report explains that the term "willfully" has been interpreted as "having different meanings and requiring differing standards depending on the context." *Id.* at 21. The report then says that "willfully" in this context has been interpreted as requiring an "actual awareness of the reporting requirement to sustain violations." *Id.* at 22. The report also states that the proposed alteration to "knowingly" was not intended to change the meaning of the statute, but only to express the requisite state of mind more clearly. *Id.* at 21–22. This portion of the legislative history is relied on heavily by Dashney on this appeal. [5]

Dashney also relies on the report from the House Committee on Banking, Finance and Urban Affairs, which echoes the aforementioned Judiciary Committee Report and states that "[i]n the criminal context the term 'knowingly' means with specific intent to commit a violation of the Bank Secrecy Act" or "specific intent to commit a crime." H.R.Rep. No. 746, 99th Cong., 2d Sess. 29, 41 (1986) (hereinafter Banking Committee Report). The heading for this discussion is "Clarifying the 'State of Mind' Standard for Criminal and Civil Money Penalties." *Id.* at 28–29.

***538** Although the House reports show that two House Committees recognized some ambiguity in the term "willfully," and suggested that it be revised to "knowingly," this provides us with little guidance, for this proposed change was not made. Dashney argues that the change to “knowingly”—the proposed “clarification”—was not made because Congress deemed it unnecessary since “knowingly” was already implicit in the statute, thus showing legislative intent in accord with Dashney's contention that proof of knowledge of the antistructuring statute and the illegality of his actions are required for a conviction. Therefore, according to Dashney, we should interpret the statutes in question here, §§ 5324(3) and 5322(a), as requiring specific knowledge of illegality of structuring under the antistructuring provision in § 5324(3). Or, in any event, Dashney says there is such ambiguity that we should thus construe the statutes under the rule of lenity, citing *Bifulco v. United States,* 447 U.S. 381, 387, 400, 100 S.Ct. 2247, 2252, 2258, 65 L.Ed.2d 205 (1980), and *United States v. Bass,* 404 U.S. 336, 347–48, 92 S.Ct. 515, 522, 30 L.Ed.2d 488 (1971).

While criminal intent is not specifically addressed, it is implicitly dealt with in another related report from the Senate Committee on the Judiciary. *See* S.Rep. No. 433, 99th Cong., 2d Sess. (1986) (hereinafter Senate Report). The report gives an example of the intended application of the proposed statute:

> For example, a person who converts $18,000 in currency to cashier's checks by purchasing two $9,000 cashier's checks at two different banks or on two different days with the specific intent that the participating bank or banks not be required to file [CTRs] for those transactions, would be subject to potential civil and criminal liability. A person conducting the same transactions for any other reasons ... would not be subject to liability under the proposed amendment.

Senate Report at 22. Thus, this Report contemplates a criminal intent element for prosecution for structuring crimes, but the intent required is merely to avoid the currency transaction reporting requirements, and not specific knowledge of the antistructuring law itself. We are not persuaded that the legislative history as a whole impels a construction of the statutes in the restrictive manner which Dashney suggests.

Dashney further submits that in any event the rule of lenity should be applied here, in his favor, due to ambiguity of the currency transaction report statutes. *See Bifulco v. United States,* 447 U.S. 381, 387, 100 S.Ct. 2247, 2252, 65 L.Ed.2d 205 (1980). *Bifulco,* however, notes that the touchstone of the rule of lenity is statutory ambiguity. *Id.* at 387, 100 S.Ct. at 2252. We feel, however, that the intent of Congress in the statute's usage of the term “willfully” in § 5322(a) was to adopt the interpretation of the statute explained in *United States v. Scanio,* 900 F.2d 485 (2d Cir.1990):

> The meaning of the term ‘willful’ depends upon the context in which it is used, see *United States v. Stroud,* 893 F.2d 504, 507 (2d Cir.1990) (quoting *Screws v. United States,* 325 U.S. 91, 101, 65 S.Ct. 1031, 1035, 89 L.Ed. 1495 (1945) (plurality opinion)), and *a requirement that an act be done ‘willfully’ normally does not necessitate proof that the defendant was specifically aware of the law penalizing his conduct.* Where the law imposes criminal liability for certain conduct, a requirement that the conduct be ‘willful’ generally ‘means no more than that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.’ *American Surety Co. v. Sullivan,* 7 F.2d 605, 606 (2d Cir.1925) (L. Hand, J.); *United States v. Gregg,* 612 F.2d 43, 51 (2d Cir.1979) (‘It is well settled that ignorance of the law is no defense to purposeful and intentional action.’ (citing *Lambert v. California,* 355 U.S. 225, 228, 78 S.Ct. 240, 242, 2 L.Ed.2d 228 (1957)).

....

> ... With respect to the applicable *mens rea,* the legislative history indicates that Congress only intended to require ***539** proof that the defendant structured a currency transaction in order to prevent the financial institution from filing a CTR.

900 F.2d at 489, 491 (emphasis added).

The Ninth Circuit's opinion in *United States v. Hoyland,* 914 F.2d 1125 (9th Cir.1990), persuasively makes the same interpretation of the statutes, concluding, *id.* at 1129:

> Congress was aware that several circuits, including ours, had held it no crime to structure deposits so that

> the reporting requirement would not be triggered. S.Rep. No. 433, 99th Cong., 2d Sess. 22 (1986). Congress changed the law to make it a crime so to structure with the intent to prevent reporting. To act willfully under the statute is to act with this intent.

See also United States v. 316 Units of Municipal Securities, 725 F.Supp. 172, 178 (S.D.N.Y.1989) (to restrict prosecutions to those few cases in which the government could prove actual knowledge of the antistructuring statute would contravene the legislative intent to broaden the scope of the currency reporting statute) (dictum). Hence we feel that the rule of lenity does not benefit Dashney here since the statutes' intent is not unclear.

Finally, Dashney says that "willfully" in the penalty provision of 31 U.S.C. § 5322 has previously been interpreted as requiring knowledge of illegality in relation to other violations of Title 31 and should therefore be interpreted in the same manner regarding violations of § 5324(3). *See United States v. Eisenstein,* 731 F.2d 1540, 1543 (11th Cir.1984) (importation and exportation of over $10,000 without filing a CTR, in violation of 31 U.S.C. §§ 1059, 1081, 1082 (1976)); *United States v. Granda,* 565 F.2d 922, 926 (5th Cir.1978) (importation of over $5,000 without filing a CTR, in violation of 31 U.S.C. §§ 1058, 1101).[6] Furthermore, Dashney argues that the interpretation of "willfully" as requiring knowledge of illegality is supported by *Cheek v. United States,* 498 U.S. 192, 111 S.Ct. 604, 112 L.Ed.2d 617 (1991). *Cheek* holds that, in a criminal tax violation context, "the standard for the statutory willfulness requirement is the 'voluntary, intentional violation of a known legal duty.' " *Cheek,* 111 S.Ct. at 610.

Both *Eisenstein* and *Granda* involve what is now recodified, in amended form, as 31 U.S.C. § 5316, requiring reports to be filed upon the exporting or importing of over $10,000 across United States borders. *See Eisenstein,* 731 F.2d at 1542; *Granda,* 565 F.2d at 923. The requirement of knowledge of illegality is necessary there because "[t]he isolated act of bringing money in excess of $5,000 into the country is not illegal or even immoral." *Granda,* 565 F.2d at 926; *see Eisenstein,* 731 F.2d at 1543. An innocent traveler could certainly decide to go overseas carrying a large amount of money or traveler's checks, and absent knowledge of the reporting requirements, there is no reason to believe that such activity can be a crime. When typically innocent behavior is criminalized, there is a strong argument for requiring a person to have knowledge of the illegality of his actions to justify a conviction. *See Lambert v. California,* 355 U.S. 225, 228–29, 78 S.Ct. 240, 242–43, 2 L.Ed.2d 228 (1957). In the case before us, however, and in context of the statutes before us, no wholly innocent person faces such a predicament since a scienter element is incorporated into both 31 U.S.C. §§ 5324 and 5322.

The prohibition of the antistructuring statute, § 5324, includes this basic proviso—"*no person shall for the purpose of evading the reporting requirements of section 5313(a)* ..." 31 U.S.C. § 5324 (emphasis added). Innocent or accidental structuring of transactions does not trigger § 5324, and consequently, both Dashney's indictment and his jury instructions properly included the element of willful intent to evade the reporting requirements. *See* I R. Doc. 1; I R. Doc. 27, Instruction No. 12, 15–16.

Cheek addresses "willfulness" in the context of criminal violations of federal tax ***540** statutes. *Cheek,* 111 S.Ct. at 609. The Court stated that

> The general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system....
>
> The proliferation of statutes and regulations has sometimes made it difficult for the average citizen to know and comprehend the extent of the duties and obligations imposed by the tax laws. Congress has accordingly softened the impact of the common-law presumption by making specific intent to violate the law an element of certain federal criminal tax offenses. Thus, the Court almost 60 years ago interpreted the statutory term 'willfully' as used in the federal criminal tax statutes as carving out an exception to the traditional rule. This special treatment of criminal tax offenses is largely due to the complexity of the tax laws.

Id.

Dashney argues that the complexity of the statutes governing the reporting of monetary transactions is equal to that of the tax statutes and, thus, a similar exception to the general rule should be made in interpreting these reporting statutes. We disagree. *Cheek* involves only certain criminal tax statutes, and we see no reason to extend similar statutory interpretation into the straightforward currency reporting requirements. Criminal tax statutes are more analogous to the international currency reporting statutes involved in *Granda* and *Eisenstein,* since entirely innocent actions can lead to violations of the law. *See Hoyland,* 914 F.2d at 1129; *Scanio,* 900 F.2d at 490–91. As previously noted, Dashney's actions were anything but innocent, as he went to great lengths to avoid the filling out of CTRs in connection with his transactions. The various witnesses' testimony regarding Dashney's comments, along with the several checks under the $10,000 mandatory reporting limit, indicate that Dashney was quite aware of the reporting requirement and intended to evade such reporting.

In sum, we are not persuaded that the trial judge's instructions were in error or that the government's proof was lacking as to an essential element. The evidence amply supported the guilty verdicts on the charges which were tried.

IV

[2] After argument of this appeal, defendant Dashney was granted leave to file a supplemental brief asserting an issue not argued in his original briefs or at argument. The substance of this claim of error was argued below, however, by a pretrial motion.[7] The gist of this contention is that it was fundamental error for the government to divide the allegations of defendant's acts at the various banks into two charges of structuring on which Dashney received two convictions, two special assessments of $50, and his sentence of 24 months' imprisonment under the Sentencing Guidelines. *See* Counts 1 and 2, note 2, *supra.*

The government has filed a response to defendant Dashney's supplemental brief arguing that there are bona fide distinctions between the conduct charged in Counts 1 and 2; that each count alleges a cognizable violation of 31 U.S.C. § 5324(3); and that therefore there was no multiplicity in the charging of two separate counts. And the government says that the defendant Dashney was in no way harmed by having been charged in two counts in any event, since his sentence on two counts did not involve any additional imprisonment, fine or restitution order, and that the imposition of a second $50 special assessment in the judgment was *de minimis.*

The government makes no objection to our considering the additional issue and we ***541** conclude that we should do so since it goes to the fundamental validity of one conviction and one $50 special assessment, and might affect the sentence imposed. We feel we should decide this new issue as a proper exercise of our discretion since injustice might otherwise result. *Singleton v. Wulff,* 428 U.S. 106, 121, 96 S.Ct. 2868, 2877, 49 L.Ed.2d 826 (1976). We have therefore considered the recent opinion of the Seventh Circuit which Dashney relies on, *United States v. Davenport,* 929 F.2d 1169 (7th Cir.1991), and have reconsidered our record in light of that opinion.

Davenport involved a similar situation where the defendants were charged with separate counts of violation of the antistructuring statute, 31 U.S.C. § 5324(3). There Count 1 charged a conspiracy to violate § 5324(3), Count 2 charged one violation of the antistructuring statute, consisting of the making of ten deposits viewed as an effort to "structure" an $81,500 transaction, and the last ten counts charged each of the ten same deposits as separate violations of the statute. The court held that these latter ten counts were invalid:

> These counts should have been thrown out. The statute does not forbid the making of deposits. It forbids the structuring of a transaction. The Davenports received $100,000 in cash, which they wanted to deposit. *The receipt and deposit of the $100,000 were the transaction that the Davenports structured by breaking it up into multiple deposits, of which ten had been made when they were caught. There was one structuring, one violation.* The government's position leads to the weird result that if a defendant receives $10,000 and splits it up into 100 deposits he is ten times guiltier than a defendant who splits up the same amount into ten deposits.

Id. at 1171 (emphasis added). The court stated further:

> The statute's aim was to prevent people from either causing the (usually innocent) bank to fail to file a required report or defeating the goal of the requirement that large cash deposits be reported to the Internal Revenue Service *by breaking their cash hoard into enough separate deposits to avoid activating the requirement. S. Rep. No. 433, 99th Cong., 2d Sess. 22 (1986); United States v. Scanio, supra, 900 F.2d at 488.*

Id. at 1173 (emphasis added).

We must agree with the defendant that the rationale of *Davenport* clearly applies to the facts in the instant case. As in *Davenport,* there was one "cash hoard" involved here. Count 1 of the indictment here alleges that the defendant Dashney "structured or attempted to structure a transaction or transactions" with the purchase on the same business day of $99,999.93 in cashier's checks at ten banks. Count 2 here alleged that Dashney attempted to structure a transaction or transactions with the purchase of cashier's checks totaling approximately $100,000, alleging transactions at two banks.[8] It is clear from our record that the same $100,000 fund was involved in the conduct alleged in both counts. Dashney testified that he left the hotel in Las Vegas on December 9 with $100,000, after he had won $113,000 and then bought an expensive watch there. IX R. at 3. Following his trip to Florida, he returned to Colorado Springs and there he told two officers from the Sheriff's Department that his bag contained $100,000 he had won in Las Vegas, and they counted out $100,000 in his bag. VI R. at 185–86. Then, in one day—December 14, 1989—Dashney and his friend Jarrett went to all the banks covered by the charges in Counts 1 and 2, making the purchases or attempted purchases of cashier's checks. This record thus shows that Dashney, throughout the events alleged, was dealing with the same fund of approximately $100,000 brought from Las Vegas and which he attempted repeatedly to use in separate purchases of cashier's checks for $10,000 or less. The persuasive opinion in *Davenport* convinces us that here also there was a multiplicity of charges, splitting up one unit of prosecution contemplated ***542** by the statute into two separate counts.

The government makes two unconvincing arguments to avoid the *Davenport* holding. First, the government suggests that a distinction exists here between the counts; that Count 2 charged only attempted structuring transactions, which were not consummated, and that "there is a logical separation between consummated structured transactions and attempted but unconsummated structured transactions." Government Response at 4. We see no logic in this argument. This interpretation would mean that if one sets out to structure transactions so as to avoid CTRs on one $100,000 cash hoard by buying ten cashier's checks, and all ten purchases succeeded, only one structuring count would be proper. But if two checks of the ten were not obtained, then one would be guiltier and two structuring counts could be charged relating to the same efforts to avoid CTRs on one cash hoard. As the court said in *Davenport,* 929 F.2d at 1171, about a similar contention, "[t]he government's position leads to [a] weird result...." The basic violation of structuring by attempting to conceal *one* large cash hoard, during one day's conduct, underlies both counts charged against Dashney. They concerned only *one* structuring violation in our opinion.

The remaining contention of the government is that Dashney has suffered no harm by being charged in two separate counts. It is true that such multiple counts are grouped together for sentencing purposes. *See* U.S.S.G. §§ 3D1.2(d) and 3D1.3(b). Nevertheless, separate convictions are involved and an additional conviction does bear an onus that the defendant is entitled to be relieved of, if invalid. The government says that the extra $50 special assessment is *de minimis.* Apparently the Congress did not think so and directed imposition of the assessments on separate valid convictions. We have held that a separate invalid special assessment of $50 would prevent the application of the concurrent sentence doctrine. *United States v. Sullivan,* 919 F.2d 1403, 1429 n. 42 (10th Cir.1990).

In sum, we are convinced that the *Davenport* result is sound and that it requires the vacation of the conviction on Count 2 here.

V

Accordingly, the conviction on Count 1 is AFFIRMED. The conviction on Count 2 is REVERSED. The cause is remanded to the district court to vacate the sentence and resentence the defendant in accord with this opinion.

IT IS SO ORDERED.

All Citations

937 F.2d 532, 60 USLW 2059

Footnotes

[*] Judge Seymour heard the argument in this case but did not participate in this decision.

[1] Section 5324 states in part that “[n]o person shall for the purpose of evading the reporting requirements of section 5313(a) with respect to such transaction ... structure or assist in structuring, any transaction with one or more domestic financial institutions.” 31 U.S.C. § 5324. Section 5313(a) of Title 31 requires financial institutions to file reports of currency transactions involving more than $10,000.

Section 5322(a) of Title 31 provides in part that “[a] person willfully violating this subchapter ... shall be fined not more than $250,000, or imprisonment [of] not more than five years, or both.” Thus § 5322(a) acts to prescribe criminal penalties for a variety of Title 31 violations, including § 5324.

[2] The indictment reads in part:

COUNT 1

The Grand Jury charges that:

> On or about December 14, 1989, in the State and District of Colorado, DAVID A. DASHNEY, for the purpose of evading the reporting requirements of 31 U.S.C. § 5313(a) and Title 31, Code of Federal Regulations, Section 103.22(a)(1), knowingly, intentionally, and unlawfully structured or attempted to structure a transaction or transactions or knowingly, intentionally, and unlawfully induced, counseled, or commanded Sandra Jarrett to structure or attempt to structure a transaction or transaction, to wit: the purchase with cash on the same business day of $99,999.93 of cashiers checks payable to the order of DAVID A. DASHNEY, with one or more domestic financial institutions in metropolitan Denver, to wit: [alleging transactions with eleven financial institutions] ... or knowingly, intentionally, and unlawfully procured or caused the structuring or attempted structuring of a transaction or transaction, to wit: the purchase of cash on the same business day of $99,999.93 of cashier's checks payable to the order of DAVID A. DASHNEY, with one or more domestic financial institutions, to wit: those transactions described above in violation of 31 U.S.C. §§ 5324(3), 5322(a), all in violation of 18 U.S.C. § 2.

COUNT 2

The Grand Jury charges that

> On or about December 14, 1989, in the State and District of Colorado, DAVID A. DASHNEY, for the purpose of evading the reporting requirements of 31 U.S.C. § 5313(a) and Title 31, Code of Federal Regulations, Section 103.22(a)(1), knowingly, intentionally, and unlawfully attempted to structure a transaction or transactions, to wit: the purchase with cash of a series of cashiers checks, none of which is in excess of $10,000.00, totaling approximately $100,000.00, all such cashiers checks to have been payable to the order of DAVID A. DASHNEY, with one or more domestic financial institutions in metropolitan Denver, to wit: World Savings and Green Mountain Bank, in violation of 31 U.S.C. §§ 5324(3), 5322(a), all in violation of 18 U.S.C. § 2.

I R. at 1–3. The government argued at a hearing on a motion to require the government to elect on which count it would proceed that the Count 1 transactions were completed, while those alleged in Count 2 were attempted, but unsuccessful. II R. at 6–12. The argument raised in this motion of defendant is addressed further in Part IV, *infra.*

[3] The defendant's Las Vegas winnings were seized by the government in a civil forfeiture action pursuant to 18 U.S.C. § 981(a)(1)(A), 31 U.S.C. § 5324(3), 21 U.S.C. § 881(a)(6), and Supplemental Rule for Certain Admiralty and Maritime Claims C(2). *See* I R. Doc. 9, Ex. Q.

[4] When committee reports are used in divining legislative intent, the reports used are usually those which accompanied the proposed and enacted legislation. It has been said that “[c]oncerning those parts of the bill passed as introduced by the committee without change, it is reasonable to assume that the legislature adopted the intent of the committee.” Sutherland Stat. Const. § 48.06 at 308 (4th Ed). This is not the case before this court as the reports discussed were attached to rejected proposed bills.

[5] We note that the legislation proposed in this House Judiciary Committee Report contained no prohibition on structuring. Thus, the interpretations of “willfully” were not made with reference to legislative proposals on an antistructuring law.

[6] The relevant currency reporting statutes were originally codified at 31 U.S.C. §§ 1051–1101 (1976). They were revised and recodified at 31 U.S.C. §§ 5311–26 (1986).

[7] The motion below was titled “MOTION TO REQUIRE GOVERNMENT TO ELECT DUE TO DUPLICITY IN INDICTMENT,” but it actually was directed at the multiplicity of the indictment, arguing that “[b]oth counts allege the same wrongful conduct on behalf of the defendant.” I R. Doc. 3. Duplicity refers to the inclusion of various offenses in a single count of an indictment, while multiplicity refers to multiple counts of an indictment which cover the same criminal behavior. *United States v. Chrane,* 529 F.2d 1236, 1237 n. 3 (5th Cir.1976).

[8] Only one of these two banks was not involved in Count 1.

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2015 WL 4508688
United States District Court, W.D. Washington,
at Seattle.

James MOORE, Plaintiff,
v.
UNITED STATES of America, Defendant.

No. C13–2063RAJ.
|
Signed July 24, 2015.

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Adam D. Strait, Jennifer Y. Golden, Washington, DC, for Defendant.

ORDER

RICHARD A. JONES, District Judge.

I. INTRODUCTION

***1** This matter comes before the court on the parties' supplemental briefs following the court's April 1, 2015 order. The court assumes the parties' familiarity with that order, and will not repeat the summary and analysis of this litigation contained therein.

In light of the April 1 order, the parties' supplemental briefs and evidence, and the reasons stated below, the court directs the clerk to DISMISS this case and to enter judgment for the United States.

II. DISCUSSION

The court summarizes its rulings today as follows:

1) The United States has demonstrated that the IRS's decision to assess Mr. Moore FBAR penalties of $10,000 for each year from 2005 through 2008 was not arbitrary, not capricious, and not an abuse of its discretion.

2) The IRS's conduct in assessing those FBAR penalties, by contrast, was in several respects arbitrary and capricious. In particular, the IRS disclosed no adequate basis for its decision to assess the penalties until this litigation forced its hand. Even after this litigation began, the IRS refused to disclose the evidence on which it now relies to demonstrate the basis for its decision to impose those penalties. With respect to the 2005 penalty, the IRS broke its own promise not to impose a penalty until Mr. Moore had an opportunity to respond to its "proposed" assessment.

3) In light of these rulings, the Government is entitled to judgment for $40,000, although that amount will be offset by the more than $10,000 that Mr. Moore has already paid. In light of the arbitrary and capricious conduct described above, the court rules that any interest, late fee, or other supplemental assessment that the IRS or another agency of the United States has attempted to tack on to Mr. Moore's FBAR penalties is void. The United States shall treat the FBAR penalties as if they were first assessed on the date of this order.

The court briefly explains each of those rulings. First, it finds that the supplemental declaration of IRS Appeals Officer Daisy Batman, which includes the case memorandum that the IRS previously refused to disclose to Mr. Moore, discloses the basis for the IRS's decision to assess the FBAR penalties. That memorandum leads the court to conclude that the IRS did not act arbitrarily and capriciously or abuse its discretion in determining the amount of the penalties. In particular, the court finds that the guidelines for determining the amount of FBAR penalties contained in the Internal Revenue Manual are not arbitrary or capricious, and that it was not an abuse of discretion for the IRS to follow those guidelines in this case.

The IRS's refusal to disclose anything about the basis for its decision until this litigation, and in particular its decision to withhold Agent Batman's memorandum until after the court ordered it produced, was arbitrary and capricious. The IRS did not simply fail to disclose Agent Batman's memorandum, it opposed Mr. Moore's motion to compel its disclosure. Once the Government determined that it could point to no other evidence justifying its decision to impose the maximum penalties, the Government produced the memorandum. The IRS has offered no explanation for its apparent policy not to explain the assessment of FBAR penalties to citizens, and in particular for its apparent policy not to put that explanation in writing. It has also offered no explanation for its steadfast refusal to disclose Agent Batman's memo in this litigation until it was left with no other options. No citizen should have to sue his own Government to find out why he is being fined, or to find out why he is being fined $40,000 as opposed to a smaller amount. And once a citizen has sued, he should not have to fight over the most basic disclosures.

***2** As to its bizarre conduct in assessing the 2005 penalty, the IRS explains that it has an internal policy to assess FBAR penalties at least 180 days before the expiration of the statute of limitations for doing so. That policy is well within its discretion. What is not within its discretion is its decision to offer Mr. Moore the opportunity to contest the 2005 FBAR penalty before its assessment, and then to impose the penalty before the deadline the IRS imposed. The IRS offers no explanation for why it allowed rote application of its internal policies to trump the individual assurances it made to Mr. Moore.

In light of the court's conclusion that the amount of the penalty the IRS imposed was appropriate, there are two apparent harms arising from its arbitrary and capricious conduct in imposing that penalty. First, Mr. Moore was given the unappealing choice to either accept the IRS's unexplained imposition of a $40,000 penalty or to file suit. The court assumes that Mr. Moore's choice to sue cost him a substantial sum. Second, the IRS has assessed interest and other penalties on top of the FBAR penalties. The court expresses no opinion at this time on whether the first harm can be remedied. The court remedies the second harm by preventing the IRS from profiting by imposing penalties without explaining them. The court voids the IRS's assessment of interest and other charges on top of its previously unexplained penalties.

III. CONCLUSION

For the reasons stated above, the court directs the clerk to DISMISS this case and to enter judgment for the United States for $40,000, although the United States must offset that amount by the amount of any payments it has received from Mr. Moore. The United States shall treat the FBAR penalties underlying that judgment as if they were imposed on the date of this order. Mr. Moore owes no interest, late charge, or other assessment supplemental to the $40,000 in penalties accruing before the date of this order.

All Citations

Not Reported in F.Supp.3d, 2015 WL 4508688, 116 A.F.T.R.2d 2015-5397, 2015-2 USTC P 50,411

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2017 WL 1743837
United States District Court,
S.D. New York.

UNITED STATES of America,
v.
Michael LITTLE, Defendant.

12-cr-647 (PKC)
|
Signed 05/03/2017

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MEMORANDUM AND ORDER

P. Kevin Castel, United States District Judge

***1** Defendant Michael Little moves for partial dismissal of the Second Superseding Indictment on the grounds that his prosecution for failure to file individual income tax returns and Reports of Foreign Bank and Financial Accounts ("FBARs") would deprive him of due process of law in violation of the Fifth Amendment to the United States Constitution. Little asserts that at the time of the events charged in the indictment he was a U.K. citizen and a lawful permanent resident of the U.S. He argues that the statutes and regulations requiring U.K. citizens with permanent residence status under U.S. immigration law to file U.S. income tax returns and FBARs, when read in conjunction with the U.S./U.K. Tax Treaty (the "Treaty"), are ambiguous, such that a person of ordinary intelligence lacks notice as to what constitutes compliance with the law. The Court finds that none of the relevant statutes or regulations, whether read in isolation or together, or in conjunction with the Treaty, are so ambiguous that they could properly be found unconstitutionally vague as applied to the charged conduct. Defendant's motion for partial dismissal of the indictment is thus denied.

BACKGROUND

A grand jury returned a nineteen count Second Superseding Indictment against defendant Little, filed on March 18, 2013, charging him with willful failure to file individual income tax returns and FBARs, as well various crimes arising out of his alleged assistance of Harry G. A. Seggerman's heirs in a scheme to avoid the taxes due on their inheritance held in undeclared offshore accounts. (Dkt. No. 48.) Little first raised his due process arguments in a letter to the Court dated February 9, 2017. (Dkt. No. 230.) The Court directed the government to respond. (Dkt. No. 231.) The government responded on March 2, 2016, (Dkt. No. 234), Little replied on March 21, 2017, (Dkt. No. 239), and supplemented this submission on April 10, 2017, (Dkt. No. 244.)

DISCUSSION

Defendant Little moves to dismiss Counts One through Eight of the Second Superseding Indictment on the grounds that the statutes and regulations requiring him to file individual income tax returns and FBARs, as well as those attaching criminal liability to such failure, are unconstitutionally vague in violation of the Due Process Clause of the Fifth Amendment.

I. Void for Vagueness Standard.

"As generally stated, the void-for-vagueness doctrine requires that a penal statute define the criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement." United States v. Rybicki, 354 F.3d 124, 129 (2d Cir. 2003) (quoting Kolender v. Lawson, 461 U.S. 352, 357 (1983)). Because the First Amendment is not implicated, the Court assesses Little's challenge as applied, i.e., "in light of the specific facts of the case at hand and not with regard to the statute's facial validity." Id. (quoting United States v. Nadi, 996 F.2d 548, 550 (2d Cir. 1993)). Courts examine as-applied vagueness claims in two steps: "a court must first determine whether the statute gives the person of ordinary intelligence a reasonable opportunity to know what is prohibited and then consider whether the law provides explicit standards for those who apply it." Rubin v. Garvin, 544 F.3d 461, 468 (2d Cir. 2008) (quoting

Farrell v. Burke, 449 F.3d 470, 486 (2d Cir. 2006)). The "novelty" of a prosecution does not bolster a vagueness challenge, for the lack of a prior "litigated fact pattern" that is "precisely" on point is "immaterial." United States v. Kinzler, 55 F.3d 70, 74 (2d Cir. 1995).

***2** "A scienter requirement may mitigate a law's vagueness, especially where the defendant alleges inadequate notice." Rubin, 544 F.3d at 467 (citing Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 499 (1982)). Where "the punishment imposed is only for an act knowingly done with the purpose of doing that which the statute prohibits, the accused cannot be said to suffer from lack of warning or knowledge that the act which he does is a violation of law." United States v. Tannenbaum, 934 F.2d 8, 12 (2d Cir. 1991) (quoting Screws v. United States, 325 U.S. 91, 102 (1945) (plurality opinion)) (Bank Secrecy Act provision requiring reporting by financial institutions not void for vagueness when applied to an individual because the Act defined financial institutions to include "[a] person who engages as a business in dealing in or exchanging currency" and defendant knew he was "committing a wrongful act.")

The Court must conduct separate inquiries into the underlying statutes and regulations and then into the statutes imposing criminal penalties for certain types of violations of these statutes and regulations. First, the Court finds that the U.S. statutes and regulations that require alien lawful permanent residents (green card holders) to either (a) file a tax return and pay taxes on worldwide income, or (b) file a tax return reporting worldwide income and indicate that he or she is taking a particular protection under the Treaty, are not unconstitutionally vague as applied. Second, the Court finds that the statutes providing for criminal sanctions against individuals who violate these obligations are not vague as applied to alien lawful permanent residents.

II. U.S. Tax and Reporting Obligations for Alien Lawful Permanent Residents.

An alien individual who is a lawful permanent resident of the United States is treated as a resident of the United States for tax payment and reporting purposes. 26 U.S.C. § 7701(b)(1)(A). This treatment applies regardless of whether the individual is physically present in the U.S. or not. An individual is a lawful permanent resident of the U.S. if the individual has been lawfully accorded the privilege of residing permanently in the U.S. as an immigrant in accordance with the immigration laws, as long as this status has not been revoked or administratively or judicially determined to have been abandoned. 26 U.S.C. § 7701(b)(6). In 2008 Congress amended 26 U.S.C. § 7701(b)(6) to add the following language:

> An individual shall cease to be treated as a lawful permanent resident of the United States if such individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.

26 U.S.C. § 7701(b)(6)(B).

Under 26 U.S.C. § 6012 and 26 C.F.R. § 1.6012-1, a U.S. resident is required to file an income tax return each year on a Form 1040.

An individual who is a U.S. resident as well as a resident of a foreign country is a dual resident. If the U.S. is party to a tax treaty with the foreign country of which the dual resident is also a resident, then that treaty will determine the residency status of that resident.

The U.S. is party to a tax treaty with the U.K.: the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, effective July 24, 2001. The residence provisions of the Treaty, or "tie breaker rules," dictate that, for the purposes of the taxation of worldwide income, when an individual is a dual resident of the U.S. and U.K.:

> ***3** a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

> b) if the State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
>
> c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
>
> d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall endeavour to settle the question by mutual agreement.

Treaty, art. IV, § 4. Explicitly excluded from this treatment are taxes due to either State by "any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State." Id. at art. IV, § 1.

A dual resident of the U.S. and the U.K. may claim benefits under the Treaty and be treated as a nonresident alien for the purposes of computing his U.S. federal income tax liability. To receive such treatment, the individual must file a Form 1040NR:

> An alien individual ... who determines his or her U.S. tax liability as if he or she were a nonresident alien shall make a return on Form 1040NR on or before the date prescribed by law (including extensions) for making an income tax return as a nonresident. The individual shall prepare a return and compute his or her tax liability as a nonresident alien. The individual shall attach a statement (in the form required in paragraph (c) of this section) to the Form 1040NR. The Form 1040NR and the attached statement, shall be filed with the Internal Revenue Service Center, Philadelphia, PA 19255.

26 C.F.R. § 301.7701(b)-7(b). The individual must also file as an attachment to his or her Form 1040NR a completed Form 8833 (Treaty-Based Return Position Disclosure). 26 C.F.R. § 301.7701(b)-7(c).

The filing of this Treaty-Based Return Position Disclosure is also mandated as part of a separate and independent reporting obligation pursuant to 26 U.S.C. § 6114:

> (a) Each taxpayer who, with respect to any tax imposed by this title, takes the position that a treaty of the United States overrules (or otherwise modifies) an internal revenue law of the United States shall disclose (in such manner as the Secretary may prescribe) such position—
>
> (1) on the return of tax for such tax (or any statement attached to such return), or
>
> (2) if no return of tax is required to be filed, in such form as the Secretary may prescribe.

Thus, the filing of Form 8833 satisfies the reporting requirements of both 26 C.F.R. § 301.7701(b)-7(b) and 26 U.S.C. § 6114 with respect to disclosing that the filing individual is taking a Treaty position. See 26 C.F.R. § 301.7701(b)-7(d).

For further clarification regarding filing requirements, 26 C.F.R. § 301.7701(b)-7(e) sets forth examples to illustrate the application of these rules and the tax and reporting obligations of individuals who do or do not take a Treaty position.

III. The Tax and Reporting Obligations Applicable to Alien Permanent Residents are not Void as Applied.

A. Failure to File Tax Returns.

***4** Little argues that the 2008 amendment to 26 U.S.C. § 7701(b)(6), when read in conjunction with the Treaty, created an ambiguity regarding a permanent resident's tax and reporting obligations. (Def.'s Reply in Supp. of Mot. to Dismiss, March 21, 2017, Dkt. No. 239 ("D.'s Reply") at 2.) He argues that this amendment brought the law into compliance with the Treaty, which states:

> An individual who is a United States citizen or an alien admitted to the United States for permanent residence (a 'green card' holder) is a resident of the United States only if the individual has a substantial presence, permanent home or habitual abode in the

> United States and if that individual is not a resident of a State other than the United Kingdom for the purposes of a double taxation convention between that State and the United Kingdom.

Treaty, art. 4 § 2. Little argues that because he was only temporarily in the U.S. between 2005-2008, this language from the Treaty would lead a person of ordinary intelligence to believe that he was not a resident of the U.S. for tax purposes. (D.'s Reply at 2.) Little also argues that the Court should not interpret any subsequently passed legislation or regulation as having modified the Treaty, citing TWA v. Franklin Mint Corp., 466 U.S. 243, 252 (1984) ("A treaty will not be deemed to have been abrogated or modified by a later statute unless such purpose on the part of Congress has been clearly expressed."). (D.'s Reply at 3.)

Little cites several more provisions of the Treaty that he claims are inconsistent with the above described tax and reporting obligations imposed by U.S. statutes and regulations, arguing that an alien lawful permanent resident of ordinary intelligence would be unclear as to what was needed to comply with the law. He cites, among other portions of the Treaty, Article 25, which states:

> Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith that is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, particularly with respect to taxation on worldwide income, are or may be subjected.

Treaty, art. 25, § 1.

Little appears to interpret this language to mean that a U.K. national cannot be subject to any requirement in the U.S. that is more burdensome than that which that person would be subject to in the U.K. (D.'s Reply at 4.) Little's interpretation is erroneous. A plain reading of the forgoing language is that a U.K. national cannot be subject to requirements in the U.S. that are more burdensome than those that U.S. nationals are subject to within the U.S. Thus, Little's contention that failure to file tax returns in the U.K. is not a criminal offence is irrelevant.

Little goes on to argue that even under U.S. law the penalty for failing to disclose a Treaty position is a financial penalty, not the denial of Treaty benefits, citing 26 U.S.C. § 6712 (imposing a $1,000 penalty for failure to comply with 26 U.S.C. § 6114). (Id. at 3.) He further argues that failure to disclose that one is taking a Treaty position does not prohibit one from doing so, citing Pekar v. Commissioner, 113 T.C. 158, 161 n.5 (1999) ("A taxpayer who fails in a material way to disclose one or more positions taken for a taxable year is subject to a separate penalty for each failure to disclose a position. However, there is no indication that this failure estops a taxpayer from taking such a position.") (internal citations omitted).

***5** Little also cites language in Articles 3, 5, 7, and 26 of the Treaty, which he argues exempt the income he made working in the U.S. from taxation by the U.S. (D.'s Reply at 4.)

Little's arguments lack merit. Based on the above cited statutes and regulations, an alien lawful permanent resident of ordinary intelligence would know that he or she needed to either (a) file a tax return and pay taxes on worldwide income, or (b) file a tax return reporting worldwide income and indicate that he or she is taking a particular protection under the Treaty. An individual's obligation to pay taxes on either his income earned while in the U.S., or his worldwide income, is irrelevant to his or her obligation to disclose such income and report it pursuant to the above discussed statutes and regulations.

The U.S. statutes and regulations giving rise to these obligations are thus not void as applied to the conduct with which Little is charged in the Second Superseding Indictment. Dicta in a decades-old Tax Court case does not render the obligations imposed on Little by these statutes and regulations unconstitutionally vague.

Little's argument that the failure to take a Treaty position can result only in a financial penalty also lacks merit. 26 U.S.C. § 6712(c) expressly states that "[t]he penalty imposed by this section shall be in addition to any other penalty imposed by law."

Little also contends that he was informed by Her Majesty's Revenue and Customs that he was a U.K. tax resident pursuant to the Treaty and thus not required to file U.S. tax returns. (Def.'s February 9, 2017 Letter, Dkt. No. 230 at 2.)

Advice of counsel is an affirmative defense that must be based in fact and raised at trial by the defendant, who must prove that he "(1) 'honestly and in good faith' sought the advice of counsel; (2) 'fully and honestly la[id] all the facts before his counsel'; and (3) 'in good faith and honestly follow[ed]' counsel's advice, believing it to be correct and intending that his acts be lawful. United States v. Colasuonno, 697 F.3d 164, 181 (2d Cir. 2012) (quoting Williamson v. United States, 207 U.S. 425, 453 (1908)) (alternations in original). It remains to be determined whether information from a U.K. tax official can qualify as advice of counsel.

Under the present circumstances, no advice that Little may have received from U.K. tax authorities affects the void for vagueness analysis of his duty to file U.S. tax returns.

B. Failure to File FBARs.

Both Little and the Government agree that the Treaty does not affect any individual's obligation to file FBARs and that the 2007 and 2008 FBAR forms provided that FBARs were to be filed by "citizen[s] or resident[s] of the United States, or a person in and doing business in the United States." (Gov.'s Opp. to Mot. to Dismiss, March 2, 2017, Dkt. No. 234 ("Gov.'s Opp.") at 11; D.'s Reply at 4.) However, Little contends that IRS announcements 2009-51 and 2010-51 suspended the requirement for a person "in and doing business in the United States" to file and FBAR. (D.'s Reply at 4.) Internal Revenue Bulletin: 2009-51, "Temporary Suspension of FBAR filing Requirements for Persons who are not Citizens, Residents, or Domestic Entities," June 22, 2009, stated:

> ***6** [A]ll persons may rely on the definition of 'United States person' found in the instructions for the prior version of the FBAR (the July 2000 version) to determine whether they have an obligation to file an FBAR. The definition of 'United States person' from the prior version is as follows: ... The term 'United States person' means (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust.

Prior to February 24, 2011, the FBAR regulations did not define the term "U.S. resident." Internal Revenue Manual 4.26.16.3.1.2(1). "For FBARs required to be filed June 30, 2011 or later, 31 C.F.R. § 1010.350(b) defines 'United States resident' using the definition of resident alien in IRC 7701(b)," which includes green card holders such as Little. Internal Revenue Manual 4.26.16.3.1.2(2)(1).

For FBARs due before the June 22, 2009 announcement, there does not appear to be any ambiguity regarding the duty to file for persons 'in and doing business in the United States.' Even before the term 'United States resident' was defined by FBAR regulations, it appears likely that an alien lawful permanent resident of ordinary intelligence not 'in or doing business in' the U.S. would have understood themselves to be under an obligation to file an FBAR based on the definition of 'United States resident' in other parts of the U.S. code and regulations. To the extent that there was any ambiguity regarding this duty, that ambiguity is remedied for the purposes of this void for vagueness analysis by the fact that criminal penalties only apply to a failure to file an FBAR if such failure to file was willful, as will be discussed below.

IV. The Relevant Criminal Statutes as Applied are not Void for Vagueness.

Little argues that Counts One through Eight of the Second Superseding Indictment must be dismissed pursuant to the void for vagueness doctrine of the Due Process Clause of the Fifth Amendment. Count One of the Second Superseding Indictment charges Little with Obstructing and Impeding the Due Administration of Internal Revenue Laws in violation of 26 U.S.C. § 7212(a); Counts Two through Seven charge Little with Failure to File Individual Income Tax Returns for Tax Years 2005-2010 in violation of 26 U.S.C. § 7203; Count Eight charges Little with Willful Failure to File Reports of Foreign Bank and Financial Accounts in violation of 31 U.S.C. § 5322(a). Because a person of ordinary intelligence would understand that these statutes impose criminal penalties on persons engaging in the conduct in which Little is alleged to have engaged, these statutes are not void for vagueness as applied to Little.

26 U.S.C. § 7212(a) makes it unlawful to "corruptly ... obstruct[ ] or impede[ ], or endeavor[ ] to obstruct or impede, the due administration of" the Internal Revenue Code. 26 U.S.C. § 7212(a). "To act or endeavor 'corruptly,' within the meaning of this section, means to act or endeavor 'with the intent to secure an unlawful advantage or benefit either for one's self or for another.' " United States v. Parse, 789 F.3d 83, 121 (2d Cir. 2015) (quoting United States v. Kelly, 147 F.3d 172, 177 (2d. Cir. 1998)).

Count One, paragraph nine of the Second Superseding Indictment alleges that Little took six separate actions, in addition to failing to file FBARs and tax returns, that violated Section 7212(a) in connection with the alleged scheme to avoid the taxes due on the Seggerman heirs' inheritance, and the government represents it intends to rely on those actions rather than on the failure to file tax returns or FBARs. (Gov.'s Opp. at 14-15.) A person of ordinary intelligence would understand that conduct of the type alleged in paragraph nine would expose an individual to criminal penalties for obstruction under the meaning of section 7212(a). Thus, there is no void for vagueness issue with respect to Little's prosecution for obstruction of the internal revenue laws.

***7** 26 U.S.C. § 7203 makes it unlawful for "[a]ny person required under [Title 26] to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, [to] willfully fail[ ] to pay such estimated tax or tax, make such return, keep such records, or supply such information...." In Section 7203 and other statues prohibiting tax evasion, "the word 'willfully' ... generally connotes a voluntary, intentional violation of a known legal duty." United States v. Bishop, 412 U.S. 346, 360 (1973). The Supreme Court has "formulated the requirement of willfulness as bad faith or evil intent, or evil motive and want of justification in view of all the financial circumstances of the taxpayer, or knowledge that the taxpayer should have reported more income than he did." Id. (internal citations and quotation marks omitted).

31 U.S.C. 5322(a) makes it unlawful to "willfully violat[e]" 31 U.S.C. §§ 5311 et seq., "or a regulation prescribed or order issued" thereunder, including 31 C.F.R. § 1010.350, which requires certain individuals to file FBARs. Thus, to be convicted under Section 5322(a) for violating the requirement to file an FBAR, a defendant must know of his duty to file but intentionally fail to do so anyway. See United States v. Sturman, 951 F.2d 1466, 1476 (6th Cir. 1991) (defining "willfulness" in prosecution for failure to file records and reports of foreign financial agency transactions as the "voluntary, intentional violation of a known legal duty"); United States v. Eisenstein, 731 F.2d 1540, 1543 (11th Cir. 1984) ("[A]s it is used in the currency reporting statute, the term *willful* require[s] proof of the defendant's knowledge of the reporting requirement and his specific intent to commit the crime.") (internal quotation marks omitted) (alterations and emphasis in original); United States v. Granda, 565 F.2d 922, 925-26 (5th Cir. 1978) ("[T]he terms knowing and willful require proof of the defendant's knowledge of the reporting requirement and his specific intent to commit the crime. Congress, by adding these terms, took this regulatory statute out of the ranks of strict liability type crimes."); United States v. San Juan, 545 F.2d 314, 318 (2d Cir. 1976) ("Without proof of any knowledge of, or notice to, Mrs. San Juan of the reporting requirements, a jury could not determine beyond a reasonable doubt that she had the requisite willful intent.").

Thus, conviction pursuant to each of these statutes requires the government to prove beyond a reasonable doubt that Little acted willfully with respect to the failure to file tax returns and FBARs, and corruptly with respect to the obstruction of the internal revenue laws. As described above, the presence of this scienter requirement undercuts any due process void for vagueness challenge. Because a conviction may only be obtained only if the government proves, beyond a reasonable doubt, that the defendant knew he was legally required to file tax returns or file an FBAR, and so knowing, intentionally did not do so with the knowledge that he was violating the law, he cannot complain that he could be convicted for actions that he did not realize were unlawful. See, e.g., 3 L. Sand, et al., Modern Federal Jury Instructions, Criminal Inst. 50B-11 at 50B-16 (2013) ("A willful violation of this reporting requirement can only occur if the government proves beyond a reasonable doubt that the defendant knew of the reporting requirement and that the defendant acted with the specific intent to violate that requirement.")

CONCLUSION

Neither the legal obligation for alien lawful permanent residents of the U.S. to file tax returns or FBARs, nor the statutes criminalizing such failure, nor the statute prohibiting the obstruction of the internal revenue laws, are vague as applied to Little's alleged conduct. A person of ordinary intelligence would know if his or her actions conformed to law. Defendant's motion to dismiss Counts One through Eight of the Second Superseding Indictment is DENIED. The Clerk of the Court is directed to terminate the motion (Dkt. No. 239.)

***8** SO ORDERED.

All Citations

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2016 WL 1642968
United States District Court,
S.D. Ohio, Western Division,
Western Division at Dayton.

Mark Crawford, et al., Plaintiffs,
v.
United States Department of
the Treasury, et al., Defendants.

Case No.: 3:15–CV–00250
|
Signed April 25, 2016
|
Filed 04/26/2016

Attorneys and Law Firms

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ENTRY AND ORDER DENYING PLAINTIFFS' MOTION FOR LEAVE TO FILE AN AMENDED VERIFIED COMPLAINT (DOC. 32); GRANTING DEFENDANTS' MOTION TO DISMISS (DOC. 26) PLAINTIFFS' COMPLAINT (DOC. 1); AND TERMINATING CASE.

THOMAS M. ROSE, UNITED STATES DISTRICT JUDGE

***1** Plaintiffs[1] filed suit against the United States Department of the Treasury (“Treasury Department”), United States Internal Revenue Service (“IRS”), and United States Financial Crimes Enforcement Network (“FinCEN”), referred to, collectively, as “Defendants”, seeking declaratory and injunctive relief on all claims. (Doc. 1, at PageID# 48–50.) Plaintiffs' Verified Complaint (doc. 1) and proposed Amended Verified Complaint (doc. 32–1) challenge the Foreign Account Tax Compliance Act (“FATCA”), the intergovernmental agreements (“IGAs”) negotiated by the Treasury Department to supplant FATCA in the signatory countries, and the Report of Foreign Bank and Financial Accounts (“FBAR”) administered by FinCEN. FATCA mandates that foreign financial institutions (“FFIs”) report the tax return information of their U.S. citizen account holders directly to the IRS using the FATCA Report (Form 8966). 26 U.S.C. § 1471(b)(1)(C); 26 C.F.R. §§ 1.1471–4(d)(3)(v), –4(d)(3)(vi).

Previously, Plaintiffs moved for a preliminary injunction on all claims (doc. 8, at PageID# 135–38) and attached a Memorandum in Support of their Motion for Preliminary Injunction. (Doc. 8–1, at PageID# 139–74.) After full briefing, the Court denied Plaintiffs' Motion for Preliminary Injunction. (Doc. 30.) Now before the Court is Defendants' Motion to Dismiss filed pursuant to Fed. R. Civ. P. 12(b)(1), (6). (Docs. 26, 27.) Plaintiffs filed a Memorandum in Opposition to the Motion to Dismiss. (Doc. 37.) Defendants filed a Reply Memorandum in Support of their Motion to Dismiss. (Doc. 38.)

In addition, Plaintiffs filed a Motion for Leave to File an Amended Verified Complaint, (doc. 32), and attached a proposed Amended Verified Complaint, (doc. 32–1), to their motion. Defendants filed a Memorandum in Opposition to Plaintiffs' Motion for Leave, (doc. 34), arguing that amendment is futile because the proposed Amended Verified Complaint does not cure the deficiencies stated in Defendants' Motion to Dismiss, (docs. 26, 27), and the Court's Entry and Order Denying Plaintiff's Motion for Preliminary Injunction. (Doc. 30.) Plaintiffs filed a Reply Memorandum in support of their Motion for Leave. (Doc. 35.)

There are eight proposed claims before the Court. (Doc. 32–1, at 154–209.) The first claim challenges the validity of the Canadian, Czech, Israeli, French, Danish, and Swiss IGAs[2] used by the Treasury Department. (*Id.*, at 154–65.) The second claim addresses the information reporting provisions FATCA and the IGAs impose not on Plaintiffs, but on FFIs. (*Id.*, at 166– 71.) The third claim aims at the heightened reporting requirements for foreign bank accounts under FATCA, the IGAs, and the FBAR. (*Id.*, at 172–78.) The fourth claim challenges the 30% tax imposed by FATCA on payments to FFIs from U.S. sources when these foreign institutions choose not to report to the IRS about the bank accounts of their U.S. customers (the “FFI Penalty”). (*Id.*, at 179–88.) Similarly, the fifth claim challenges the 30% tax imposed by FATCA on account holders who exercise their rights under the statute not to identify themselves as United States citizens to their banks and to refuse to waive privacy protections afforded their accounts by foreign law (the "Passthrough Penalty"). (*Id.*, at 189–93.) The sixth claim challenges the penalty imposed under the Bank Secrecy Act for "willful" failures to file an FBAR for foreign accounts, which can be as much as the greater of $100,000 or 50% of the value of the unreported account (the "Willfulness Penalty"). (*Id.*, at 194–98.) The seventh and eighth claims challenge the information reporting requirements of FATCA and the IGAs as unconstitutional under the Fourth Amendment. (*Id.*, at 199–209.)

***2** The Motion to Dismiss and Motion for Leave to Amend are now fully briefed and ripe for decision. A relevant factual background will first be set forth, followed by the applicable legal standard and analysis of the motions.

I. BACKGROUND

A. FATCA Statute and Regulations

Congress passed FATCA in 2010 to improve compliance with tax laws by U.S. taxpayers holding foreign accounts. FATCA accomplishes this through two forms of reporting: (1) by FFIs about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest, 26 U.S.C. § 1471; and, (2) by U.S. taxpayers about their interests in certain foreign financial accounts and offshore assets. 26 U.S.C. § 6038D.

1. FATCA

President Obama signed FATCA into law on March 18, 2010. Senator Carl Levin, a co–sponsor of the FATCA legislation, declared, "offshore tax abuses [targeted by FATCA] cost the federal treasury an estimated $100 billion in lost tax revenues annually." 156 Cong. Rec. 5 S1745–01 (2010). FATCA became law as the IRS began its Offshore Voluntary Disclosure Program ("OVDP"), which since 2009 has allowed U.S. taxpayers with undisclosed overseas assets to disclose them and pay reduced penalties. By 2014, the OVDP collected $6.5 billion through voluntary disclosures from 45,000 participants. *IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance*, IRS (June 18, 2014), https://www.irs.gov/uac/Newsroom/IRS–Makes–Changes–to–Offshore–Programs% 3B–Revisions–Ease–Burden–and–Help–More–Taxpayers–Come–into–Compliance. The success of the voluntary program has likely been enhanced by the existence of FATCA.

2. Foreign Financial Institution Reporting Under FATCA

Foreign Financial Institution reporting encourages FFIs to disclose information on U.S. taxpayer accounts. If the FFI does not, then a 30% withholding tax may apply to U.S.–sourced payments to the non–reporting FFI. A 30% withholding tax may also apply to FFI account holders who refuse to identify themselves as U.S. taxpayers.

> In the case of any withholdable payment to a foreign financial institution which does not meet the requirements of subsection (b) [specifying reporting criteria], the withholding agent with respect to such payment shall deduct and withhold from such payment a tax equal to 30 percent of the amount of such payment.

26 U.S.C. § 1471(a).

Section 1471(b)(1) then provides that, "[t]he requirements of this subsection are met with respect to any foreign financial institution if an agreement is in effect between such institution and the Secretary [of the Treasury] under which such institution agrees" to make certain information disclosures and "to deduct and withhold a tax equal to 30 percent of...[a]ny [pass–through] payment which is made by such institution to a recalcitrant account holder or another foreign financial institution which does not meet the requirements of this subsection[.]" § 1471(b)(1)(D)(i); *see also* § 1471(d)(7) (defining "pass[–through] payment"). A "recalcitrant account holder" is one who "[f]ails to comply with reasonable requests for information" that is either information an FFI needs to determine if the account is a U.S. account, § 1471(b)(1)(A), or basic information like the account holder's name, address, and taxpayer identification number. § 1471(c)(1)(A). Section 1471(c)(1) specifies the "information required to be reported on U.S. accounts," including "account balance or value." § 1471(c)(1)(C). In their Amended Verified Complaint, Plaintiffs seek a preliminary injunction against enforcement of § 1471(a), (b)(1)(D), (c)(1), and (c)(1)(C). (Doc. 32–1, Prayer for Relief at W.)

***3** Under § 1471(b)(2), “Financial Institutions Deemed to Meet Requirements in Certain Cases,” an FFI “may be treated by the Secretary as meeting the requirements of this subsection if ... such institution is a member of a class of institutions with respect to which the Secretary has determined that the application of this section is not necessary to carry out the purposes of this section.” That means that an FFI that is treated this way is not subject to the reporting criteria in § 1471(b)(1). The Secretary can statutorily exempt FFIs from “attempt[ing] to obtain a valid and effective waiver” of foreign nondisclosure laws from each account holder and can exempt FFIs from closing such account “if a waiver ... is not obtained from each such holder within a reasonable period of time.” § 1471(b)(1)(F). [3] The Secretary's exemption of an FFI under § 1471(b)(2) also means that the FFI no longer has to make the report described in § 1471(c)(1) because that report is based on “[t]he agreement described in subsection (b)” that an FFI the Secretary has exempted does not need to have in place to avoid withholding. Furthermore, the FATCA statute provides, “[t]he Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of, and prevent the avoidance of, this chapter,” i.e., §§ 1471–74. 26 U.S.C. § 1474(f).

Plaintiffs also seek to enjoin enforcement of 26 C.F.R. § 1.1471–2T(a)(1). The “[g]eneral rule of withholding” under § 1471(a) is largely reiterated by 26 C.F.R. § 1.1471–2T(a)(1), which Plaintiffs also target. (Doc. 32–1, Prayer for Relief at Z.) Plaintiffs seek to enjoin enforcement of 26 C.F.R. §§ 1.1471–4(a)(1), 1.1471–4(d), and 1.1471–4(d)(3)(ii), which repeat the content of § 1471(b) and (c). (*Id.*, Prayer for Relief at AA.) In addition, Plaintiffs seek an injunction against 26 C.F.R. § 1.1471–4T(b)(1), which addresses the 30% withholding tax for recalcitrant account holders established by the statute. (*Id.*, Prayer for Relief at BB.) Plaintiffs also seek to enjoin the IRS's use of Form 8966, “FATCA Report”, the form on which FFIs make disclosures under § 1471(c). *See* 26 C.F.R. § 1.1471–4(d)(3)(v); (doc. 32–1, Prayer for Relief at DD.) In Plaintiffs' view, these FATCA regulations “primarily elaborate on the [ ] requirements of the statutory provisions and clarify the statutory requirements.” (Doc. 32–1, at 37.)

3. Individual Reporting Under FATCA

There is a companion individual reporting requirement to § 1471's FFI reporting requirement located at 26 U.S.C. § 6038D. Under § 6038D, individuals holding more than $50,000 of aggregate value in “specified foreign financial assets”, § 6038D(b), must file a report with their annual tax returns, § 6038D(a), that includes, for each asset “[t]he maximum value of the asset during the taxable year.” § 6038D(c)(4). Plaintiffs seek to enjoin this asset–value reporting requirement. (Doc. 32–1, Prayer for Relief at X.) Section 6038D(h) also provides that, “[t]he Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section ....” Plaintiffs seek to enjoin enforcement of the regulation that states this same reporting requirement. 26 C.F.R. § 1.6038D–4(a)(5); (*see* doc. 32–1, Prayer for Relief at CC.) Plaintiffs also target two other regulatory reporting requirements: disclosing whether a depository or custodial account was opened or closed during the taxable year, 26 C.F.R. § 1.6038D–4(a)(6); and “[t]he amount of any income, gain, loss, deduction, or credit recognized for the taxable year with respect to the reported specified foreign financial asset”, 26 C.F.R. § 1.6038D–4(a)(8). (Doc. 32–1, Prayer for Relief at CC.)

B. The Canadian, Czech, Israeli, French, Danish, and Swiss Intergovernmental Agreements

Once FATCA became law, the Government began requiring coordination with FFIs and foreign governments. To facilitate FATCA implementation, the United States has concluded over seventy IGAs with foreign governments addressing the exchange of tax information. Plaintiffs seek to enjoin IGAs with Canada, the Czech Republic, Israel, France, Denmark, and Switzerland in their entirety. (Doc 32–1, Prayer for Relief at B1 [4], E, I, M, Q, U.) Alternatively, they seek to enjoin parts of those IGAs. (*Id.*, Prayer for Relief at B2–D, F–H, J–L, N–P, R–T, V.)

***4** The Canadian, Czech, French, Danish, and Israeli IGAs are similar because they are all “Model 1” IGAs, whereas the Swiss IGA is a “Model 2” IGA. The key distinction is that under Model 1 IGAs, foreign governments agree to collect their FFIs' U.S. account information and to send it to the IRS, whereas under Model 2 IGAs, foreign governments agree to modify their laws to the extent necessary to enable their FFIs to report their U.S. account information directly to the IRS. All six IGAs, in their preambulatory clauses, recognize the partner governments' mutual "desire to conclude an agreement to improve international tax compliance" [5] or, in the case of Switzerland, a "desire to conclude an agreement to improve their cooperation in combating international tax evasion." [6]

All six IGAs mention the Tax Information Exchange Agreements ("TIEAs") that the United States has with these six countries as part of preexisting treaties. *See supra* notes 5–6. All six IGAs similarly note the need for "an intergovernmental approach to FATCA implementation", or, in the Swiss case, "intergovernmental cooperation to facilitate FATCA implementation". *Id.*

The five Model 1 IGAs—Canadian, Czech, French, Danish, and Israeli—define "Obligations to Obtain and Exchange Information with Respect to Reportable Accounts" in Article 2. Canadian IGA art. 2; Czech IGA art. 2; French IGA art. 2; Danish IGA art. 2; Israel IGA art. 2. In addition to seeking to enjoin Article 2 in full, (doc. 32–1, Prayer for Relief at B2, F, J, N, R), Plaintiffs attack the agreement that IGA partners, with respect to each "U.S. Reportable Account" of its FFIs, will report, "the account balance or value ... as of the end of the relevant calendar year or other appropriate reporting period ...." Canadian IGA art. 2, § 2(a)(4); Czech IGA art. 2, § 2(a)(4); French IGA art. 2, § 2(a)(4); Danish IGA art. 2, § 2(a)(4); Israeli IGA art. 2, § 2(a)(4); (*see* doc. 32–1, Prayer for Relief at C, G, K, O, S.) If Model 1 partner countries comply with Article 2 as well as the "Time and Manner of Exchange of Information" agreed to in Article 3 and other rules, then their reporting FFIs "shall be treated as complying with, and not subject to withholding under, section 1471", nor will they be required to withhold "with respect to an account held by a recalcitrant account holder" under § 1471. Canadian IGA art. 4, §§ 1, 2; Czech IGA art. 4 §§ 1, 2; French IGA art. 4 §§ 1, 2; Danish IGA art. 4 §§ 1, 2; Israeli IGA art. 4, §§ 1, 2. This is consistent with the Treasury Secretary's power to deem FFIs to be in compliance with § 1471 if statutory purposes are met. 26 U.S.C. § 1471(b)(2)(B).

***5** The Israeli IGA is not yet in force. *See* Israeli IGA art. 10, § 1. However, the Government asserts that the Treasury Secretary has exercised his discretion not to impose § 1471 withholding against Israeli FFIs or recalcitrant account holders.

The Swiss IGA is different in that under its Article 3 —which Plaintiffs seek to enjoin (doc. 32–1, Prayer for Relief at V)—the Swiss government agrees to "direct all Reporting Swiss Financial Institutions" to report certain information directly to the IRS. Swiss IGA art. 3, § 1. Under Article 5—which Plaintiffs also seek to enjoin (doc. 32–1, Prayer for Relief at V)—the U.S. government "may make group requests...based on the aggregate information reported to the IRS pursuant to" Article 3. Swiss IGA art. 5, § 1. "Such requests shall be made pursuant to Article 26 of the [Swiss] Convention, as amended by the Protocol," and, "such requests shall not be made prior to the entry into force of the Protocol[.]" Swiss IGA art. 5, § 2. The "Protocol" being "the Protocol Amending the [Swiss] Convention that was signed at Washington on September 23, 2009." Swiss IGA pmbl. That Protocol has not yet been approved by the Senate, and because of that, Article 5 of the Swiss IGA cannot yet be implemented.

C. Report of Foreign Bank and Financial Accounts

The third body of law at issue in this case pertains to the FBAR requirements. U.S. persons who hold a financial account in a foreign country that exceeds $10,000 in aggregate value must file a FBAR with the Treasury Department reporting the account. *See* 31 U.S.C. § 5314; 31 C.F.R. §§ 1010.306(c), .350. The current FBAR form is FinCEN Form 114. The form has been due by June 30 of each year regarding accounts held during the previous calendar year. 31 C.F.R. § 1010.306(c). Beginning with the 2016 tax year, the due date of the form will be April 15. Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114–41, § 2006(b)(11), 129 Stat. 443. A person who fails to file a required FBAR may be assessed a civil monetary penalty. 31 U.S.C. § 5321(a)(5)(A). The amount of the penalty is capped at $10,000 unless the failure was willful. *See* § 5321(a)(5)(B)(i), (C). A willful failure to file increases the maximum penalty to $100,000 or half the value in the account at the time of the violation, whichever is greater. § 5321(a)(5)(C). In either case, whether to impose the penalty and the amount of the penalty are committed to the Secretary's discretion. *See* § 5321(a)(5)(A) ("The Secretary of the Treasury may impose a civil money penalty [.]"); § 5321(a)(5)(B) ("[T]he amount of any civil penalty ... shall not exceed" the statutory ceiling). Plaintiffs seek to enjoin enforcement of the willful FBAR penalty under § 5321(a)(5). (Doc. 32–1, Prayer for Relief at Y.) They also ask for an injunction against "the FBAR account–balance reporting requirement" of FinCen Form 114. (*Id.*, Prayer for Relief at EE.)

II. MOTIONS TO AMEND AND DISMISS PURSUANT TO FED. R. CIV. P. 12(B)(1), 15(A)(2)

A. Motion to Dismiss pursuant to Fed. R. Civ. P. 12(b)(1) for Lack of Standing

1. Standard of Review

Defendants challenge Plaintiffs' standing, which relates to the Court's jurisdiction; therefore, the Court must consider the issue first. *Sault Ste. Marie v. United States*, 9 Fed.Appx. 457, 460 (6th Cir. 2001) (citing *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 93–94 (1998)). Federal courts may only decide actual cases or controversies. *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 341 (2006). "One element of the case–or–controversy requirement" is that plaintiffs "must establish that they have standing to sue." *Raines v. Byrd*, 521 U.S. 811, 818 (1997). The standing requirement protects the "time–honored concern about keeping the Judiciary's power within its proper constitutional sphere." *Id.* at 820. "[S]tanding inquir[ies are] especially rigorous when reaching the merits of the dispute would force [a court] to decide whether an action taken by one of the other two branches of the Federal Government was unconstitutional." *Clapper v. Amnest Int'l USA*, 133 S. Ct. 1138, 1146 (2013).

***6** Standing contains three elements:

> First, plaintiffs must have suffered an injury in fact—an invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of—the injury has to be fairly traceable to the challenged action of the defendant, and not the result of the independent action of some third party not before the court. Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.

Lujan v. Defs. of Wildlife, 504 U.S. 555, 560–61 (1992) (citations and internal quotation omitted).

As for the first consideration, a "threatened injury must be certainly impending to constitute injury in fact," and "'[a]llegations of possible future injury' are not sufficient." *Clapper*, 133 S. Ct at 1147 (quoting *Whitmore v. Ark.*, 495 U.S. 149, 158 (1990)) (emphasis in original). Similarly, "a plaintiff raising only a generally available grievance about government—claiming only harm to his and every citizen's interest in proper application of the Constitution and laws, and seeking relief that no more directly and tangibly benefits him than it does the public at large—does not state an Article III case or controversy." *Lujan*, 504 U.S. at 573–74; *see also id.* at 577 (rejecting attempt "to convert the undifferentiated public interest in executive officers' compliance with the law into an 'individual right' vindicable in the courts"). In addition, plaintiffs generally cannot establish standing indirectly when their injury is the result of "the independent action of some third party not before the court." *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 42 (1976); *see also Lujan*, 504 U.S. at 560–61 (same); *Shearson v. Holder*, 725 F.3d 588, 592 (6th Cir. 2013) (same); *Ammex, Inc. v. United States*, 367 F.3d 530, 533 (6th Cir. 2004) (finding no standing to challenge excise tax assessed against third party, since "alleged injury ... in the form of increased fuel costs was not occasioned by the Government").

As to the second consideration, "a plaintiff must 'assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties.' " *Coyne*, 183 F.3d at 494 (quoting *Warth v. Seldin*, 422 U.S. 490, 499 (1975)); *see also United States v. Ovalle*, 136 F.3d 1092, 1100–01 (6th Cir. 1998); *Powers v. Ohio*, 499 U.S. 400, 410 (1991). The rare exception to this requirement arises where a plaintiff can "show that (1) it has suffered an injury in fact; (2) it has a close relationship to the third party; and (3) there is some hindrance to the third party's ability to protect his or her own interests." *Mount Elliott Cemetery Ass'n v. City of Troy*, 171 F.3d 398, 404 (6th Cir. 1999); *see also Connection Distrib. Co. v. Reno*, 154 F.3d 281, 295 (6th Cir. 1998).

"A plaintiff bears the burden of demonstrating standing and must plead its components with specificity." *Coyne*, 183 F.3d at 494; *see also Lujan*, 504 U.S. at 561. A plaintiff "must demonstrate standing separately for each form of relief sought." *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 185 (2000). The Supreme Court has "always insisted on strict compliance with this jurisdictional standing requirement." *Raines*, 521 U.S. at 819. Moreover, "suits challenging, not specifically identifiable Government violations of law, but the particular programs agencies establish to carry out their legal obligations are, even when premised on allegations of several instances of violations of law, rarely if ever appropriate for federal–court adjudication." *Lujan*, 504 U.S. at 568 (quotation omitted).

2. United States Senator Rand Paul

***7** Plaintiff Paul seeks to base legal standing for Counts 1 and 2 on his role as a U.S. Senator, charged with the institutional task of advice and consent under the U.S. Constitution. He contends that the IGAs exceed the proper scope of Executive Branch power and should have been submitted for Senate approval. (Doc. 32–1, at 32–33.) In its Entry and Order Denying Plaintiffs' Motion for Preliminary Injunction, the Court found this insufficient to meet the requirements of standing for three reasons, stating: (1) Plaintiff Paul has alleged no injury to himself as an individual, (2) the institutional injury he alleges is wholly abstract and widely dispersed, and (3) his attempt to litigate this dispute at this time and in this form is contrary to historical experience. (Doc. 30, at 14.)

As Defendants argue, Plaintiffs have failed to cure the deficiencies behind the Court's denial for preliminary injunction. The lone amendment in Plaintiffs' proposed amended complaint, in regards to Plaintiff Paul, states:

> Senator Paul now suffers, and will continue to suffer, the concrete and particularized injury of not being able to vote against the FATCA IGAs, which injury was caused by the unconstitutional and illegal action creating the IGAs, and which injury will be redressed by the IGAs being held beyond constitutional and statutory authority.

(Doc. 32–1, at 34.) This proposed amendment formulaically recites the elements for standing, while reasserting the same basis for standing that the Court previously found insufficient. As Plaintiff Paul's claim of standing is based on a loss of political power, not a loss of any private right, the asserted injury is not "concrete" for purposes of Article III standing. (*See* doc. 30, at 13) (citing *Raines*, 512 U.S. at 821.) Moreover, the additional deficiencies previously identified by the Court are likewise, not cured, by the proposed amendment. Senator Paul has neither been authorized to sue on behalf of the Senate nor can he base his standing on a more generalized interest in "vindication of the rule of law." (Doc. 30, at 14 (citation omitted).) A legislator does not hold any legally protected interest in proper application of the law that is distinct from the interest held by every member of the public. Therefore, Plaintiff Paul does not allege a particularized, legally cognizable injury by his claim that the Executive Branch is not adhering to the law. *See Campbell v. Clinton*, 203 F.3d 19, 22 (D.C. Cir. 2000) (stating Congressional plaintiffs do not "have standing anytime a President allegedly acts in excess of statutory authority").

Plaintiff Paul has an adequate remedy to challenge the reporting requirements and penalties that he opposes by working to repeal these laws through the legislative process. *Raines*, 521 U.S. at 821.

3. Individual Plaintiffs

The Court previously found that all Plaintiffs lacked standing to sue, except Plaintiff Daniel Kuettel because Defendants conceded he had standing with respect to Counts three and six regarding FBAR requirements. (Doc. 30 at 14–23.) Defendants, in their Motion to Dismiss, assert that they did not make such concession; therefore, the Court will analyze standing as it relates to all individual plaintiffs on all counts. (Doc. 27, at 4 n.1.) This analysis will include three new plaintiffs—Katerina Johnson, Lois Kuettel, and Richard Adams —named in Defendants' proposed Amended Verified Complaint. (Doc. 32–1, at 1.)

The basis for the Court's previous finding for lack of standing was due to no individual plaintiffs alleging they suffered or was about to suffer injury under the FATCA withholding tax. (Doc. 30, at 14.) Neither were any plaintiffs an FFI to which the tax under § 1471 applies nor were they assessed the tax. (*Id.*) No plaintiffs had even been informed that the IRS intends to assess the recalcitrant account holder withholding tax imposed by § 1471(b). (*Id.* at 14–15.) Moreover, all Plaintiffs, but Crawford, live in jurisdictions where FFIs are not currently subject to the § 1471(b) withholding tax.

a. Mark Crawford

***8** Plaintiff Crawford seeks to invalidate FATCA and the FBAR requirements on three bases: (1) his brokerage firm cannot accept U.S. citizens—including Crawford himself—as clients, due to a relationship with a bank that has a policy against taking on American clients, (*see* doc. 32–1, at 11–12); (2) he does not want the "financial details of his accounts" disclosed to the U.S. government, (*see id.*, at 12); and (3) he fears "unconstitutionally excessive fines imposed by 31 U.S.C. § 5321 if he willfully fails to file an FBAR." (*See id.*, at 12–13).

Previously, the Court found Plaintiff Crawford lacked standing because standing cannot be established when third parties are the causes of the alleged injuries. (Doc. 30, at 15.) The alleged injury involved his bank's policy against U.S. citizens as clients, and subsequent denial of his application for a brokerage account as possibly affecting Plaintiff Crawford financially. (Doc. 32–1, at 11–12.) The Court found any such harm as not fairly traceable to an action by Defendants, which are not responsible for the decisions of a third party. (Doc. 30, at 15.) In an attempt to cure this deficiency, Plaintiff Crawford identifies a specific denial of his application by Saxo Bank in Copenhagen, Denmark, which was allegedly because he is a U.S. citizen. (Doc. 32–1, at 12.) However, this amendment fails to establish the required connection between the Defendants and the harm. Instead, the amendment provides further explanation of the harm that the Court previously found to be not fairly traceable to an action by Defendants.

Plaintiffs argue that *Warth v. Seldon* recognized that indirect harm may be sufficient to establish standing. (Doc. 35, at 9 (citing 422 U.S. 490, 504–05).) The Supreme Court in *Warth*, stated:

> The fact that the harm to petitioners may have resulted indirectly does not in itself preclude standing. When a governmental prohibition or restriction imposed on one party causes specific harm to a third party, harm that a constitutional provision or statute was intended to prevent, the indirectness of the injury does not necessarily deprive the person harmed of standing to vindicate his rights. But it may make it substantially more difficult to meet the minimum requirement of Art. III: to establish that, in fact, the asserted injury was the consequence of the defendants' actions, or that prospective relief will remove the harm.

Id. (citation omitted). While an injury may be indirect, in certain circumstances, the injury must still be "fairly traceable to the challenged action of the defendant[,]" *Lujan*, 504 U.S. at 560–61, and "not dependent on speculation about the possible actions of third parties not before the court." *Village of Arlington Heights v. Metro. Housing Dev. Corp.*, 429 U.S. 252, 264 (1977). Although the amendment does identify that Plaintiff Crawford was unsuccessful in his attempt to obtain a brokerage account, the causation of such harm is dependent on speculation of possible third party action by the Court.

In *Village of Arlington Heights*, an African–American man alleged that he sought and would qualify for a prospective housing complex, and that he would probably move there, as it was closer to his job. 429 U.S. at 264. However, the man alleged that he was unable to move there because he was an African American. *Id.* The Supreme Court found it compelling that if the Court were to grant the relief sought, there was at least a "substantial probability" the man would be afforded the housing opportunity. *Id.* (citation omitted). Here, if the Court were to grant the relief sought, the facts as alleged do not suggest that there is a "substantial probability" that Plaintiff Crawford will be successful in his banking endeavors. Rather, it requires the Court to speculate as to the actions of Saxo Bank. The question of whether or not Saxo Bank would grant Plaintiff Crawford's application for a brokerage account cannot be determined with "substantial probability" without speculation as to the general practices and policies of Saxo Bank, if Plaintiff Crawford meets the criteria of the Saxo Bank's general practices and policies for a brokerage account, and any other aspects of Saxo Bank's application process that fall squarely within their discretion.

***9** In addition, as the Court previously found, Plaintiff Crawford's discomfort with the information reporting requirements of FATCA does not establish the concrete, particularized harm that confers standing. (Doc. 30, at 15.) Plaintiff Crawford states, "[he] now suffers, and will continue to suffer, concrete and particularized injuries to legally protected interest, which interests are caused by the challenged government actions and will be redressed by the requested relief." (Doc. 32–1, at 13.) However, merely reciting the elements of a cause of action is not sufficient to convey standing. Furthermore, regardless of Plaintiff Crawford's fear of "unconstitutionally excessive fines imposed by 31 U.S.C. § 5321 if he willfully fails to file an FBAR," (*id.*, at 12–13), there was no allegation that he failed to file any FBAR that may have been required, much less the assessment of an "excessive" FBAR penalty, (doc. 30, at 15), nor was there any proposed amendment that spoke to this deficiency.

b. Roger and Katerina Johnson

Plaintiff Roger Johnson states that he is a U.S. citizen who resides in the Czech Republic. (Doc 32–1, at 14.) Plaintiff Katerina Johnson is a citizen of, and resides, in the Czech Republic. (*Id.*, at 16.) They seek to invalidate the Czech IGA, FATCA, and the FBAR reporting requirements because: (1) Plaintiff Katerina Johnson, Plaintiff Roger Johnson's wife, who has been added as a party in the proposed Amended Verified Complaint, "strongly objected to having her financial affairs disclosed to the United States government", leading to the couple's decision to separate their assets, (*see id.*, at 15, 17); (2) they do not want the financial details of their accounts disclosed, (*see id.*, at 16); and (3) they fear "unconstitutionally excessive fines" if they willfully fail to file an FBAR. (*See id.*).

Previously, the Court found Plaintiff Roger Johnson lacking standing for three reasons. (Doc. 30, at 16.) First, the harm Plaintiff Roger Johnson alleges resulted from his wife's objections to FATCA and the choices they made in response were not traceable to the government. (*Id.*); *see Simon*, 426 U.S. at 41–42. Second, Plaintiff Roger Johnson's discomfort with reporting requirements of American law did not support standing, as he did not allege any concrete constitutional injury. (Doc. 30, at 16 (citing *Lujan*, 504 U.S. at 561).) Third, the prospect of the hypothetical imposition of an excessive fine, if he willfully fails to file a required FBAR, was insufficient. (Doc. 30, at 16 (citing *Clapper*, 133 S. Ct. at 1477).)

To cure these deficiencies, Plaintiffs Roger Johnson states the value of his accounts subjects him to the reporting requirements of FACTA and FBAR, as well as adds a recurring recitation of the elements of standing, that they "now suffer[ ], and will continue to suffer, concrete and particularized injuries to legally protected interests, which injuries are caused by the challenged government actions and will be redressed by the requested relief." (Doc. 30, at 16.) However, the reporting requirement, itself, does not constitute "an invasion of a legally protected interest" and despite Plaintiffs discomfort with the alleged invasion of their privacy, they still have not identified a constitutionally protected interest for the same reasons identified in the Court's denial of Plaintiffs' Motion for Preliminary Injunction. (*Id.*, at 22–23.) Therefore, the new allegations regarding being subjected to reporting requirements do not cure the aforementioned deficiencies. There is no allegation that they failed to file any FBAR that may have been required, much less that the Government has assessed an "excessive" FBAR penalty against them.

c. Stephen J. Kish

Plaintiff Kish states that he is a dual citizen of the United States and Canada, residing in Toronto, Canada. (Doc. 32–1, at 18.) The Court previously found that Kish's allegation that his wife "strongly opposes the disclosure of her personal financial information" under FATCA to be insufficient to convey standing because his wife is not a plaintiff. (Doc. 30, at 17 (citing *Coyne*, 183 F.3d at 494).) Plaintiff Kish's proposed amendments include being subjected to reporting requirements and the same recurring recitation of the elements of standing, that he "now suffers, and will continue to suffer, concrete and particularized injuries to legally protected interests, which injuries are caused by the challenged government actions and will be redressed by the requested relief." (Doc. 32–1, at 19.) However, as analyzed above, these proposed amendments do not cure the deficiencies previously identified by the Court to have standing. As before, Plaintiff Kish may not assert claims on his wife's behalf. (Doc. 30, at 17.) The fact that he has suffered some "discord" in his marriage, (*id.*), is too vague and indirect of a harm to establish standing. Furthermore, as explained above, reluctance to comply with the requirements of American law and theoretical "excessive fines" that would be imposed if he willfully violated the law, do not convey standing. (Doc. 32–1, at 19.)

d. Daniel and Lois Kuettel

***10** Plaintiff Daniel Kuettel states that he is a citizen of Switzerland who renounced his U.S. Citizenship in 2012. (*Id.*, at 20.) The Court previously found that the only ongoing injury that Plaintiff Daniel Kuettel alleged was related to a college savings account maintained at a Swiss bank for his daughter, Plaintiff Lois Kuettel, who has been added to this action. (Doc. 32–1, at 22–23; Doc. 30, at 17.) The Court previously inferred a concession by Defendants as to standing for Plaintiff Daniel Kuettel on Counts 3 and 6; however, the Defendants deny such concession and these Counts will be analyzed in the same regard as all other Counts. (*See* doc. 30, at 18; doc. 34, at 4 n.1 (discussing doc. 16, at PageID# 216).) Plaintiff Lois Kuettel is a tri–citizen of the United States, Switzerland, and the Philippines. (Doc. 32–1, at 23.) There were several issues identified by the Court with regard to standing, for Plaintiff Daniel Kuettel, which will be analyzed in conjunction with Plaintiff Lois Kuettel.

First, the account balance was approximately $8,400, which fell below the $10,000 threshold for FBAR reporting. (Doc. 30, at 17.) This deficiency is cured by alleging that "[t]he account currently has a balance of greater than $10,000." (Doc. 32–1, at 22.) Second, Plaintiff Daniel Kuettel's daughter was only ten years old and not a plaintiff to the case. (Doc. 30, at 17.) This deficiency is also cured as Plaintiff Daniel Kuettel's daughter has been added as a plaintiff, as a minor child, by and through her next friend, Plaintiff Daniel Kuettel. (Doc. 32–1, at 1, 23.) Third, Plaintiff Daniel Kuettel's objection "to filing an FBAR as required by FinCEN because he is not a U.S. citizen and would not do so for his daughter's account" was insufficient because "[t]he relief for any wrong [was] either for Kuettel's daughter to sue her Swiss bank for disparate treatment ..., or to seek recourse in the power of the market moving her accounts to an institution that wishes to compete for her business." (Doc. 30, at 18.)

Plaintiffs Daniel and Lois Kuettel allege that Plaintiff Lois Kuettel cannot avoid FBAR reporting by renouncing her U.S. citizenship and that Plaintiff Daniel Kuettel does not want to violate his daughter's privacy by filing the FBAR on her behalf. (Doc. 32–1, at 23–24.) For these reasons, Plaintiff Daniel Kuettel closed his daughter's account and opened another account in his name. (*Id.*, at 24.) However, as stated in the Court's denial for preliminary injunction, any advantages his daughter might receive by Plaintiff Daniel Kuettel filing an FBAR on his daughter's behalf or by placing the account in his name are based on a bank policy, not the conduct of the Defendants. (Doc. 30, at 18–19.) The failure to reap those advantages is due to the Bank's policies regarding someone like Plaintiff Daniel Kuettel's reluctance to comply with the FBAR requirements, not any action that is fairly traceable to the Government. (*See* doc. 30, at 18.)

Likewise, any assertion of past harm because Plaintiff Daniel Kuettel was "mostly unsuccessful" in refinancing his mortgage due to FATCA still does not convey standing. Any conceivable harm is attributable to the actions of a third–party foreign bank, not the actions of the Government. Finally, any past harm alleged is not redressable here because Plaintiff Daniel Kuettel renounced his American citizenship and has since obtained acceptable refinancing. (*See id.*, at 18) (citing *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 210–11 (1995) ("[T]he fact of past injury ... does nothing to establish a real and immediate threat that he would again suffer similar injury in the future." (quotations omitted)).)

e. Donna–Lane Nelson and Richard Adams

Plaintiff Nelson is a citizen of Switzerland who has renounced her U.S. citizenship. (Doc. 32–1, at 26–27.) She renounced her citizenship because a Swiss bank "offered investment opportunities that were not available to her as an American." (*Id.*, at 27.) She "resents having to provide" "explanations" to Swiss banks that have requested information on her past U.S. citizenship and payments to her daughter, who lives in the United States, and she sees "threats implied by these requests which appear to be prompted by FATCA." (*Id.*, at 28.) Furthermore, she does not want to disclose financial information to the Government, and fears she may be subjected to willful FBAR penalties, despite no such penalty having been imposed or threatened against her. Additionally, she fears the 30% withholding tax may be imposed against her "if her business partner", who is her husband, with whom she holds joint accounts, "opts to become a recalcitrant account holder." (*Id.*, at 28–29.)

***11** Previously, the Court found Plaintiff Nelson lacked standing because her allegations of harm stemmed from third–party conduct. (Doc. 30, at 19.) Consistent with the above analyses, fear of hypothetical events that might have befallen her if she had not renounced her citizenship was not sufficient to constitute concrete harm to confer Article III standing. (*Id.*, at 19–20.) The Court further found that discretionary decisions of a foreign bank do not create standing, and without standing, she could not air her "resentment" of U.S. law in this Court. (*Id.*, at 20.) In order to attempt to cure the above deficiencies, Plaintiff Nelson claims that she was "worried that her account would be closed and that she would be unable to open another account with her U.S. citizenship." (Doc. 32–1, at 27.) However, this allegation fails to cure the deficiencies for the same reasons. The discretionary decisions or future discretionary decisions of a foreign bank do not create standing. Furthermore, as identified above, fear of a hypothetical harm that may or may not occur if she had not renounced her citizenship is not sufficient to constitute concrete harm.

Plaintiff Nelson also proposes the following amendment: "[s]he also knew of many accounts of U.S. citizens that had been closed because of a person's ties to the U.S. and because of FATCA and IGAs." (*Id.*) This amendment fails to cure her standing deficiencies for all the same reasons previously stated. Moreover, knowledge of hypothetical harm to people not a party to this case by a third party cannot confer standing for Plaintiff Nelson.

Plaintiff Adams, Plaintiff Nelson's business partner and husband, is named as a party in the proposed amended complaint, and is a United States citizen currently residing in Switzerland. (*Id.*, at 29.) Plaintiff Adams alleges that he was unable to incorporate the business he shares with his wife in France because he is a U.S. citizen. (*Id.*) Like his wife, Plaintiff Adams is fearful that he will be unable to continue banking in Switzerland, and anticipates his account may be closed. (*Id.*, at 30.) If such event occurs, the couple will reluctantly consider separating their accounts. (*Id.*) With a closed account and separated marital accounts, Plaintiff Adams fears that he will be unable to open another account for everyday use. (*Id.*) Additionally, Plaintiff Adams does not wish to disclose the financial details of the accounts he currently holds. (*Id.*) Again, like his wife, Plaintiff Adams fears "unconstitutionally excessive fines" due to FBAR reporting requirements. (*Id.*, at 31.)

Plaintiff Adams lacks standing for all the same reasons as his wife. Plaintiff Adams' hypothetical fear of the harms that may be caused by a third party bank are insufficient to confer standing because it does constitute concrete harm. Likewise, as discussed above, the discretionary decisions of a foreign bank do not create standing.

Consistent with the aforementioned proposed amendments, Plaintiffs Nelson and Adams formulaically recite the elements of standing, "[Nelson and Adams] now suffer[ ], and will continue to suffer, concrete and particularized injuries to legally protected interests, which injuries are caused by the challenged government actions and will be redressed by the requested relief." (*Id.*, at 29, 31.) As analyzed above, this is insufficient to convey standing.

f. L. Marc Zell

Plaintiff Zell is a dual citizen of the United States and the State of Israel, currently residing in Israel. (*Id.*, at 31.) In the Court's denial for a preliminary injunction, the Court found that the majority of Plaintiff Zell's allegations concerned the conduct of Israeli banks and his belief that these actions have been unfair to him or his clients, as a practicing attorney. (Doc. 30, at 21.) As stated above, the conduct of third parties—even if related to the banks' compliance with FATCA—does not confer standing to bring suit against Defendants, nor may Plaintiff Zell seek redress on behalf of third parties who have allegedly suffered harm, including unidentified clients not a party to this case.

Moreover, his compliance with a client's wish to avoid the FATCA reporting requirements potentially subjected the client—not Plaintiff Zell—to the risk of imposition of a 30% tax. (*See id.* (citing 26 U.S.C. § 1471(b)(1)(D).)) Plaintiff Zell had not alleged that he has been assessed a 30% withholding tax under FATCA, nor could he (or his clients) be, because such withholding under § 1471 is not presently being imposed against Israeli FFIs or their recalcitrant account holders. (Doc. 30, at 21–22.) Plaintiff Zell had not had a penalty imposed against him for any willful failure to file an FBAR either. (*Id.*, at 22.)

Therefore, he had suffered no concrete and particularized injury sufficient to convey standing. (*Id.* (citing *Lujan*, 504 U.S. at 560).)

***12** Plaintiff Zell's newly proposed allegations do not cure the above–mentioned deficiencies. The proposed amendments include statements that his accounts are subject to FATCA and FBAR required reporting, to which he is choosing not to comply. (Doc. 32–1, at 34.) But, again, Plaintiff Zell does not allege that he has been assessed a withholding tax under FATCA, as they are not presently imposed against Israeli recalcitrant account holders, nor has he alleged that he has been assessed a penalty for his willful failure to file an FBAR. Based on the Court's previous holdings, these allegations do not support that Plaintiff Zell has suffered a concrete and particularized injury sufficient to convey standing. Additionally, Plaintiff Zell recites the same statement that he meets the elements of standing, by formulaically reciting such elements, (doc. 32–1, at 35), which the Court finds as insufficient to confer standing.

4. Motion to Amend

Plaintiffs bring their Motion for Leave to Amend pursuant to Fed. R. Civ. P. 15(a)(2). “Rule 15(a)(2) provides that leave to amend is to be freely given when justice so requires.” *Riverview Health Institute LLC v. Medical Mutual of Ohio*, 601 F.3d 505, 520 (6th Cir. 2010). “However, a motion for leave to amend may be denied where there is 'undue delay, bad faith, or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, *futility of amendment*, etc.' ” *Id.* (quoting *Foman v. Davis*, 371 U.S. 178, 182 (1962) (emphasis in original)). A proposed amendment is futile if the amendment could not withstand a motion to dismiss. *Riverview Health*, 601 F.3d at 520 (citing *Rose v. Hartford Underwriters Ins. Co.*, 203 F.3d 417, 420 (6th Cir. 2000)) (quotations omitted); *Thiokel Corp. v. Dep't of Treasury, Revenue Div.*, 987 F.2d 376, 383 (6th Cir. 1993).

Here, analyzing each Plaintiff individually, the Court finds that none of the Plaintiffs has standing to sue Defendants. No individual Plaintiff has suffered an invasion of a legally protected interest, which is concrete and particularized, and actual or imminent, not conjectural or hypothetical. Moreover, no alleged injury is fairly traceable to the actions of the Defendants, but rather, the actions of an independent third party. Finally, there are no allegations that it is likely that the alleged injury will be redressed by a favorable decision. *See Lujan*, 504 U.S. at 560–61. In reaching these holdings, the Court analyzed the proposed Amended Verified Complaint, (doc. 32–1), which could not withstand Defendants' Motion to Dismiss, (doc. 26); therefore, the proposed amendments are futile.

Accordingly, all claims are **DISMISSED** for lack of subject–matter jurisdiction under Fed. R. Civ. P. 12(b)(1), against all Defendants, without prejudice.

III. MOTION TO DISMISS PURSUANT TO FED. R. CIV. P. 12(B)(6)

In addition to challenging Plaintiffs' standing pursuant to Fed. R. Civ. P. 12(b)(1), Defendants' Motion to Dismiss, (*id.*), challenged Plaintiffs' proposed Amended Verified Complaint, (doc. 32–1), under Fed. R. Civ. P. 12(b)(6) for failure to state a claim upon which relief can be granted. (Doc. 26.) Because the Court has dismissed all claims under Rule 12(b)(1), the Court does not reach Defendants' Rule 12(b)(6) arguments.

IV. CONCLUSION

For the reasons set forth above, the Court **DENIES** Plaintiffs' Motion for Leave to File an Amended Verified Complaint, (doc. 32), and the Court **GRANTS** Defendants' Motion to Dismiss, (doc. 26), Plaintiffs' Complaint. The captioned case is hereby **TERMINATED** upon the docket records of the United States District Court for the Southern District of Ohio, Western Division, at Dayton. [7]

***13** **DONE** and **ORDERED** in Dayton, Ohio, this Monday, April 25, 2016.

All Citations

Not Reported in F.Supp.3d, 2016 WL 1642968, 117 A.F.T.R.2d 2016-1400, 2016-1 USTC P 50,268

Footnotes

[1] Plaintiffs include Mark Crawford ("Plaintiff Crawford"), Senator Rand Paul ("Plaintiff Paul"), in his official capacity as a member of the United States Senate, Roger Johnson ("Plaintiff Roger Johnson"), Katerina Johnson ("Plaintiff Katerina Johnson"), Daniel Kuettel ("Plaintiff Daniel Kuettel"), Lois Kuettel ("Plaintiff Lois Kuettel"), a minor child, by and through her next friend, Daniel Kuettel, Stephen J. Kish ("Plaintiff Kish"), Donna–Lane Nelson ("Plaintiff Nelson"), Richard Adams ("Plaintiff Adams"), and L. Marc Zell ("Plaintiff Zell"), referred to, collectively, as "Plaintiffs."

[2] Agreement Between the Government of the United States of America and the Government of Canada to Improve International Tax Compliance through Enhanced Exchange of Information under the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Can.–U.S., Feb. 5, 2014, U.S. Dep't of Treasury, available at https://www.treasury.gov/resource–center/tax–policy/treaties/Documents/FATCA–Agreement–Canada–2–5–2014.pdf [hereinafter Canadian IGA]; Agreement between the United States of America and the Czech Republic to Improve International Tax Compliance and with Respect to the United States Information and Reporting Provisions Commonly Known as the Foreign Account Tax Compliance Act, Czech–U.S., Aug. 4, 2014, U.S. Dep't of Treasury, available at https://www.treasury.gov/resource–center/tax–policy/treaties/Documents/FATCA–Agreement–Czech–Republic–8–4–2–14.pdf [hereinafter Czech IGA]; Agreement between the Government of the United States of America and the Government of the State of Israel to Improve International Tax Compliance and to Implement FATCA, Isr.–U.S., June 30, 2014, U.S. Dep't of Treasury, available at https://www.treasury.gov/resource–center/tax–policy/treaties/Documents/FATCA–Agreement–Israel–6–30–2014.pdf [hereinafter Israeli IGA]; Agreement Between the Government of the United States of America and the Government of the French Republic to Improve International Tax Compliance and to Implement FATCA, Fr.–U.S., Nov. 14, 2013, available at https://www.treasury.gov/resource–center/tax–policy/treaties/Documents/BilateralAgreementUSFranceImplementFATCA [hereinafter French IGA]; Agreement between the Government of the United States of America and the Government of the Kingdom of Denmark to Improve International Tax Compliance and to Implement FATCA, Den.–U.S., Nov. 19, 2012, available at https://www.treasury.gov/resource–center/tax–policy/treaties/Documents/FATCA–Agreement–Denmark–11–19–2012.pdf [hereinafter Danish IGA]; Agreement between the United States of America and Switzerland for Cooperation to Facilitate the Implementation of FATCA, Switz.–U.S., Feb. 14, 2013, available at https://www.treasury.gov/resource–center/tax–policy/treaties/Documents/FATCA–Agreement–Switzerland–2–14–2013.pdf [hereinafter Swiss IGA].

[3] If the country enters into an IGA this provision becomes irrelevant because consent is no longer a legal impediment under foreign law.

[4] Plaintiffs' proposed Amended Verified Complaint contains two "B" sections in the Prayer for Relief; therefore, the first "B" section will be referred to as "B1" and the second "B" section will be referred to as "B2".

[5] Canadian IGA pmbl.; Czech IGA pmbl.; Israel IGA pmbl.; French IGA pmbl.; Danish IGA pmbl.

[6] Swiss IGA pmbl.; *see also* Convention between the United States and Canada with Respect to Taxes on Income and Capital, Can.–U.S., art. XXVII, Sept. 26, 1980 ("Canadian Convention"); Convention between the United States of America and the Czech Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Czech–U.S., art. 29, Sept. 16, 1993 ("Czech Convention"); Convention between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, Isr.–U.S., art. 29, Nov. 20, 1975 ("Israeli Convention"); Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Together with Two Related Exchanges of Notes, Fr.–U.S., art. 26(2), Aug. 31, 1994 ("French Convention"); Convention between the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Den.–U.S., art. 26, Aug. 19, 1999 ("Danish Convention"); Convention between the United States and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, Switz.–U.S., art. 26, Oct. 2, 1996 ("Swiss Convention").

[7] The Court acknowledges the assistance of student extern Anthony Graber of the University of Dayton School of Law in the preparation of this opinion.

End of Document

2017 WL 6021420
United States District Court, C.D. California.

UNITED STATES of America
v.
John Van KATWYK

Case No. CV 17–3314–GW(JCx)
|
Filed 10/23/2017

Attorneys and Law Firms

James C. Hughes, AUSA—Office of US Attorney, Los Angeles, CA, for United States of America.

PROCEEDINGS: PLAINTIFF'S MOTION FOR DEFAULT JUDGMENT AGAINST JOHN VAN KATWYK [14]

GEORGE H. WU, UNITED STATES DISTRICT JUDGE

***1** Court and counsel confer. The Tentative circulated and attached hereto, is adopted as the Court's Final Ruling. Plaintiff's Motion is GRANTED.

The Court will allow Defendant to file his motion under Rule 60 within 30 days from the date of this order.

I. Background

United States of America ("Plaintiff") moves for a default judgment against John Van Katwyk ("Defendant"). Plaintiff personally served Defendant with a copy of the Summons and Complaint in this case—regarding Defendant's willful failure to report his interest in foreign financial accounts—on May 19, 2017. *See generally* Docket No. 1 ("Complaint"); *see also* Motion for Default Judgment ("MDJ"), Docket No. 14. Defendant has failed to file an answer. *See generally* MDJ.

Defendant has been a lawful permanent resident of the United States since approximately 1983. *See* Complaint ¶ 11. In 1992, Defendant obtained ownership and control over an account held with UBS AG in the name of the Calimco Foundation, with an account number ending #2603 ("Calimco Account"). *See id.* ¶ 12. Between 1993 and 2004, Defendant used the Calimco Account for the payment of his own expenses. *See id.*

Defendant successfully filed foreign bank account reports ("FBAR") with the United States for the taxable years 1993, 1998, 1999, 2000, and 2003. *See id.* ¶ 13. For example, on his 1993 FBAR form, Defendant reported his interest in an account with "Credit Lyonnais BK Nederland Par" with a balance between $10,000 and $50,000. *See id.* In addition, on Defendant's 1998, 1999, 2000, and 2003 FBAR forms, Defendant reported his interest in an account held with Fortis Bank Netherlands with the account number ending #7773, and an account balance between $10,000 and $50,000. *See id.* However, Defendant failed to report his interest in the Calimco Account on any of the abovementioned FBAR forms. *See id.*

In 2004, Defendant traveled to Liechtenstein and set up a foreign trust entity named the Shaq Foundation. *See id.* ¶ 14. Defendant then traveled to Zurich in Switzerland and opened a new account with UBS AG in the name of the Shaq Foundation, with an account number ending #8555 ("Shaq Foundation Account"). *See id.* All funds held in the Calimco Account were subsequently transferred into the Shaq Foundation Account. *See id.* During the years 2004 through 2008, while the balance of the Shaq Foundation Account always exceeded $10,000, Defendant failed to file FBAR forms and report the Shaq Foundation Account's existence to his U.S. income tax return preparer. *See id.* ¶¶ 15, 17. Throughout those five years, Defendant used funds from the Shaq Foundation Account to pay for his personal expenditures. *See id.* ¶ 16.

During the time of Defendant's failure to file an FBAR, the balance of the Shaq Foundation Account was at least $800,432. *See id.* ¶ 22. On June 12, 2015, the Internal Revenue Service ("IRS") assessed an FBAR penalty in the amount of $80,043 against Defendant for his willful failure to report his interest in foreign financial accounts in violation of 31 U.S.C. § 5314. *See id.* ¶ 23. On the same date, the IRS sent Defendant notice and demand for payment. *See id.* Despite being issued notice and demand for payment, Defendant failed to make any payments against his FBAR penalty for the 2008 taxable year. *See id.* ¶ 24. As of December 2, 2016, the total outstanding balance, consisting of the FBAR penalty, penalties for late payment, and statutory interest, totaled $88,341.16. *See id.* ¶ 25.

II. Legal Standard

***2** The procedural prerequisites to the entry of default judgment are set out in Federal Rule of Civil Procedure ("FRCP") 55 and Local Rule 55–1. These prerequisites require that a party moving for default judgment submit a declaration or otherwise provide information (1) indicating when and against which party default has been entered; (2) identifying the pleading as to which default has been entered; (3) indicating whether the defaulting party is an infant, or incompetent person, and if so, whether that person is represented by a general guardian, committee, conservator or other representative; (4) stating that the Servicemembers Civil Relief Act, 50 U.S.C. App. § 521, does not apply; and (5) affirming that notice has been served on the defaulting party, if required by Rule 55(b)(2). *See* FRCP 55(b)(2); C.D. Cal. L.R. 55–1.

Once the procedural prerequisites have been satisfied, entry of default judgment is left to the trial court's sound discretion. *Aldabe v. Aldabe*, 616 F.2d 1089, 1092–93 (9th Cir. 1980); *Landstar Ranger, Inc. v. Parth Enters., Inc.*, 725 F.Supp.2d 916, 919 (C.D. Cal. 2010). The Ninth Circuit has held that a district court may consider the following factors in exercising its discretion to award a default judgment:

> (1) the possibility of prejudice to the plaintiff; (2) the merits of plaintiff's substantive claim, (3) the sufficiency of the complaint, (4) the sum of money at stake in the action; (5) the possibility of a dispute concerning material facts; (6) whether the default was due to excusable neglect; and (7) the strong policy underlying the [FRCP] favoring decisions on the merits.

Eitel v. McCool, 782 F.2d 1470, 1471–72 (9th Cir. 1986). "In applying this discretionary standard, default judgments are more often granted than denied." *PepsiCo v. Triunfo–Mex, Inc.*, 189 F.R.D. 431, 432 (C.D. Cal. 1999). Such judgments are proper, for instance, where defendant has never appeared in the action, his failure to defend is unexplained, and the plaintiff would suffer prejudice if the default were not entered. *See Chrysler Credit Corp. v. Macino*, 710 F.2d 363, 367 (7th Cir. 1983). Further, a party seeking a default judgment must state a claim upon which it may recover. *See PepsiCo, Inc., v. Cal. Sec. Cans*, 238 F.Supp.2d 1172, 1172 (C.D. Cal. 2002). After a default has been entered by the court clerk, the well-pleaded factual allegations of the complaint are taken as true, except for those allegations relating to damages. *TeleVideo Sys., Inc. v. Heidenthal*, 826 F.2d 915, 917 (9th Cir. 1987); *Discovery Commc'ns, Inc. v. Animal Planet, Inc.*, 172 F.Supp.2d. 1282, 1288 (C.D. Cal. 2001). Where damages are liquidated (*i.e.*, ascertainable from definite figures contained in the documentary evidence or in detailed affidavits), default judgment may be entered without a damages hearing. *See Dundee Cement Co. v. Howard Pipe & Concrete Prods., Inc.*, 722 F.2d 1319, 1323 (7th Cir. 1983); *Allergan Inc. v. Mira Life Grp. Inc.*, No. SACV 04–36 JVS (MLGx), 2004 U.S. Dist. LEXIS 26881, at *9 (C.D. Cal. June 9, 2004). The Court need not make detailed findings of fact in the event of default. *See Adriana Int'l Corp. v. Thoeren*, 913 F.2d 1406, 1414 (9th Cir. 1990).

III. Analysis

A. Plaintiff Has Met the Procedural Requirements for Default Judgment

Plaintiff's application for default judgment complies with FRCP 55(a) and (b)(2), as well as Local Rule 55–1. First, Plaintiff has stated, by declaration, that Plaintiff filed a request for default against Defendant with the Clerk of the Court on August 8, 2017 and default was entered by the Clerk on August 9, 2017. Declaration of James C. Hughes ("Hughes Decl."), MDJ, ¶ 9. Second, Plaintiff's Complaint is the pleading on which default was entered. Hughes Decl. ¶¶ 2–3. Third, Plaintiff declared that Defendant is not an infant based on correspondence containing Defendant's date of birth. Hughes Decl. ¶¶ 15–16. Plaintiff also declared that Defendant is not incompetent based on: (a) Plaintiff's ignorance of any proceeding to adjudicate competency or prior judicial determinations of incompetency; (b) Plaintiff's ignorance of any guardian or other representative appointed to act on behalf of Defendant; and (c) the absence of any obvious outward signs of mental incompetency when speaking with Defendant on the phone. Hughes Decl. ¶¶ 15, 17. Fourth, Plaintiff informs the Court that the Servicemembers Civil Relief Act does not apply based on a copy of the results of a search for Defendant in the Department of Defense Manpower Data Center. Hughes Decl. ¶ 18. Finally, under FRCP 55(b)(2) Plaintiff is not required to serve Defendant with written notice of the application because Defendant failed to appear personally or by a representative. FRCP 55(b)(2).

B. Eitel Factors Weigh in Favor of Awarding Plaintiff Default Judgment

***3** In exercising its discretion to award a default judgment, this Court considers the *Eitel* factors. The first six *Eitel* factors appear to weigh in favor of granting Plaintiff's Motion for Default Judgment. The seventh factor tends to weigh against default judgment since it always favors adjudication on the merits. However, the seventh factor is not dispositive in and of itself. Consequently, on balance, the Court would GRANT Plaintiff's request.

1. Plaintiff Will Suffer Prejudice If Motion for Default Judgment Is Denied

With respect to the first *Eitel* factor, Plaintiff has demonstrated that prejudice will result in the absence of entry of a default judgment against Defendant because his failure to participate in this action would leave Plaintiff without apparent recourse for recovery. *See Roberts v. Cal. Dep't of Corr.*, No. 2:13–CV–07461–ODW, 2014 WL 879808, at *2 (C.D. Cal. Mar. 5, 2014) (citing *Cal. Sec. Cans,* 238 F.Supp.2d at 1177) ("There is a possibility of prejudice to the plaintiff when denying default judgment would leave the plaintiff without an alternate recourse for recovery."). The evidence before this Court establishes that Defendant has been assessed a civil FBAR penalty (along with accumulated penalties and interest) of $88,341.16. Hughes Decl., Exh. D. As a result, Plaintiff will be prejudiced if this court does not reduce the aforementioned civil penalty to judgment because Plaintiff will have no other recourse for recovering that penalty.

2. Substantive Merits and Sufficiency of the Complaint

The second and third *Eitel* factors require that a plaintiff "state a claim on which the [plaintiff] may recover." *Cal. Sec. Cans*, 238 F.Supp.2d at 1175 (*quoting Kloepping v. Fireman's Fund*, No. C 94–2684 THE, 1996 WL 75314, at *2 (N.D. Cal. Feb. 13, 1996) (*citing Danning v. Lavine*, 572 F.2d 1386, 1388 (9th Cir. 1978). On entry of a default, well-plead allegations in the complaint regarding liability are generally deemed true. *See Geddes v. United Fin. Corp.*, 559 F.2d 557, 560 (9th Cir. 1977); *see also Alan Neuman Prods., Inc. v. Albright*, 862 F.2d 1388, 1392 (9th Cir. 1988) (holding that "facts which are not established by the pleadings of the prevailing party, or claims which are not well-pleaded, are not binding and cannot support the [default] judgment").

In the instant case, Plaintiff sufficiently stated a claim on which it can recover. To prevail on its Complaint to reduce an FBAR penalty to judgment, Plaintiff must prove that Defendant: 1) is a United States citizen or resident; 2) who has an interest in, or signature or other authority over, a foreign bank, securities, or other financial account; 3) in which the aggregate balance of such account exceeded, at any time during the calendar year, $10,000; and 4) failed to report that interest to the IRS by June 30 of the year following any calendar year. *See* 31 C.F.R. §§ 1010.350, 1010.306(c); 31 U.S.C. § 5314; *United States v. Bohanec*, No. 2:15–CV–4347 DDP (FFMx), 2016 WL 7167860, at *3 (C.D. Cal. Dec. 8, 2015) ("United States citizens who have a financial interest in, or signature authority over, a foreign bank account are required to file a [FBAR]."). If any person willfully fails [1] to timely report interest in a foreign bank, securities, or other financial account to the IRS, then the maximum penalty shall be increased to the greater of either $100,000 or fifty percent of the balance in the account at the time of the violation. 31 U.S.C. § 5321(a)(5)(C)–(D). Here, Plaintiff has sufficiently alleged that: (1) Defendant is a permanent resident of the United States; (2) Defendant is the beneficial owner of the Shaq Foundation Account held with UBS AG in Switzerland during the tax year 2008; and (3) the aggregate balance of the Shaq Foundation Account exceeded $10,000 during the tax year 2008. *See* Complaint ¶¶ 11, 14–16. Accordingly, Defendant was required to annually file an FBAR to report his interest in the Shaq Foundation Account for each year the account existed and contained an amount greater than $10,000. *See* 31 U.S.C. § 5314; 31 C.F.R. § 1010.305(c). Defendant failed to make any such report or filing on or before June 30, 2009, with respect to the 2008 tax year. *See id.* ¶ 17. Consequently, Defendant is liable for the FBAR violation for the tax year 2008.

***4** Furthermore, Plaintiff plead facts sufficient to establish that Defendant's failure to report his foreign bank account constituted a willful violation. A reckless disregard to statutory duty may be sufficient to satisfy willfulness. *United States v. McBride*, 908 F.Supp.2d 1186, 1204 (D. Utah 2012) (" 'willfulness' may be satisfied by establishing the individual's reckless disregard of statutory duty ...."). In a case concerning a failure to report certain information to the IRS, conduct can be classified as willful if the defendant failed to investigate the legality of the conduct. *Id.* at 1209. Here, Defendant was clearly aware of FBAR reporting requirements as he had made previous disclosures to the IRS regarding his other foreign bank accounts. Furthermore, if Defendant was unaware of his obligation to report the Shaq Foundation Account (which he failed to even disclose to his US income tax return preparer), he recklessly ignored the risk that the conduct is illegal by failing to investigate the conduct's legality. The second and third *Eitel* factors thus weigh in favor of granting default judgment.

3. Sum of Money at Stake in the Action

The fourth *Eitel* factor requires the Court to weigh the amount of money at stake against the seriousness of Defendant's conduct. *See Cal. Sec. Cans,* 238 F.Supp.2d at 1176; *see also Eitel*, 782 F.2d at 1471–72. "Default Judgment is disfavored where the sum of money at stake is too large or unreasonable in relation to defendant's conduct." *Vogel v. Rite Aid Corp.*, 992 F.Supp.2d 998, 1012 (C.D. Cal. 2014). Here, Defendant's willful failure to disclose his foreign bank account for five consecutive calendar years constituted an egregious violation of United States law and could have subjected him to a penalty of more than $400,000—half the balance of the account at the time of the violation. However, Plaintiff seeks a judgment only of $88,341.16, including late fees and interest. While the amount Plaintiff seeks is significant, the Court would find that in light of the potential amount Defendant could have been required to pay, the amount is reasonable.

4. Possibility of Dispute Concerning Material Facts

The fifth *Eitel* factor requires the Court to consider whether it is likely a dispute exists as to any material facts in the case. *See Eitel*, 782 F.2d at 1471–72. "Where a plaintiff's complaint is well-pleaded and the defendant makes no effort to *properly* respond, the likelihood of disputed facts is very low." *See United States v. Yermian,* No. SACV 15–0820–DOC (RAOx), 2016 WL 1399519, at * 3 (C.D. Cal. Mar. 18, 2016) (emphasis added); *see also Landstar Ranger*, 725 F.Supp.2d at 921. Additionally, upon default, the factual allegations of the complaint, except those relating to the amount of damages, will be taken as true. *TeleVideo Systems Inc.*, 826 F.2d at 917.

Here, the allegations in the Complaint are well-pleaded and straightforward. In response to the Complaint, Defendant mailed unfiled pleadings to the office of counsel for the United States ("Unfiled Pleadings"). In the Unfiled Pleadings, Defendant contends that his "actions were never willful," and that the two year statute of limitations had run out. *See* MDJ at 33. However, Defendant failed to file his answer with the court prior to August 9, 2017—when the Court Clerk entered default. He appears to have attempted to file the materials on September 5, 2017, but because default had already been entered, the Court rejected the filing. *See* Docket No. 16. Once a Court Clerk enters default, a defendant's right to appear in the action or to present evidence is cut off. *Clifton v. Tomb*, 21 F.2d 893, 897 (4th Cir. 1927). The only procedure available to Defendant is to file a motion to set aside the default under FRCP 55(c), and Defendant has failed to file such a motion. O'Connell & Stevenson, *Rutter Group Prac. Guide: Federal Civ. Pro. Before Trial* § 6:43, at 6–10 (The Rutter Group 2017). Accordingly, the facts alleged by Plaintiff were sufficient to establish its claim of a FBAR violation and the fifth factor weighs in favor of granting Plaintiff's Motion for Default Judgment.

5. Possibility of Excusable Neglect

***5** In respect to the sixth *Eitel* factor, the possibility of excusable neglect in the instant case is remote. The underlying reason for this factor is to uphold due process by requiring that all interested parties be given notice reasonably calculated to apprise them of the pendency of the action, and be afforded opportunity to present their objections before a judgment is rendered. *See Philip Morris USA, Inc. v. Castworld Prods., Inc.,* 219 F.R.D. 494, 500 (C.D. Cal. 2003). Here, Plaintiff personally served Defendant with a copy of the Summons and Complaint. *See generally* Docket No. 9. Furthermore, Plaintiff has repeatedly advised and instructed Defendant of his need to file an answer with the Court. Hughes Decl. at ¶¶ 5, 8, 10. Despite such notice, Defendant failed to file an answer presenting his objections. Therefore, the Court would find that Defendant was provided reasonable notice and that the possibility of excusable neglect is unlikely.

6. Strong Policy Favoring Decisions on the Merits

The seventh *Eitel* factor emphasizes that "cases should be decided upon their merits whenever reasonably possible." *Eitel,* 782 F.2d at 1472. However, "this preference, standing alone, is not dispositive." *Id.* "Defendant's failure to answer Plaintiff's Complaint makes a judgment on the merits impractical, if not impossible." *Cal. Sec. Cans*, 238 F.Supp.2d at 1177. Accordingly, the inability to comply with the strong policy favoring deciding cases on the merits does not preclude the Court from entering default judgment against Defendant.

IV. Plaintiff Is Entitled to a Penalty

Plaintiff's Motion for Default Judgment "must also prove all damages sought in the complaint." *Dr. JKL Ltd. v. HPC IT Educ. Ctr.,* 749 F.Supp.2d 1038, 1046 (N.D. Cal. 2010) (citing *Philip Morris USA, Inc.,* 219 F.R.D. 498). Rule 55 does not require the court to conduct a hearing on damages, so long as it ensures there is an adequate basis for the damages awarded in the default judgment. *Action S.A. v. Marc Rich & Co. Inc.,* 951 F.2d 504, 508 (2d Cir. 1991). "The Court considers Plaintiff's declarations, calculations, and other documentation of damages in determining if the amount at stake is reasonable." *Truong Giang Corp. v. Twinstar Tea Corp.,* No. 06–CV–03594, 2007 WL 1545173, at *12 (N.D. Cal. May 29, 2007).

Under 31 U.S.C. § 5321(a)(5)(A), a civil monetary penalty may be imposed on individuals who fail to file a required FBAR. U.S.C. § 5321(a)(5)(A). Here, Plaintiff sufficiently addressed and established all the elements necessary to demonstrate a violation. Plaintiff seeks to reduce a penalty of $88,341.16[2] to judgment due to Defendant's failure to report a required FBAR and for late payments authorized by 31 U.S.C. § 3717. Accordingly, the Court would find that Plaintiff is as a matter of law entitled to the penalty, and that the amount requested is reasonable.

V. Conclusion

The Court would GRANT Plaintiff's Application for Default Judgment against Defendant and award Plaintiff a total of $88,341.16. However, as for the interest, costs, expenses, and any additional penalties, the Court would allow Plaintiff to enumerate those costs in a supplemental filing.

All Citations

Slip Copy, 2017 WL 6021420, 120 A.F.T.R.2d 2017-6380

Footnotes

[1] "If a foreign account holder 'willfully' failed to report the account on an FBAR, the maximum penalty is increased from $10,000 to the greater of $100,000 or fifty percent of the balance in the account at the time of violation." *Bohanec*, 2016 WL 7167860, at *3 (citing 31 U.S.C. §§ 5321(a)(5)(C), (D)(ii)).

[2] Interest and penalties have accrued on the assessed FBAR penalty of $80,043. As of December 2, 2016, the total outstanding balance, consisting of the FBAR penalty, penalties for late payment under 31 U.S.C. § 3717(e)(2), and statutory interest, totaled $88,341.16. 31 U.S.C. § 3717(e)(2); Hughes Decl. ¶ 14, Exh. D.

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2017 WL 401228
United States District Court,
E.D. Wisconsin.

Milo KENTERA and Lois Kentera, Plaintiffs,
v.
UNITED STATES of America, Defendant.

Case No. 16–CV–1020–JPS
|
Signed 01/30/2017

Attorneys and Law Firms

Joseph M. Bray, Lynn K. Ching, Anthony V. Diosdi, Moskowitz LLP, San Francisco, CA, for Plaintiffs.

Martin M. Shoemaker, United States Department of Justice, Washington, DC, for Defendant.

ORDER

J.P. Stadtmueller, U.S. District Judge

***1** Plaintiffs, Milo and Lois Kentera, filed a complaint against the United States, alleging violations of the Administrative Procedures Act ("APA"), 5 U.S.C. § 701 *et seq.*, and their due process rights under the Fifth Amendment. (Docket #1). This action arises from Plaintiffs' failure to file a Report of Foreign Bank and Financial Accounts ("FBAR") for several tax years despite having assets that should have been identified in that form. The Internal Revenue Service assessed civil penalties against Plaintiffs for these failures. Plaintiffs challenge those penalties, arguing that they are void because Plaintiffs had reasonable cause for their failure to file the FBARs. They further assert that the IRS' decision to impose the penalties was arbitrary and capricious, in violation of the APA. The government moved to dismiss the complaint, asserting that it has not waived its sovereign immunity with respect to Plaintiffs' claims and, even if it had, venue is not proper in this District. (Docket #15). The motion is fully briefed, and, for the reasons stated below, it will be granted on the basis of sovereign immunity.[1]

1. APPLICABLE LAW

1.1 Motion to Dismiss for Failure to State a Claim

Federal Rule of Civil Procedure 12(b) provides for dismissal of complaints which fail to state a viable claim for relief or for improper venue. Fed. R. Civ. P. 12(b)(3) and (6). To state a viable claim, a complaint must provide "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). In other words, the complaint must give "fair notice of what the ... claim is and the grounds upon which it rests." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (citation omitted). The allegations must "plausibly suggest that the plaintiff has a right to relief, raising that possibility above a speculative level[.]" *Kubiak v. City of Chicago*, 810 F.3d 476, 480 (7th Cir. 2016) (citation omitted). In reviewing Plaintiffs' complaint, the Court is required to "accept as true all of the well-pleaded facts in the complaint and draw all reasonable inferences in favor of the plaintiff." *Id.* at 480–81.

1.2 Sovereign Immunity

"It is axiomatic that the United States may not be sued without its consent and that the existence of consent is a prerequisite for jurisdiction." *United States v. Mitchell*, 463 U.S. 206, 212 (1983). Waivers of sovereign immunity are narrowly construed because the immunity protects the public fisc. *See West v. Gibson*, 527 U.S. 212, 222 (1999); *Nelson v. Miller*, 570 F.3d 868, 883–84 (7th Cir. 2009). The court must strictly construe the scope of any alleged waiver in favor of the sovereign. *Lane v. Pena*, 518 U.S. 187, 192 (1996). A court may "not enlarge the waiver beyond what the language [of the statute] requires." *Library of Congress v. Shaw*, 478 U.S. 310, 318 (1986) (internal citations and quotation marks omitted). Consent to suit cannot be implied, and ambiguities are construed in favor of immunity. *See United States v. Nordic Village*, 503 U.S. 30, 34 (1992). In this Circuit, a sovereign immunity defense, if sustained, shows that the plaintiff failed to state a claim; it is not a matter affecting the court's subject-matter jurisdiction. *Collins v. United States*, 564 F.3d 833, 837–38 (7th Cir. 2009). The plaintiff, as the party seeking to breach the government's sovereign immunity, bears the burden to show that a waiver exists. *See Macklin v. United States*, 300 F.3d 814, 819 (7th Cir. 2002); *Cole v. United States*, 657 F.2d 107, 109 (7th Cir. 1981).

2. RELEVANT FACTS

***2** The relevant facts are drawn from Plaintiffs' complaint. The Bank Secrecy Act ("BSA"), 31 U.S.C. § 5311 *et seq.*, requires U.S. citizens to keep records and file reports when they "mak[e] a transaction or maintai[n] a relation with a foreign financial agency." 31 U.S.C. § 5314(a). The report must be made in an FBAR, which is IRS Form TD F 90–22.1. The FBAR must be filed on or before June 30 of the year following the calendar year for which the report is made. If the individual fails to comply with the requirements of Section 5314, the BSA provides that civil penalties may be imposed. *Id.* § 5321(a)(5). For non-willful violations, the penalty cannot exceed $10,000. *Id.* § 5321(a)(5)(B)(I).

In 1984, Plaintiff Milo Kentera inherited money located in a foreign bank account at Banque Cantonale de Geneve ("BCGE"). He added his wife's name to the BCGE account shortly thereafter. The balance in the account increased dramatically in 2007 due to the sale of Milo Kentera's parents' property in Montenegro, certain proceeds of which were distributed to Milo and deposited in the BCGE account.

Plaintiffs have consistently disclosed the BCGE account on their federal income tax returns since 1984. However, in 2006 their accountant failed to prepare or file an FBAR in connection with their federal income tax return. Their accountant for tax years 2007, 2008, and 2009 made the same error, despite having information from which he could have discovered the existence of the BCGE account. In 2010, a third accountant acknowledged the existence of the BCGE account in Plaintiffs' return, but again seems to have failed to prepare or file an FBAR.

In February 2011, the IRS announced a federal amnesty program for taxpayers with foreign bank accounts—the 2011 Offshore Voluntary Disclosure Initiative ("OVDI"). To participate, taxpayers were required to amend their tax returns and file FBARs for tax years 2003–2010. OVDI participants were required to pay all delinquent taxes, interest, and penalties, and, under this program, taxpayers were subject to a 25% penalty on the highest aggregate account balance on their previously undisclosed accounts during those years.

In around September 2011, Plaintiffs applied to the OVDI program. They amended their tax returns for 2006–2010 to include omitted income and filed completed FBARs for 2005–2010. In August 2013, the IRS provided Plaintiffs with a Form 906, *Closing Agreement on Final Determination Covering Specific Matters*(the "Closing Agreement"). The Closing Agreement provided, in relevant part, that Plaintiffs would be liable under the tax code for a miscellaneous penalty of $90,092. Plaintiffs withdrew from the OVDI program the next month.

After Plaintiffs withdrew from the program, IRS agent Kimberly Nguyen ("Nguyen"), who works in Milwaukee, examined the matter and recommended that Plaintiffs be assessed non-willful FBAR penalties pursuant to 31 U.S.C. § 5321(a)(5). The amounts of the penalties were as follows:

> (1) Lois Kentera: $500 for calendar year 2006; and $2,500 per year for calendar years 2007, 2008, 2009, and 2010, for a total penalty of $10,500; and
>
> (2) Milo Kentera: $500 for calendar year 2006; and $10,000 per year for calendar years 2007, 2008, 2009, and 2010, for a total penalty of $40,500.

On September 17, 2014, the government mailed each Plaintiff a letter advising that the IRS was proposing assessment of these penalties.

On or about December 14, 2014, Plaintiffs' counsel communicated with Nguyen, protesting the proposed penalties. He also had a conference with her sometime thereafter. By letter dated April 22, 2015, the government mailed Milo Kentera a letter of an "appeals determination," upholding the IRS' proposed FBAR penalties. A similar letter was sent to Lois Kentera on April 29, 2015.

***3** In their complaint, Plaintiffs assert that the government was wrong to assess these penalties. First, Plaintiffs contend that the BSA prohibits the imposition of an FBAR penalty if the violation was "due to reasonable cause." 31 U.S.C. § 5321(a)(5)(B)(ii)(I). According to Plaintiffs, reasonable cause for their violations exists because the fault lay with their various accountants. The government disregarded this defense, and Plaintiffs believe this was a violation of their due process rights under the Fifth Amendment. Second, Plaintiffs allege that because the IRS wrongfully rejected their reasonable cause defense under the BSA, its assessment of the penalties was arbitrary and capricious, in violation of the APA. *See* 5 U.S.C. § 706(2)(A) (a district court may set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"). Plaintiffs request that the Court find that the government abused its discretion in assessing these penalties and ask that the Court declare the penalties void.

3. DISCUSSION

The government contends that Plaintiffs have failed to state any claims against it because it has not waived its sovereign immunity with respect to Plaintiffs' claims. The parties' dispute focuses on the APA, which provides a waiver of sovereign immunity when two prerequisites are met.[2] First, the action in question must "see[k] relief other than money damages and stat[e] a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority." *See* 5 U.S.C. § 702. Second, the plaintiff must show that (1) review of the agency action in question is authorized by a substantive statute or (2) review is made of a "final agency action for which there is no other adequate remedy in a court." *Id.* § 704; *Bowen v. Massachusetts*, 487 U.S. 879, 891–93 (1988); *Consol. Edison of N.Y. v. U.S. Dep't of Energy*, 247 F.3d 1378, 1382 (Fed. Cir. 2001) ("The Supreme Court has explained that a litigant may invoke the APA as a waiver of sovereign immunity, thereby invoking district court jurisdiction, if the litigant can satisfy both ... § 702 and ... § 704.") (parentheticals omitted); *see also Blagojevich v. Gates*, 519 F.3d 370, 372 (7th Cir. 2008). Both parties agree that none of the substantive law on which Plaintiffs rely contains a waiver of sovereign immunity. (Docket #16 at 4); (Docket #17 at 3).

Nevertheless, the government asserts that Plaintiffs have adequate remedies outside the instant suit. (Docket #16 at 4). In the government's view, Plaintiffs can pay some or all of the penalties and then file a refund suit under the Tucker Act, 28 U.S.C. § 1491, or the Little Tucker Act, 28 U.S.C. § 1346(a)(2). *Id.* at 4–5. Such a suit would permit Plaintiffs to raise the reasonable cause defense that forms the basis of this action. *Id.* at 5. Alternatively, if Plaintiffs simply decline to pay the penalties, they could assert the reasonable cause defense during a suit brought by the government to reduce the penalties to judgment pursuant to 31 U.S.C. § 5321(b)(2). *Id.*[3]

***4** Plaintiffs rejoin that the government's proposed alternative avenues are not adequate substitutes for APA review. (Docket #17). The availability of remedies under the Tucker Act and Little Tucker Act turn on different prerequisites, so the Court will treat them in turn.

3.1 The Tucker Act and Money Mandating Statutes

First, there is the Tucker Act, which established the Court of Federal Claims in order to provide a forum for certain monetary claims against the United States. Under the Tucker Act, the Court of Federal Claims has "jurisdiction to render judgment upon any claim against the United States, founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." *See* 28 U.S.C. § 1491 (a)(1). The Tucker Act waives the government's sovereign immunity for such actions. *United States v. Mitchell*, 463 U.S. 206, 212–18 (1983); *United States v. Testan*, 424 U.S. 392, 397–98 (1976). Thus, says the government, Plaintiffs could pay some of the penalties and seek a refund under the Tucker Act.

There is an additional wrinkle, however, since the Tucker Act only confers jurisdiction and itself creates no substantive rights. *Testan*, 424 U.S. at 398. As such, to assert a claim in the Court of Federal Claims under the Tucker Act, Plaintiffs would need a source of substantive law that creates for them a damages remedy. *Mitchell*, 463 U.S. at 216; *Todd v. United States*, 386 F.3d 1091, 1094 (Fed. Cir. 2004). This is referred to as the requirement for a "money-mandating" source of law. *See Roth v. United States*, 378 F.3d 1371, 1384 (Fed. Cir. 2004) ("Because the Tucker Act itself does not provide a substantive cause of action, a plaintiff must find elsewhere a money mandating source upon which to base a suit.").

According to Plaintiffs, neither the BSA nor the Due Process Clause of the Fifth Amendment qualify. (Docket #17 at 6–7). First, although the BSA provides the means for the government to enforce FBAR requirements, it says nothing about the taxpayer's ability to seek repayment of unauthorized penalties. (Docket #17 at 6). Second, the Due Process Clause of the Fifth Amendment has, as Plaintiffs point out, been flatly held not to be money mandating. *Id.* at 7; *Smith v. United States*, 709 F.3d 1114, 1116 (Fed. Cir. 2013) ("The Due Process clauses of both the Fifth and Fourteenth Amendments do not mandate the payment of money, and thus do not provide a cause of action under the Tucker Act.").

Yet Plaintiffs acknowledge that this is not the end of the story. Rather, the Court of Federal Claims could hear Plaintiffs' claims—statutory, constitutional, or otherwise—under an "illegal exaction" theory. *Consol. Edison Co. of N.Y.*, 247 F.3d at 1384. An illegal exaction occurs when money is "improperly paid, exacted, or taken from the claimant" in violation of the Constitution or some statutory power. *See Eastport S.S. Corp. v. United States*, 178 Ct. Cl. 599, 605 (1967). The classic illegal exaction claim is a tax refund suit alleging that taxes have been improperly collected or withheld by the government. *See, e.g., City of Alexandria v. United States*, 737 F.2d 1022, 1028 (Fed. Cir. 1984). As Plaintiffs admit, "[a]lthough the [Court of Federal Claims] ordinarily lacks jurisdiction over due process claims under the Tucker Act, cases have held that [it] does have jurisdiction over illegal exaction claims when the exaction is based upon an asserted statutory power." (Docket #17 at 7) (citing *Gahagan v. United States*, 72 Fed. Cl. 157, 163 (2006); *Aerolineas Argentinas v. United States*, 77 F.3d 1564, 1573 (Fed. Cir. 1996)). Here, that statutory power would be the BSA itself.

***5** Plaintiffs argue, however, that even in illegal exaction cases, a money-mandating source of law is still required to create jurisdiction under the Tucker Act. (Docket #17 at 7–8) (citing *Starr Int'l Co., Inc. v. United States*, 121 Fed. Cl. 428, 464 (2015)). The government disagrees. It claims that either a money-mandating statute *or* an illegal exaction, but not both, are required to bring a claim in the Court of Federal Claims. (Docket #19 at 7) (citing *Aerolineas Argentinas*, 77 F.3d at 1579).

The Court need not resolve the parties' disagreement on this question because it finds that the BSA qualifies as money-mandating. To prove that a statute is money-mandating, it "must be such that [it] 'can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained.' " *Jones v. United States*, 122 Fed. Cl. 490, 508 (2015) (quoting *United States v. White Mountain Apache Tribe*, 537 U.S. 465, 472 (2003)); *Testan*, 424 U.S. at 401–02. The Court of Appeals for the Federal Circuit explained in *Norman* that

> [t]o invoke Tucker Act jurisdiction over an illegal exaction claim, a claimant must demonstrate that the statute or provision causing the exaction itself provides, either expressly or by "necessary implication," that "the remedy for its violation entails a return of money unlawfully exacted." *Cyprus Amax Coal Co. v. United States*, 205 F.3d 1369, 1373 (Fed. Cir. 2000) (concluding that the Tucker Act provided jurisdiction over an illegal exaction claim based upon the Export Clause of the Constitution because the language of that clause "leads to the ineluctable conclusion that the clause provides a cause of action with a monetary remedy").

Norman v. United States, 429 F.3d 1081, 1095 (Fed. Cir. 2005).

It is not the case, as Plaintiffs believe, that the BSA is not money-mandating simply because it does not expressly provide the taxpayer a remedy for an unauthorized FBAR penalty. Rather, the absence of money-mandating language is not fatal to jurisdiction so long as a monetary remedy can be implied for an illegal exaction under the relevant statute. *White Mountain Apache Tribe*, 537 U.S. at 477 ("To the extent that the Government would demand an explicit provision for money damages to support every claim that might be brought under the Tucker Act, it would substitute a plain and explicit statement standard for the less demanding requirement of fair inference that the law was meant to provide a damages remedy for breach of a duty."). In other words, "[the court] asks what would be the explicit or implicit remedy for the Government's violation of the statute." *Northern California Power Agency v. United States*, 122 Fed. Cl. 111, 115–16 (2015). If, "by necessary implication, the remedy would be a return of the payments that were assessed ... in violation of [the statute]," jurisdiction exists. *Id.* Thus, the court in *Greene* found that a monetary remedy could be fairly implied for an illegal offset against a tax refund made pursuant to 31 U.S.C. § 3720A because the taxpayer would have no other recourse for return of those funds. *Greene v. United States*, 124 Fed. Cl. 636, 641 (2015). The same logic held sway in *Starr*, where the court found that if jurisdiction did not exist, the government "could nationalize a private corporation, as it did to AIG, without fear of any claims or reprisals." *Starr*, 121 Fed. Cl. at 464–65.

The analysis is the same with respect to the BSA. The statute authorizes the government to impose a penalty for failure to file an FBAR, unless the failure was due to reasonable cause. 31 U.S.C. § 5321(a)(5)(B)(ii)(I). If there was no failure to file or if the failure was due to reasonable cause, there should be no penalty and any money the government receives as payment of the penalty was illegally exacted in violation of the statute. Though the BSA admittedly lacks money-mandating language, it is by necessary implication that the taxpayer has a monetary remedy—the return of his illegally exacted funds—when the statute is violated. *Norman*, 429 F.3d at 1095; *N. California Power Agency*, 122 Fed. Cl. at 116; *White Mountain Apache Tribe*, 537 U.S. at 477. As a result, Plaintiffs could bring their statutory and constitutional claims in the Court of Federal Claims pursuant to the Tucker Act. This, in turn, compels the Court to conclude that APA review is unavailable here, since Plaintiffs have an adequate remedy to replace it.[4]

3.2 The Little Tucker Act

***6** Plaintiffs could not only assert a claim under the Tucker Act in the Court of Federal Claims, they could also raise a claim under the Little Tucker Act in either the district court or the Court of Federal Claims. The Little Tucker Act provides concurrent jurisdiction in the district courts and the Court of Federal Claims over suits against the United States for $10,000 or less founded upon "the Constitution, or any Act of Congress,...or upon any express or implied contract with the United States" and waives sovereign immunity for those claims. 28 U.S.C. § 1346(a)(2); *Mitchell*, 463 U.S. at 212–218. However, the Tucker Act limits the Court of Federal Claims to awarding damages and not granting injunctive or declaratory relief. *Richardson v. Morris*, 409 U.S. 464, 465–66 (1973). This limitation applies to district courts when they exercise jurisdiction under the Little Tucker Act, since the district court is essentially sitting in place of the Court of Federal Claims. *United States v. Sherwood*, 312 U.S. 584, 589–91 (1941).[5]

This limitation, Plaintiffs contend, undermines the government's contention that the Little Tucker Act is an adequate substitute for their APA claim. Plaintiffs argue first that because the FBAR penalties against them total $51,000, their claims exceed the jurisdictional reach of the Little Tucker Act. (Docket #17 at 9–10). However, the $10,000 limitation applies per claim, not per case, and because none of the individual FBAR penalties exceeds $10,000, the Little Tucker Act provides jurisdiction. *See Baker v. United States*, 722 F.2d 517, 518 (9th Cir. 1983); *United States v. Louisville & Nashville R.R. Co.*, 221 F.2d 698, 703 (6th Cir. 1955); *Zumerling v. Devine*, 769 F.2d 745, 748 (Fed. Cir. 1985); *Commonwealth of Pa. v. National Ass'n of Flood Ins.*, 520 F.2d 11, 25 (3d Cir. 1975).

Second, Plaintiffs assert that the inability of the court to grant equitable relief when exercising jurisdiction under the Act is problematic. *Id.* at 10–11. They reason as follows:

> If the government declined to answer or counterclaim, plaintiffs could theoretically obtain a default judgment for refund of the $10,000. However, since the Tucker Act does not empower the district court to render declaratory relief, and a default judgment is not given preclusive effect under the doctrine of collateral estoppel, plaintiffs would remain liable for the balance of the civil penalty assessment. As such the United States would be able to offset any federal benefits to which plaintiffs may be entitled, including social security benefits.

Id. (internal citations omitted). The government claims that Plaintiffs' fear "is entirely theoretical and also incorrect." (Docket #19 at 4).

The Court agrees that Plaintiffs' argument is speculative. Moreover, the argument has been rejected by other courts. *See Briggs v. United States*, 564 F. Supp. 2d 1087, 1093 (N.D. Cal. 2008). If Plaintiffs were successful in achieving a refund of even a partial payment of the FBAR assessments, the government would be barred by *res judicata* from seeking to collect the remainder of the assessments. *See id.* at 1092–93; *Consol. Edison Co. of N.Y.*, 247 F.3d at 1384–85 (if the plaintiff succeeded in obtaining a partial refund, one "cannot imagine that the United States would continue to require the [plaintiff] to pay unlawful exactions"). This Court agrees with *Briggs* inasmuch as once Plaintiffs were repaid, "it would be unlikely (and inappropriate) for defendan[t] to continue with wrongful offsets." *Briggs*, 564 F. Supp. 2d at 1094. Thus, the fact that a district court could not grant a prospective, equitable ban on future collection of the FBAR assessments under the Little Tucker Act is of no moment. *See Telecare Corp. v. Leavitt*, 409 F.3d 1345, 1349 (Fed. Cir. 2005) (noting that "[t]he availability of an action for money damages under the Tucker Act ... is presumptively an 'adequate remedy' for § 704 purposes" and "a final decision in a Little Tucker Act case ... will finally resolve the issue and as a practical matter make repeated suits unnecessary"). Thus, Plaintiffs could bring their claims in this case under the Little Tucker Act.[6]

3.3 Plaintiffs Have Not Established a Waiver of Sovereign Immunity

***7** The parties' present dispute requires the Court to assess the nuances of Tucker Act and Little Tucker Act jurisdiction. But recall that the ultimate inquiry here is whether the United States has waived its sovereign immunity as to Plaintiffs' claims. This does not occur by implication; instead, waiver must be unmistakable. *Nelson*, 570 F.3d at 883–84. Waiver in this case must be decided by reference to the APA, which waives immunity only when the plaintiff lacks another adequate remedy elsewhere. 5 U.S.C. § 704. The question is not whether Plaintiffs might have a better chance of success in the present suit; rather, dismissal is required merely if they have an *adequate* remedy in another proceeding. *See Walsh v. Dep't of Veterans Affairs*, 400 F.3d 535, 537–38 (7th Cir. 2005); *Consol. Edison Co. of N.Y.*, 247 F.3d at 1383.

Considering these principles together, the Court is obliged to conclude that Plaintiffs have failed to meet their burden to show that sovereign immunity has been waived. *Macklin*, 300 F.3d at 819. Plaintiffs have an adequate alternative to this lawsuit in either the Tucker Act or the Little Tucker Act. Moreover, to the extent Plaintiffs believe that they should not be required to pay *any* of the FBAR assessments before filing suit, either by preemptively paying them to create jurisdiction under the statutes discussed above, or by waiting for the government to offset their funds from them administratively, this is merely a complaint that APA review might be better for them financially in the short term. It does not, standing alone, demonstrate that paying some or all of the assessments and filing a refund suit in the Court of Federal Claims is inherently inadequate. *Cf. Greene v. United States*, 124 Fed. Cl. 636, 641 (2015) (noting that illegal exaction claim does not require the taxpayer to first fully pay the tax liability). In any event, Plaintiffs never expressly assert that there is a problem with Tucker Act or Little Tucker Act claims simply because they require a prepayment of the allegedly illegal penalty in order to create jurisdiction. As such, the Court remains unconvinced that the government has waived its sovereign immunity and it must dismiss Plaintiffs' claims.

4. CONCLUSION

Plaintiffs have not met their substantial burden to show that the government waived its sovereign immunity with respect to the claims they assert in this action. As a result, the complaint must be dismissed for failure to state a claim. The dismissal is without prejudice so that Plaintiffs may avail themselves of whatever other avenues for relief they deem appropriate, including potential claims under the Tucker Act or Little Tucker Act. *See Sorrentino v. Godinez*, 777 F.3d 410, 414–15 (7th Cir. 2015).

Accordingly,

IT IS ORDERED that the United States' motion to dismiss for failure to state a claim (Docket #15) be and the same is hereby **GRANTED**; and

IT IS FURTHER ORDERED that this action be and the same is hereby **DISMISSED without prejudice**.

The Clerk of Court is directed to enter judgment accordingly.

All Citations

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Footnotes

[1] Because the Court finds that the complaint should be dismissed because of the government's sovereign immunity, it need not reach the question of whether this District is the proper venue for the suit.

[2] The other two asserted jurisdictional bases for the suit—28 U.S.C. § 1331 and 28 U.S.C. § 2201—do not create waivers of the United States' sovereign immunity. *See* (Docket #16 at 3, 5–6). Plaintiffs admit as much with respect to Section 1331. (Docket #17 at 3). Further, while Plaintiffs do not expressly concede that the Declaratory Judgment Act, 28 U.S.C. § 2201, does not create a waiver of sovereign immunity, the Act "neither provides nor denies a jurisdictional basis for actions under federal law, but merely defines the scope of available declaratory relief." *See McCarthy v. Marshall*, 723 F.2d 1034, 1037 (1st Cir. 1983). As a result, the Act cannot itself work a waiver of sovereign immunity.

[3] Plaintiffs believe that this is not a viable option because the government can recoup the penalties without litigation by offsetting payments made by other federal agencies, including Social Security benefits. (Docket #17 at 11); 31 U.S.C. § 3716; 31 C.F.R. § 285.5(a)(1). The government does not address Plaintiffs' position in its reply and therefore seems to have abandoned this argument. Because the Court finds that the Tucker Act and Little Tucker Act afford Plaintiffs an adequate alternative to a claim under the APA, the Court does not decide whether waiting for the government to sue them would also qualify.

[4] The Court notes that the parties have not cited, and it has not located, specific guidance on whether APA review of FBAR penalties should be permitted to proceed or be rejected in favor of a Tucker Act claim. The Court found only one case coming close: *Moore v. United States*, No. C13–2063RAJ, 2015 WL 1510007 (W.D. Wash. Apr. 1, 2015). The court in *Moore* heard (and rejected on the merits) an APA challenge to the imposition of an FBAR penalty. *See id.* at *3. Nevertheless, the government appears not to have raised sovereign immunity in *Moore*, so the Court does not find *Moore* helpful on the specific question raised here.

[5] The Little Tucker Act also subsumes the requirement in the Tucker Act that there be a money-mandating statute or an illegal exaction. (Docket #19 at 7 n.5). Because that point was addressed above, *see supra* Part 4.1, the Court need not repeat its analysis here.

[6] The government argues, for the first time in its reply, that 28 U.S.C. § 1355 also affords an adequate alternative to the present request for APA review. (Docket #19 at 2). Section 1355 provides that federal district courts have original jurisdiction "of any action or proceeding for the recovery or enforcement of any fine, penalty, or forfeiture, pecuniary or otherwise, incurred under any Act of Congress, except matters within the jurisdiction of the Court of International Trade." 28 U.S.C. § 1355(a). Whether or not this statute provides an adequate alternative, Plaintiffs were not given a chance to respond to the government's position. The Court will, therefore, disregard it. *Studio & Partners v. KI*, No. 06–C–0628, 2008 WL 426496, at *6 (E.D. Wis., Feb. 14, 2008) (citing *TAS Distributing Co., Inc. v. Cummins Engine Co., Inc.*, 491 F.3d 625, 630–31 (7th Cir. 2007)).

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2014 WL 3746497
United States District Court, E.D. Virginia,
Alexandria Division.

UNITED STATES of America, Plaintiff,
v.
J. Bryan WILLIAMS, Defendant.

Civil Action No. 1:09–CV–00437.
|
Signed June 26, 2014.

Attorneys and Law Firms

Gerard J. Mene, United States Attorney's Office, Alexandria, VA, Christopher David Belen, Washington, DC, for Plaintiff.

David H. Dickieson, Schertler & Onorado, Washington, DC, for Defendant.

ORDER

LIAM O'GRADY, District Judge.

***1** In April 2009, the United States brought a civil action in the Eastern District of Virginia against J. Bryan Williams to collect $200,000 in civil penalties assessed against him by the IRS for failing to file a Foreign Bank Account Report ("FBAR") form for his two foreign accounts during the tax year 2000. This Court held a bench trial on April 26, 2010, and thereafter reviewed supplemental briefs from the parties. On September 1, 2010, the Court ruled in favor of Mr. Williams, finding that the government failed to meet its burden of establishing that Williams's violations under 31 U.S.C. § 5314 were willful.

The United States appealed to the Fourth Circuit Court of Appeals, and on July 20, 2012 the Fourth Circuit reversed. The Fourth Circuit held that Williams willfully violated Section 5314 by signing his 2000 federal tax return. The court found Williams's signature "prima facie evidence that he knew the contents of his return," Op. at 12, and concluded that he was also on notice of the FBAR requirement. The court held that Williams's admission that he did not carefully review the instructions on his federal tax return suggested a "conscious effort to avoid learning about reporting requirements," *id.* (*citing United States v. Sturman,* 951 F.3d 1466, 1476 (6th Cir.1991)), and combined with his false answers indicated an intent to conceal his financial information. Because the Fourth Circuit found that this conduct constituted at least willful blindness to the FBAR requirement, it found that Mr. Williams's violations *were* willful and remanded for proceedings consistent with that opinion. Because the penalties imposed by the IRS were not an abuse of the agency's discretion, this Court now affirms the $200,000 in civil penalties imposed against Mr. Williams.

Although the Government argues that the amount of the penalty assessed may not be considered on remand, this Court does review the penalty amount for abuse of discretion under the "arbitrary and capricious" standard of the Administrative Procedure Act. 5 U.S. § 706. The Court rejects Defendant's contention that the Fourth Circuit's remand for "further proceedings" is an invitation to engage in *de novo* review of the penalty amount. Although some courts have held in similar contexts that *de novo* review is appropriate when the issue of a defendant's underlying tax *liability* is at issue, *see, e.g., Dogwood Forest Rest Home, Inc. v. United States,* 181 F.Supp.2d 554, 559–60 (M.D.N.C.2001) (collecting cases), the Fourth Circuit has already ruled on the issue of Mr. Williams's liability in this case. On remand, it has been established that Williams is eligible for the FBAR penalties, including the penalties for willful violations. Because review of the penalty *amount* is the only remaining issue in this case, the appropriate standard of review is abuse of discretion. [1]

Courts have specifically found that an agency's selection of a penalty is "the exercise of a discretionary grant of power, and is to be reviewed only for abuse under an arbitrary and capricious standard of review." *Ekanem v. Internal Revenue Service,* 1998 WL 773614, at *1 (D.Md.1998). Under that narrow and deferential standard, the Court must not substitute its judgment for the agency's, and must only review the record to ensure that the agency engaged in reasoned decision-making and that there was a "rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.,* 463 U.S. 29, 43 (1983) (*quoting Burlington Truck Lines, Inc. v. United States,* 371 U.S. 156, 168 (1962)).

***2** In this case, the two $100,000 penalties issued by the IRS were within the range authorized by Congress in 31 U.S.C. § 5321(a)(5)(C) for willful violations. Although the IRS *may* impose a lower penalty where the violating taxpayer meets certain criteria, *see* U.S. Br. at 6, such departures are within the discretion of the agency. The Internal Revenue Manual states that in assessing penalties, examiners "exercise discretion" in determining "the total amount of penalties to be asserted," and also states that examiners are to consider the facts and circumstances of each case when making that determination. The Manual clarifies that the penalties are determined "per account," and not per person or per unfiled FBAR. IRM § 4.26.16.4. The Manual specifically lists "[t]he nature of the violation and the amounts involved" and "[t]he cooperation of the taxpayer during the examination" as among the factors that an examiner should consider. However, it also warns that "given the magnitude of the maximum penalties permitted for each violation, the assertion of multiple penalties ... should be considered only in the most egregious cases." IRM § 4.26.16.4.7.

Although Defendant argues that the imposition of two maximum penalties is not warranted in this case, the Court finds that there is sufficient evidence in the record to demonstrate that the $200,000 penalty was the product of reasoned decision-making and consideration of the appropriate factors. While there is no evidence from which the Court can conclude that the penalties were assessed for an improper purpose, the IRS's letter to Mr. Williams bolsters the conclusion that the agency made a reasoned decision after considering the relevant factors. *See* Def. Ex. 29. Reviewing the IRS's decision under an abuse of discretion standard, this Court cannot simply substitute its judgment for that of the agency. Although the Internal Revenue Manual does state that multiple maximum penalties are for "egregious" cases, it would not be arbitrary and capricious for the IRS to find that the amount of money involved in this case justified the imposition of maximum penalties. Therefore, it is hereby **ORDERED:**

1. The two Report of Foreign Bank Accounts ("FBAR') penalties assessed against Mr. Williams under 31 U.S.C. § 5321(a)(5)(C), totaling $200,000, are **AFFIRMED.**

All Citations

Not Reported in F.Supp.3d, 2014 WL 3746497, 114 A.F.T.R.2d 2014-5036

Footnotes

[1] Although the only other court to have considered the appropriateness of an FBAR penalty amount did not specifically identify a standard of review, it reviewed the penalty with great deference to the judgment of the agency. In *United States v. McBride,* 908 F.Supp.2d, 1186, 1214 (D.Utah Nov. 8, 2012), the court affirmed two maximum penalties after determining that they were within the range authorized by Congress. The court did not consider the propriety of the penalty *amounts,* simply stating that the penalties were authorized by the statute and "[a]ccordingly ... were proper."

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2016 WL 3129530
United States District Court,
S.D. Texas, Laredo Division.

Bernhard GUBSER, Plaintiff
v.
INTERNAL REVENUE SERVICE, et al., Defendants.

CIVIL ACTION NO. 5:15-CV-298
|
Signed 05/04/2016

Attorneys and Law Firms

George M. Clarke, III, Joseph B. Judkins, Baker McKenzie LLP, Washington, DC, Brian J. Hurst, MacKenzie Marie Martin, Baker McKenzie LLP, Dallas, TX, for Plaintiff.

Jon E. Fisher, Dept. of Justice, Dallas, TX, for Defendants.

MEMORANDUM AND ORDER

Marina Garcia Marmolejo, United States District Judge

***1** This case concerns a foreign bank account that Bernhard Gubser (Plaintiff) failed to disclose to the Internal Revenue Service (IRS) in 2008 in violation of the Bank Secrecy Act. After months of engaging in IRS administrative procedures without any resolution, Plaintiff filed this suit seeking a declaratory judgment regarding the IRS's burden of proof to show a willful violation of the Report of Foreign Banks and Financial Accounts (FBAR) filing requirement. The United States filed a 12(b)(1) motion to dismiss for lack of subject matter jurisdiction. (Dkt. No. 11). Having reviewed the parties' submissions, their arguments at hearing, and the applicable law, Defendant's Motion (Dkt. No. 11) is **GRANTED** for the reasons given below.

I. BACKGROUND

Plaintiff is a dual citizen of Switzerland (by birth) and the United States (via naturalization in 1992). Department of Treasury regulations require U.S. citizens with foreign bank accounts exceeding $10,000 to file a FBAR annually with the IRS, disclosing the account information. 31 C.F.R. § 1010.350 (setting forth the reporting requirements under 31 U.S.C. § 5314). Plaintiff, however, did not file a FBAR to report his Swiss bank account to the IRS until the 2009 reporting year, when he alleges he first became aware of the reporting requirement. Since 2009, Plaintiff has filed a FBAR with the IRS annually.

In March 2015, Plaintiff received a form letter (Letter 3709) from the IRS concerning his failure to file a FBAR for 2008. The letter proposed assessing a civil penalty of half the account's balance ($1,363,336.00) for willful failure to meet FBAR filing requirements. The letter explained that Plaintiff could either agree to the proposed penalty and submit payment, or request a conference with the Appeals Office to contest the proposed penalty. If Plaintiff did neither, the letter stated that the IRS would assess the penalty and begin collection procedures.

In response to the letter, Plaintiff submitted a written request in May 2015 to meet with the Appeals Office. Plaintiff's attorneys met with an appeals officer on September 10, 2015. At the meeting, the appeals officer stated that the agency's burden of proof is by a preponderance of the evidence, and that under this burden the agency could show a willful violation of FBAR filing requirements by Plaintiff. Plaintiff also alleges, however, that the appeals officer represented if the burden of proof was clear and convincing evidence, the agency could *not* prove willfulness. Ultimately, the matter was not resolved at the meeting or in the months that followed.

Approximately three months after the Appeals Office conference, Plaintiff filed the instant suit against the IRS, United States, and IRS Commissioner in his official capacity. Plaintiff seeks a declaration that the IRS must prove willful violations of FBAR filing requirements by clear and convincing evidence.

The United States has now moved for dismissal under Rule 12(b)(1) on several grounds.[1] First, Defendant claims that the suit is barred by sovereign immunity. Second, Defendant contends that Plaintiff lacks standing because no formal penalty assessment has, or is certain to, take place. Finally, Defendant argues that Plaintiff's claims are not ripe for consideration.

II. LEGAL STANDARD FOR 12(B)(1)

***2** A Rule 12(b)(1) motion to dismiss challenges the court's subject matter jurisdiction. "Under Rule 12(b)(1), a claim is 'properly dismissed for lack of subject-matter jurisdiction when the court lacks the statutory or constitutional power to adjudicate' the claim." *In re FEMA Trailer Formaldehyde Products Liab. Litig.*, 668 F.3d 281, 286 (5th Cir. 2012) (quoting *Home Builders Ass'n, Inc. v. City of Madison*, 143 F.3d 1006, 1010 (5th Cir. 1998)). On a Rule 12(b)(1) motion, the party asserting jurisdiction bears the burden of proof, but the court must accept as true the allegations and facts in the complaint. *Life Partners Inc. v. United States*, 650 F.3d 1026, 1029 (5th Cir. 2011). The court may find that subject matter jurisdiction is lacking based on "(1) the complaint alone; (2) the complaint supplemented by undisputed facts evidenced in the record; or (3) the complaint supplemented by undisputed facts plus the court's resolution of disputed facts." *Choice Inc. of Tex. v. Greenstein*, 691 F.3d 710, 714 (5th Cir. 2012) (citation omitted).

Here Plaintiff's complaint is supplemented by two undisputed documents: the proposed penalty letter (Letter 3709) and an agreement between the Parties to extend the statute of limitations period to assess civil FBAR penalties.

III. ANALYSIS

Defendant argues that this court lacks subject matter jurisdiction and Plaintiff's complaint must be dismissed for the following reasons: (1) Plaintiff's suit is barred by sovereign immunity; (2) Plaintiff lacks standing; and (3) Plaintiff's claims are not ripe for adjudication. Because the Court concludes that this matter is not justiciable on standing grounds, the Court does not reach Defendant's ripeness and sovereign immunity arguments. *See Sinochem Int'l Co. v. Malaysia Int'l. Shipping Corp.*, 549 U.S. 422, 431 (2007) ("[A] federal court has leeway 'to choose among threshold grounds for denying audience to case on the merits.' ").

Article III of the Constitution limits the jurisdiction of federal courts to cases or controversies. Const., Art. III, § 2. Standing is an essential element of Article III's case-or-controversy requirement. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992). The requirements of Article III standing are built on separation-of-powers principles, and serve "to prevent the judicial process from being used to usurp the powers of the political branches." *Clapper v. Amnesty Int'l USA*, 133 S. Ct. 1138, 1146 (2013).

"To establish standing, a plaintiff must show: (1) it has suffered, or imminently will suffer, a concrete and particularized injury-in-fact; (2) the injury is fairly traceable to the defendant's conduct; and (3) a favorable judgment is likely to redress the injury." *Hous. Chronicle Pub. Co. v. City of League City, Tex.*, 488 F.3d 613, 617 (5th Cir. 2007) (citing *Lujan*, 504 U.S. at 560–61). "An allegation of future injury may suffice if the threatened injury is certainly impending, or there is a substantial risk that the harm will occur." *Susan B. Anthony List v. Driehaus*, 134 S. Ct. 2334, 2341 (2014) (internal quotation marks omitted) (quoting *Clapper*, 133 S. Ct. at 1150 n.5); *see also Bauer v. Texas*, 341 F.3d 352, 357–58 (5th Cir. 2003) ("A plaintiff can meet the standing requirements when suit is brought under the Declaratory Judgment Act by establishing actual present harm or a significant possibility of future harm, even though the injury-in-fact has not yet been completed." (citation omitted)). To show redressability, "it must be 'likely, as opposed to merely speculative, that a favorable decision will redress the plaintiff's injury.' " *Dep't of Tex., Veterans of Foreign Wars of U.S. v. Tex. Lottery Comm'n*, 760 F.3d 427, 432 (5th Cir. 2014) (en banc) (quoting *S. Christian Leadership Conference v. Supreme Court of State of La.*, 252 F.3d 781, 788 (5th Cir. 2001)).

***3** Here, even assuming Plaintiff can establish an injury-in-fact caused by Defendant's conduct, he cannot satisfy the redressability requirement of Article III standing. Plaintiff argues that a declaration that the IRS must prove willful violations of FBAR filing requirements by clear and convincing evidence would resolve the threat of a $1.36 million penalty. Plaintiff's arguments, however, are highly speculative, and his pleadings cannot support the conclusion that a declaration by this Court would be likely to redress the claimed harmed. Although Plaintiff alleges that an individual appeals officer represented the IRS could not meet this higher burden, Plaintiff has not claimed that this representation was legally binding or would preclude the IRS from still assessing a penalty. In fact, Plaintiff conceded at oral argument that the appeals officer could choose to assess or not assess the penalty regardless of any declarations by this Court regarding the burden of proof. In other words, without additional facts, it is far from likely that a favorable declaration regarding the IRS's burden of proof would prevent the assessment of a penalty against Plaintiff.

Accordingly, because Plaintiff fails to satisfy the redressability requirement of standing, Plaintiff cannot meet Article III's case-or-controversy requirement.

IV. CONCLUSION

For the reasons explained above, the Court concludes that it lacks subject matter jurisdiction. Accordingly, Defendant's Motion to Dismiss (Dkt. No. 11) is hereby **GRANTED**.

It is so **ORDERED**.

SIGNED this 4th day of May, 2016.

All Citations

Not Reported in F.Supp.3d, 2016 WL 3129530, 117 A.F.T.R.2d 2016-1459

Footnotes

[1] Although there are three Defendants in this lawsuit, the Motion to Dismiss (Dkt. No. 11) is entitled “United States of America's Motion to Dismiss Plaintiff's Complaint for Declaratory Judgment and Brief” and signed by Jon E. Fisher as Attorney for the United States without reference to the other two Defendants. Plaintiff, however, refers to Dkt. No. 11 as “Defendants' Motion to Dismiss” throughout his response. To the extent it is unclear whether Dkt. No. 11 was intended to serve as a filing on behalf of the IRS and the IRS Commissioner, the Court considers its jurisdiction with regard to these two Defendants sua sponte. *See Howery v. Allstate Ins. Co*, 243 F.3d 912, 919 (5th Cir. 2001) (“[F]ederal courts must address jurisdictional questions whenever they are raised and must consider jurisdiction sua sponte if not raised by the parties.”). For the same reasons that Plaintiff lacks standing to pursue claims against the United States, *see infra*, an Article III case-or-controversy is also lacking between Plaintiff and both other Defendants.

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2013 WL 4430917
United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
1. Stephen KERR; 2. Michael Quiel; Defendants.

No. CR 11–2385–PHX–JAT–DKD–001–002.
|
Aug. 16, 2013.

ORDER

JAMES A. TEILBORG, Senior District Judge.

***1** Pending before the Court are: Defendant Stephen Kerr's ("Kerr") Renewed Motion for Rule 29 Judgment of Acquittal or, in the alternative, a New Trial (Doc. 302), and Defendant Michael Quiel's ("Quiel") Motion for a Judgment of Acquittal or for a New Trial (Doc. 301). [1] The Court now rules on these Motions.

I. Background

In the Indictment (Doc. 3), Kerr was charged with Conspiracy to Defraud the United States (Count 1), Willful Subscription to False Individual Tax Returns for 2007 and 2008 (Counts 2 and 3), and Failure to File Foreign Bank and Financial Accounts (FBARs) for 2007 and 2008 (Counts 6 and 7). Count 1 charged Kerr, Quiel, and Christopher Rusch ("Rusch"), their former attorney, with conspiring to establish companies and bank accounts in Switzerland to move money out of the United States and defraud the IRS. Counts 2 and 3 charged Kerr with intentionally omitting income from the foreign accounts on his 2007 and 2008 tax returns and intentionally failing to mark the box in Schedule B indicating an interest in a foreign bank account. Counts 6 and 7 charged Kerr with willfully failing to file FBARs to report his interest in the foreign accounts. On April 11, 2013, a jury acquitted Kerr of Count 1, and convicted him of Counts 2, 3, 6, and 7. Kerr now moves the Court to set aside the jury verdicts and enter judgments of acquittal, or, alternatively, grant a new trial.

Quiel was charged with Conspiracy to Defraud the United States (Count 1), Willful Subscription to False Individual Tax Returns for 2007 and 2008 (Counts 4 and 5), and Failure to File FBARs for 2007 and 2008 (Counts 8 and 9). Count 1 charged Kerr, Quiel, and Rusch with conspiring to establish companies and bank accounts in Switzerland to move money out of the United States and defraud the IRS. Counts 4 and 5 charged Quiel with intentionally omitting income from the foreign accounts on his 2007 and 2008 tax returns and intentionally failing to mark the box in Schedule B indicating an interest in a foreign bank account. Counts 8 and 9 charged Quiel with willfully failing to file FBARs to report his interest in the foreign accounts. On April 11, 2013, a jury acquitted Quiel of Count 1, and convicted him of Counts 4 and 5. The jury was unable to reach a verdict on Counts 8 and 9, which the Government later dismissed. Quiel and Kerr now moves the Court to set aside the jury verdicts and enter judgments of acquittal, or, alternatively, grant a new trial.

II. Legal Standards

A. Judgment of Acquittal

"A defendant may move for a judgment of acquittal ... within 14 days after a guilty verdict or after the court discharges the jury." Fed.R.Crim.P. 29(c)(1). The Court may set aside the jury verdict and enter an acquittal. *Id.* at 29(c)(2). Courts review a motion for judgment of acquittal applying the same test as a challenge to the sufficiency of the evidence. *United States v. Ladum,* 141 F.3d 1328, 1337 (9th Cir.1998). In considering whether there is sufficient evidence to deny a motion for judgment of acquittal, courts "review the evidence presented in the light most favorable to the government to determine whether any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *Id.*

B. New Trial

***2** With respect to a motion for new trial, "the court may vacate any judgment and grant a new trial if the interest of justice so requires." Fed.R.Crim.P. 33(a). A district court has greater discretion to grant a new trial than to grant a judgment of acquittal. *United States v. Kellington,* 217 F.3d 1084, 1097 (9th Cir.2000). Thus, in considering a motion for new trial, "[t]he court is not obliged to view the evidence in the light most favorable to the verdict, and it is free to weigh the evidence and evaluate for itself the credibility of the witnesses." *Id.* More specifically, "[i]f the court concludes that, despite the abstract sufficiency of the evidence to sustain the verdict, the evidence preponderates sufficiently heavily against the verdict that a serious miscarriage of justice may have occurred, it may set aside the verdict, grant a new trial, and submit the issue for determination by another jury." *Id.* (internal quotations omitted). However, the authority to grant a new trial should be used "only in exceptional cases." *United States v. Rush,* 749 F.2d 1369, 1371 (9th Cir.1984).

III. Kerr's Motion for Judgment of Acquittal and New Trial

Kerr claims that the Government "failed to meet its burden as to willfulness on each of the substantive counts." (Doc. 302 at 3). Kerr moves for judgment of acquittal or new trial because: 1) Rusch's testimony should be excluded when determining the sufficiency of the evidence; 2) Kerr was acquitted of conspiracy, and the overt acts of the substantive offenses were required elements of the conspiracy count; 3) the Government failed to prove Kerr had a legal duty to report income from the foreign corporations; and 4) the Government committed prosecutorial misconduct by using the term "fraudulent" in closing arguments. Furthermore, Kerr lists eight additional grounds for acquittal or for a new trial without providing any factual support or legal authority for his arguments, including: 1) the admission of Government exhibits on redirect violates Kerr's Sixth Amendment right to confrontation;[2] 2) the indictment erroneously indicated Kerr's Failure to File FBAR forms under Schedule B, Section II, Line 7a; 3) the Court failed to provide Kerr's proposed "theory of the case" jury instruction; 4) the Government misstated in closing arguments that Kerr owed taxes; 5) the Government committed prosecutorial misconduct by accusing defense counsel of tampering with the impeachment tape of Rusch; 6) the Court improperly denied Kerr's request that the Court order the Government to provide Special Agent Giovannelli's Report; 7) the Court failed to provide jury instructions about expenses rightfully deductible from income; and 8) the Court erroneously allowed the Government to use the definitions in the FBAR form in the jury instructions.

A. Rusch's Testimony

Kerr argues that Rusch's testimony should be excluded in determining the sufficiency of the evidence on the substantive counts because it is inadmissible under the crime-fraud exception to attorney-client privilege and under the co-conspirator exception to hearsay.

1. Attorney–Client Privilege

***3** Kerr claims that the Court admitted Rusch's testimony under the crime-fraud exception to attorney-client privilege. (Doc. 302 at 4). Because Defendants were acquitted of Count 1, Conspiracy to Defraud the United States, Kerr argues that the crime-fraud exception does not apply; therefore, Rusch's testimony violates attorney-client privilege and should be excluded when determining the sufficiency of the evidence on the substantive counts. (*Id.*) However, in its July 17, 2012 Order, the Court held that Defendants waived attorney-client privilege by claiming that their failure to file FBARs and their filing false tax returns was based on the advice of counsel. (Doc. 96 at 5). Furthermore, the Court denied Kerr's Motion to Preclude Admission of Items Protected by Attorney–Client Privilege (Doc. 118), and noted that "the Court found that ... implicit waiver had occurred for any information relating to Kerr filing FBARs, and filing tax returns for tax years 2007 and 2008." (Doc. 145 at 8 n. 1). Therefore, the Court did not permit Rusch's testimony under the crime-fraud exception.[3]

Kerr argues that the advice of counsel defense may waive the privilege "as to documents presented early on[,]" but does not waive the privilege regarding Rusch's testimony because the advice of counsel defense did not require Rusch to testify. (Doc. 302 at 4 n. 2). Kerr does not cite any legal authority in support of this argument. (*Id.*) The Government was entitled to the specified privileged information because Kerr implicitly waived attorney-client privilege. (Doc. 96). Kerr offers no cases suggesting that Kerr may waive privilege as to the communications, but preserve privilege regarding Rusch's testimony about the same information. Furthermore, Kerr never objected to the testimony at trial.[4] Kerr also claims that he was "considering using [advice] of counsel as a possible defense," but instead "put on no defense." (Doc. 314 at 4). This claim is inaccurate because Kerr presented this defense in both opening and closing arguments and requested and received a jury instruction encapsulating that defense. (*See e.g.* Doc. 325 at 124) ("Now this is their lawyer. This is a tax expert. They believe him. They rely upon this advice."); (Doc. 338 at 79) ("a very, very important jury instruction in the case ... that's basically the instruction regarding the reliance on counsel"); (Doc. 287 at 35) (jury instruction for advice of counsel defense). Accordingly, the Court can find no error in the admission of Rusch's testimony, and such testimony will not be excluded when determining the sufficiency of the evidence under Rule 29(c)(2) or Rule 33(a).

2. Co–Conspirator Exception to Hearsay

Kerr argues that Rusch's testimony should not be admitted under the co-conspirator exception to hearsay (Fed.R.Evid.801(d)(2) (E)). (Doc. 302 at 8–10). However, Kerr fails to cite to any part of the Record where such admission of evidence occurred. Kerr's failure to indicate where in the Record error occurred prevents the Court from making any meaningful analysis of this issue. In his Reply, Kerr asserts that "the majority of statements" allegedly admitted under the co-conspirator exception were "Rusch's [with regard to his] understanding of the Defendants [sic] knowledge as to the legality of their actions[;]" however, he does not cite any specific statements. (Doc. 314 at 6).

***4** Without any specific statements that were allegedly admitted pursuant to the exception, the Court is skeptical of Kerr's arguments for the following reasons. First, Rusch's knowledge is not hearsay. Second, the Court can envision circumstances in which the testimony would be admissible. For example, if Rusch testified to statements made by Kerr, the testimony is admissible under Fed.R.Evid. 801(d)(2), an opposing party's statement. Furthermore, if the statements were not asserted for the truth of the matter, but to establish the effect on the listener or basis in fact for the Rusch's subsequent actions, then the statements would be allowed based on Fed.R.Evid. 801(c). *See United States v. Payne,* 944 F.2d 1458, 1472 (9th Cir.1991) (holding that out-of-court statements introduced to show the effect on the listener are not hearsay); *United States v. Walling,* 486 F.2d 229, 234 (9th Cir.1973) (holding that statement was not hearsay because it was offered to demonstrate the "circumstances which served as a foundation for [witness's] own observations and actions"). Because Kerr does not cite to the record indicating where the Court admitted the testimony under Rule 801(d)(2)(E), and does not cite to the specific statements in Rusch's testimony that he allegedly objected to at trial (Doc. 314 at 7), the Court will not exclude Rusch's testimony in determining the sufficiency of the evidence under Rule 29(c)(2) or Rule 33(a).

B. Willful Intent

Kerr argues that the "overt acts of the substantive offenses were required elements of the conspiracy count." (Doc. 314 at 10). Kerr claims that the Government failed to prove "any other knowledge or intent of illegality except for that required to prove the conspiracy—that the Defendants did this to defraud the IRS." (*Id.* at 11). Because the jury acquitted Kerr of conspiracy, he alleges that the elements of the substantive counts cannot be proven; therefore, the government "failed to prove the required illegal intent." (*Id.* at 10).

"[I]t is well-established that 'inconsistent verdicts may stand, even when a conviction is rationally incompatible with an acquittal, provided there is sufficient evidence to support a guilty verdict.' " *United States v. Suarez,* 682 F.3d 1214, 1218 (9th Cir.2012) (internal citations omitted). In this case, the jury was instructed that they must find Kerr acted "willfully" to be guilty of the substantive counts. (Doc. 287 at 25, 28). The jury could have acquitted Kerr of conspiracy for reasons unrelated to Kerr's intent. For example, the jury could have determined that the Government did not prove there was an agreement between the co-conspirators. The jury was properly instructed about Kerr's intent for the substantive counts; thus, by finding Kerr guilty, the jury found that Kerr acted willfully. Therefore, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

C. Legal Duty to Report Income

***5** Kerr claims that the Government failed to prove a legal duty to report income and foreign accounts; therefore, the Government did not prove willfulness. (Doc. 314 at 11). To prove willfulness, the Government must show the "voluntary, intentional violation of a known legal duty." *Cheek v. United States,* 498 U.S. 192, 201 (1991). In *Cheek,* the United States Supreme Court held:

> Carrying this burden requires negating a defendant's claim of ignorance of the law or a claim that because of a misunderstanding of the law, he had a good-faith belief that he was not violating any of the provisions of the tax law. This is so because one cannot be aware that the law imposes a duty upon him and yet be ignorant of it, misunderstand

> the law, or believe that the duty does not exist.

Id.

Kerr argues that the Government did not meet their burden because there was "no expert testimony or evidence" that proved the income was reportable on Kerr's personal tax return. (Doc. 302 at 16). Kerr does not cite to any legal authority requiring expert testimony to prove a legal duty to report. Furthermore, the Government presented evidence at trial from which the jury could conclude that Defendants had a legal duty to report income and foreign accounts.

In addition, during the settling conference for jury instructions, Defendants objected that the FBAR instruction "presuppose[s] that the defendants did have a legal obligation to file an FBAR." (Doc. 337 at 15). The Government responded that the instructions require that the jury first determine that Defendants had an obligation to file the FBAR based on the evidence, and the Court agreed and overruled Kerr's objection. (*Id.* at 18). Viewing the evidence in the light most favorable to the Government, the Government met its burden in proving that Kerr had a legal duty to report income and foreign accounts, and knew of the duty. Therefore, a jury could have found that Kerr acted willfully beyond reasonable doubt. Furthermore, the evidence does not preponderate heavily against the verdict and there was no miscarriage of justice. Accordingly, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

D. Prosecutorial Misconduct

Kerr asserts that the Government committed prosecutorial misconduct by continually referring to stock transactions as "fraudulent." (Doc. 302 at 25). The Court ordered the Government not to describe the securities transactions in terms of "SEC violations" or "violations of security laws." (Doc. 337 at 19). The Court permitted the Government to describe particular conduct as "fraudulent" under Fed.R.Evid. 404(b)(2) because "that conduct helps establish a motive on [Defendants'] part to violate the tax laws." (*Id.* at 22–23). The Government complied with the Court's ruling; therefore, there was no prosecutorial misconduct. Accordingly, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

E. Erroneous Indictment

***6** Kerr argues that the Indictment erroneously indicated that Kerr failed to file FBAR forms under Schedule B, Section II, instead of Schedule B, Section III. (Doc. 302 at 29). The Court overruled Kerr's objection to correcting this typographical error during the jury instructions conference. (Doc. 337 at 15). Kerr has not presented any argument that would cause the Court to reconsider its prior decision. Thus, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

F. Instructions on Defendant's Theory of the Case

Kerr argues that the Court failed to provide a jury instruction on Kerr's theory of the case. (Doc. 302 at 29). Kerr raised this issue during the jury instructions conference, and the Court rejected it. (Doc. 337 at 18–19). The jury was properly instructed on Kerr's theory of the case regarding "advice of counsel" and "good faith misunderstanding of the law." (Doc. 287 at 33–35). Accordingly, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

G. Misstated Evidence in Closing Argument

Kerr claims that the Government misstated evidence that Kerr owed taxes during the closing argument. (Doc. 302 at 29). Kerr did not object at trial, so the Court will review for plain error. *See United States v. Cabrera,* 201 F.3d 1243, 1246 (9th Cir.2000). In Response to Kerr's argument, the Government argues that no evidence was misstated because the Government presented evidence that Kerr "failed to report significant income" in 2007 and 2008, that Kerr had a "tax liability even though [he] failed to report this income," that the Government stated in closing arguments that the jury did not need to find a tax liability in order to convict Kerr on the false returns, and that a jury instruction was given in relation to this matter. (Doc. 311 at 23); (Doc. 303 at 47); (Doc. 287 at 27). Because Kerr presents no legal support for his arguments, Kerr's motion for judgment of acquittal or a new trial under this theory is denied.

H. Accusation of Evidence Tampering

Kerr asserts that the Government committed prosecutorial misconduct by accusing defense counsel of engaging in evidence tampering. Kerr argues that the Government prejudiced the jury by accusing counsel of doctoring the impeachment tape of Rusch, and suborning perjury by Rusch. (Doc. 302 at 29). However, Kerr does not provide any factual support or legal authority to support this argument. Furthermore, Kerr did not object at trial; therefore, the claim is subject to plain error review. *United States v. Cabrera,* 201 F.3d at 1246. A claim for prosecutorial misconduct is viewed in context of the entire trial. *Id.* "Reversal on this basis is justified only if it appears more probable than not that prosecutorial misconduct materially affected the fairness of the trial." *United States v. Sayakhom,* 186 F.3d 928, 943 (9th Cir.1999).

The Government responds that it did not claim that Defendants tampered with or doctored the tape. (Doc. 311 at 24). The Government merely stated that the tape was edited and did not capture the entire meeting. (*Id.*) During cross-examination by Quiel's counsel, Rusch stated that Quiel "played a clearly and obviously edited tape, which I also believe to be completely misleading." (Doc. 334 at 208). He continued on by saying, "I know for a fact that you edited the beginning of the tape." (*Id.* at 209). In closing arguments, the Government referred to the tape as being "blatantly edited" because it does not "include anything from the very beginning of this meeting." (Doc. 303 at 61). This statement does not rise to the level of prosecutorial misconduct. Accordingly, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

I. IRS Special Agent's Report

***7** Kerr claims that his right to a fair trial was violated because the Court did not order the Government to provide the Special Agent's Report ("SAR"), which he alleges may contain *Brady* material. (Doc. 302 at 29). In its October 2, 2012 Order, the Court held that Kerr failed to show that the Government is withholding *Brady* material; therefore, in accordance with the Federal Rules of Criminal Procedure, the SAR only had to be disclosed if the Special Agent testified. (Doc. 107 at 4). Kerr has not presented any argument that would cause the Court to reconsider its prior decision. The Special Agent did not testify at trial, and thus the Government was not required to disclose the SAR. Accordingly, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

J. Instruction on Deductible Expenses

Kerr claims that the Court failed to include the required jury instruction on deductible expenses. (Doc. 302 at 29). When reviewing a claim of error relating to jury instructions, the instructions must be viewed as a whole. *United States v. Abushi,* 62 F.2d 1289, 1299 (9th Cir.1982). A trial judge is given substantial latitude in tailoring jury instructions so long as they fairly and adequately address the issues presented. *United States v. James,* 576 F.2d 223, 226 (9th Cir.1978). In *United States v.. Marabelles,* the Court addressed the issue of whether the defendant was entitled to an instruction regarding deductible expenses in a tax evasion and false return case. 724 F.3d 1374, 1382 (9th Cir.1984). The defendant in that case requested an instruction related to unsubstantiated expenses that he claimed reduced his tax liability. *Id.* The Ninth Circuit Court of Appeals held that the district court's refusal to provide the defendant's instruction was not error because it would not have "materially affected the § 7206(1) conviction since a tax deficiency is not an element of that crime." *Id.*

In the present case, Kerr does not cite to a specific instruction requested, or provide any factual or legal support for his argument. Looking at the instructions as a whole, the jury was instructed that they could consider a lack of tax due when determining willfulness. (Doc. 287 at 27). Furthermore, the gross income instruction defines gross income as "all income received before making any deductions allowed by law," which indicates that Defendants may be entitled to deduct expenses. (*Id.* at 38). These instructions fairly and adequately address the issue presented. Accordingly, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

K. FBAR Definitions

Kerr argues that the Court erred in giving the Government's proposed jury instructions, which included definitions from the FBAR instructions because no regulation addressed these definitions. (Doc. 302 at 30). The FBAR filing requirements in effect during 2007 and 2008 are outlined in 31 C.F.R. § 103.24. The regulation incorporates the definitions set forth in the general instructions prescribed by the Secretary of the Treasury and included with the FBAR form. *See* 31 C.F.R. § 103.24 ("each person ... shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons"). In addition, 31 C.F.R. § 103.27(c)-(d) provides further details for reports filed pursuant to section 103.24, including the filing deadline date, the minimum account balance, and the specific reports required. The FBAR form and the instructions were modified in 2008, and the jury was properly instructed about the modified definitions for the 2008 count. Accordingly, Kerr's claim that there is no regulation addressing the FBAR definitions is incorrect. Therefore, the Court denies Kerr's motion for judgment of acquittal or a new trial under this theory.

***8** Based on the foregoing, Kerr's Renewed Motion for Rule 29 Judgment of Acquittal or, in the alternative, a New Trial is denied.

III. Quiel's Motion for Judgment of Acquittal and New Trial

Quiel moves for judgment of acquittal based on four claims: 1) the admission of new exhibits on redirect without the opportunity to cross-examine violated the Confrontation Clause of the Sixth Amendment; 2) the conviction was based on an erroneous indictment;[5] 3) Rusch's testimony should have been stricken because Rusch committed perjury and the Government never linked his testimony to the alleged conspiracy; and 4) the Court erred in admitting redacted documents. (Doc. 301).

A. Confrontation Clause

Quiel asserts that the Court erred in issuing a "complete ban on recross-examination" in violation of the Confrontation Clause of the Sixth Amendment. (Doc. 301 at 4). On day 3 of the trial, Quiel's counsel attempted to recross-examine a witness, Cheryl Bradley. (Doc. 326 at 264). At that time, Quiel's counsel stated "I ... do have three follow-up, please Your Honor." (*Id.*). The Court responded, "Well, that's called recross, which we don't permit. You had three follow-up." (*Id.*). Quiel's counsel, responded "Yes, Your Honor, in relationship to her questions." (*Id.*). In reply, the Court stated, "There's no such thing as recross examination. That will be denied." (*Id.*)

Quiel now argues that, later in the trial, during the testimony of Chris Rusch, he was chilled from recross-examination based on the Court's earlier admonition. (Doc. 312 at 6). Quiel specifically argues that limiting recross-examination regarding Exhibits 44, 51, and 52, which were admitted during the Government's redirect examination of Mr. Rusch, violated the Confrontation Clause. (*Id.* at 3). Quiel did not attempt to recross-examine Rusch at the time of the testimony and did not make any reference to the Court's earlier admonition regarding re-cross examination at the time of Rusch's testimony. Defense counsel did object that the admission of Exhibits 44, 51, and 52 was outside the scope of cross-examination, but the Court was unpersuaded that those Exhibits were new matter and, thus, overruled those objections. Quiel now appears to argue that, pursuant to the Ninth Circuit Court of Appeals decision in *United States v. Jones,* 982 F.2d 380, 383–84 (9th Cir.1992), recross-examination must be permitted.

Recross-examination is not guaranteed under the Confrontation Clause. *See United States v. Baker,* 10 F.3d 1374, 1404 (9th Cir.1993), *overruled on other grounds by United States v. Nordby,* 225 F.3d 1053 (9th Cir.2000) ("Allowing recross is within the sound discretion of the trial court"); *United States v. Riggi,* 951 F.2d 1368, 1374 (3rd Cir.1991) ("As a general rule, a trial court has wide discretion to restrict recross-examination"). However, "[w]hen material new matters are brought out on redirect examination, the Confrontation Clause of the Sixth Amendment mandates that the opposing party be given the right of recross-examination on those new matters." *United States v. Jones,* 982 F.2d 380, 384 (9th Cir.1992) (quoting *United States v. Riggi,* 951 F.2d 1368, 1375 (3rd Cir.1991)).

***9** "If 'new matter' is defined broadly, then any question asked on redirect that had not already been asked and answered would conceivably introduce 'new matter' requiring the opportunity for recross insofar as it expanded or elaborated on the witness' previous testimony. Such an approach would conflict with the trial court's discretion to impose reasonable limits on cross-examination" *Baker,* 10 F.3d at 1405. However, a "new matter" is not limited to a "new subject," but also applies to newly elicited material testimony within a particular subject area. *Id.* Accordingly, recross-examination is only necessary when "new matter" is elicited on re-direct.

Defendants did not argue during trial that they should be entitled to recross-examination because a new matter was being elicited during redirect. Although, during the testimony of Ms. Bradley, defense counsel requested re-cross, defense counsel gave no reason as to why he was entitled to recross-examination of that witness or any other witness. Further, it is of concern to the Court that, after receiving an unfavorable jury verdict, Defendants now seek reconsideration of the "alleged" "blanket ban" on recross-examination, such "ban" having occurred on day 3 of a 19–day trial, based on Defendants' argument that they were "chilled" from previously seeking such reconsideration from the Court. The Court does not see how the Defendants were chilled from seeking reconsideration during trial, but now feel completely free to seek such reconsideration. The Court's concerns about the timing of Defendants' claimed "chilling effect" is highlight by the fact that, although Defendants argue that there is a binding Ninth Circuit Court of Appeals case on point, which allows for recross-examination under certain circumstances, and Defendants believe that they are within those circumstances where recross-examination is appropriate, Defendants waited to bring that binding case to the Court's attention until after receiving an unfavorable jury verdict.

Despite these substantial concerns, the Court will assume, for the purposes of this Order, that Defendants were chilled from seeking recross-examination for witnesses that followed Ms. Bradley. Accordingly, the Court must determine whether new matter was elicited on redirect examination in violation of Defendants' Sixth Amendment right to confrontation.

In his argument, Quiel relies heavily on *United States v. Jones,* in which the defendant was convicted of drug violations. 982 F.2d at 382. In *Jones,* the defendant believed the district court imposed a blanket prohibition on recross-examination. *Id.* at 384. On redirect, the Government's witness, Alex Vasilieff, identified the defendant for the first time and placed him at the scene of the crime, corroborating the damaging testimony made by other witnesses. *Id.* The Ninth Circuit Court of Appeals held that "the district court's ban on recross examination prevented Jones from probing Vasilief's [sic] incriminating testimony." *Id.* In *Jones,* the ban on recross-examination violated the defendant's Confrontation Clause rights because he was "unable to subject the prosecution's case to the rigorous adversarial testing that is the norm of Anglo–American criminal proceedings." *Id.* at 384–85 (internal quotations omitted).

***10** In the present case, Quiel asserts that the Government's Exhibits 44, 51, and 52 were new matters presented on redirect. (Doc. 301 at 3). Exhibit 44 is a fax from Rusch to Pierre Gabris, a private banker who opened foreign bank accounts (Doc. 331 at 32) containing written instructions regarding stock transactions. (Doc. 335 at 91–92). Exhibits 51 and 52 are emails that Rusch received from Gabris that provide accounting statements for the foreign accounts. (*Id.* at 101). On direct examination, the Government asked Rusch how stock transactions occurred. (Doc. 331 at 145). Rusch responded, "The vast majority of the time Mr. Quiel would phone me and give me an instruction to sell or buy or make a transfer. I would write that down. I would type it up into a fax and fax it over to Mr. Gabris." (*Id.*) When the Government questioned Rusch about the activity in the foreign accounts, Rusch stated that he received "[a]n accounting typed up in Excel and sent to [him] by e-mail from Pierre Gabris," which Rusch would then fax to Mr. Quiel. (*Id.* at 152). Rusch further elaborated that he never emailed Kerr or Quiel regarding their foreign accounts because he was "given instruction not to have any e-mail trail for these accounts, and to send everything by fax." (*Id.* at 153).

On cross-examination, both Defendants questioned Rusch's credibility regarding his testimony on the instructions for stock transactions and the accountings he forwarded to Defendants. During cross-examination, Kerr addressed the lack of written records for stock transactions:

> Q: When those stocks are eventually sold, the whole activity of selling those stocks, getting those stocks into management companies, the mechanical process of doing that was done ply [sic] by Mr. Gabris or by you. You're the only ones that could control these. Right?
>
> A: Well, the mechanical process was Mr. Quiel would give me instructions, I would write them down, I would type up a fax, I would send that fax to Mr. Gabris and he would act upon it.
>
> Q: You say those were instructions Mr. Quiel would give you but I don't see any record of that in anything in writing. There's nothing in writing where he gave you instructions, is there?
>
> A: No. He was very specific not to keep any written—
>
> Q: There are no instructions, are there, that he put in writing to tell you to sell any stock or anything?
>
> A: No, there's not.

(Doc. 334 at 71–72). Kerr also discussed the accountings with Rusch:

> Q: Well, Mr. Kerr wasn't getting any bank records. Who was getting them?
>
> A: Mr. Gabris.
>
> Q: So Mr. Gabris got all these records. Did he send copies to you?
>
> A: Not of the bank statements.
>
> Q: So the knowledge of the money and what was going in the account was Mr. Gabris and you didn't have any knowledge about it?
>
> A: Well, no, that's not what I said. You asked me if the bank statements were sent to me. They were not. Mr. Gabris would send accountings of transactions, investments, positions in Excel format, send them to me by email and I would forward them on to Mr. Kerr and Mr. Quiel by fax.

***11** (Doc. 334 at 58–59). Furthermore, Kerr questioned Rusch about whether there are records to show that Defendants knew what Rusch was doing:

> Q: I'm asking you at this point in time, did you have documents in the file that are copies of the documents that you sent to Mr. Kerr or Mr. Quiel, which would show how you were basically handling all this money and transferring it from account to account?
>
> A: I had them on computer file, yes. I did not have them in printed files, no.
>
> Q: Okay. And where is that computer file?
>
> A: I haven't had it for a number of years. Before this—before this occurred I'd lost the computer.
>
> Q: You lost the computer before this occurred?
>
> A: Yes. The hard drive was damaged.
>
> Q: So you don't really have any records that would show that you had been giving them reports about how all of this money was getting spent, correct?
>
> A: If I recall the discovery, I think there was some accounting in there. I mean, we're talking 20,000 pages. I don't recall it all, but—
>
> Q: You're talking about bank records. I'm talking about a report where you said you apprised them of what you were doing.
>
> A: I believe there is an Excel file in the documents, yes.
>
> Q: There's an actual file that you have broken down that shows how you're spending money all during this period of time from 2006 clear up to 2008?
>
> A: No. I'm saying there's an accounting from Mr. Gabris related to their transactions.
>
> Q: But you said you did have something that was on your computer, now it's lost?
>
> A: No. I'm saying there's an accounting from Mr. Gabris related to their transactions.
>
> Q: But you said you did have something that was on your computer, now it's lost?
>
> A: I had a number of files, and I believe I only had one or two at the time of this case coming about.
>
> Q: So in effect we just don't have any records from your computer.
>
> A: Other than what I have already produced, correct.

(Doc. 334 at 135–36). During cross-examination by Quiel, Rusch also discussed the lack of records and missing computer:

> Q: And you weren't able to—as you've been cooperating and working and helping with the Government, you weren't able to give them all of your own records because many of them were destroyed when your computer disappeared.
>
> A: I gave them all of the records that I had of myself and Mr. Kerr and Mr. Quiel.
>
> Q: When did your computer disappear?
>
> A: My computer didn't disappear. I had a—lost a hard drive, which means it had become damaged, I'm thinking 2009 maybe when I moved to Switzerland.
>
> Q: Where is the hard drive now?
>
> A: I haven't had it for years.

> Q: What did you do with it?
>
> A: I just replaced the computer.
>
> Q: Did you throw the hard drive away?
>
> A: Yes, I got rid of the entire computer.
>
> Q: So it's gone. If anybody wanted to check it out or try to reconstruct it or fix it, it's gone.
>
> A: Yes.
>
> Q: You never gave your clients an opportunity to try to have someone check out that hard drive to see if it could be salvaged, correct?
>
> ***12** A: That's correct.
>
> Q: You never gave the Government an opportunity to check the hard drive to see if any of it could be salvaged, correct?
>
> A: Correct.

(Doc. 335 at 42–43). Throughout cross-examination, Defendants raised questions about whether the documents Rusch described exist or if Rusch and Gabris were acting without Defendants' knowledge.

The Government argues that the exhibits were "introduced on redirect for the limited purpose of rehabilitating Rusch's testimony and establishing that the documents indeed existed." (Doc. 310 at 7). On redirect, Rusch testified that "on each and every transaction Mr. Quiel would give me very specific instructions." (Doc. 335 at 89). In describing Exhibit 44, Rusch reiterated that Quiel provided information on the desired stock transaction, and then Rusch "wrote up the document" and "faxed it to Mr. Gabris." (*Id.* at 92, 95). When discussing Exhibits 51 and 52, Rusch described them as "e-mails that [he] received from Mr. Gabris that are accounting statements that [he] forwarded on to Messrs. Kerr and Mr. Quiel." (*Id.* at 101). The Government further questioned him:

> Q: And why did [Gabris] provide [Exhibit 51] to you?
>
> A: Mr. Quiel phoned me and asked me to get an accounting. I telephoned Mr. Gabris, obtained that accounting.
>
> Q: And what did you do once you received this e-mail?
>
> A: I printed it out and faxed it to Mr. Quiel and to Mr. Kerr, and then placed it in my file.

(Doc. 335 at 102).

Rusch's testimony on redirect examination was consistent with his testimony on direct and cross-examination. *See United States v. Croft,* 124 F.3d 1109, 1121 (9th Cir.1997) (holding that no recross is required when defendant sought to use sworn affidavits to establish "inconsistencies that could have been and were covered on cross-examination"). Unlike in *Jones,* where the witness identified the defendant and placed him at the scene of the crime for the first time on redirect, here Rusch repeated testimony that had already been covered. On cross-examination, Defendants had the opportunity to impeach Rusch regarding the stock transactions and accountings. That was not the case in *Jones,* where the Court found that the witness's testimony was not subject to the "rigorous adversarial testing" in the criminal proceedings. 982 F.2d at 384. Therefore, the present case is distinguishable from *Jones.*

In addition, the Court did not release Rusch from the subpoena; thus, he remained "subject to recall." (Doc. 335 at 159). Defendants could have recalled Rusch in their case-in-chief to further question him on direct examination.[6] *See United States v. Ross,* 33 F.3d 1507, 1518 (11th Cir.1994) ("prevention of recross-examination 'would not have prevented appellant from confronting his accusers; it would only have affected the order of confrontation. All the witnesses were equally available to the appellant and could have been called to the witness stand by him and questioned on direct examination as to any point he desired.' ") (quoting *Hale v. United States,* 435 F.2d 737, 752 n. 22 (5th Cir.1970)). Therefore, the Government did not raise new matters on redirect examination in violation of the Confrontation Clause. Accordingly, the Court denies Quiel's motion for judgment of acquittal or a new trial under this theory.

B. Rusch's Testimony

***13** Quiel claims that the Court should have stricken Rusch's testimony because he "is a known perjurer," and the Government never established that the crime-fraud exception to attorney-client privilege applied.[7] (Doc. 301

at 5). The Supreme Court has held that “a conviction obtained by the knowing use of perjured testimony is fundamentally unfair, and must be set aside if there is any reasonable likelihood that the false testimony could have affected the judgment of the jury.” *United States v. Agurs,* 427 U.S. 97, 103 (1976). A new trial is required if the false evidence is material, and its inclusion undermines the confidence in the judgment of the jury. *Maxwell v. Roe,* 628 F.3d 486, 499 (9th Cir.2010). Quiel alleges that Rusch committed perjury by: 1) denying on cross-examination that he told Defendants and their defense counsel in a January 2011 meeting that he had followed the law, but after hearing a secret tape recording of the meeting, admitted making the statements and claimed that it was “spin;” and 2) testifying that the “bathroom scene” on the secret tape recording was inserted into the tape to cover up something. (Doc. 301 at 5 n. 1).

First, Rusch did deny on cross-examination that he told Defendants and their counsel that everything was legal. (Doc. 332 at 50). However, he stated that, during the meeting, he was talking about possible lines of defense. (*Id.* at 51). On the audio recording, Rusch described proposed lines of defense as his “spin” on the matter. (Doc. 310 at 12). This statement was confirmed on redirect. (Doc. 335 at 141–42). Second, Rusch testified that he believed that other statements he made in the meeting were omitted from the tape during the “bathroom scene.” (Doc. 334 at 210). Rusch testified that he knew the beginning of the meeting was taken out of the tape, and that he was just speculating on why his other comments regarding viable defenses are not on the tape. (*Id.* at 211). It is the jury's province to determine the credibility of witnesses. *United States v. Sanchez–Lima,* 161 F.3d 545, 548 (9th Cir.1998). The tape and Rusch's statements were presented to the jury, who found Defendants guilty. Quiel has presented no evidence that proves Rusch committed perjury. Therefore, the Court denies Quiel's motion for judgment of acquittal or a new trial under this theory.

C. Redacted Documents

Quiel claims that the Court should have refused to admit redacted documents that the defense was unable to review. (Doc. 301 at 8). Quiel does not specify which exhibits he is referring to. Quiel does specifically object, however, to the Government's use of portions of the Individual Master File (IMF) without providing defense counsel the complete record. (*Id.*) Providing the relevant parts of the IMF to the defendant may be sufficient. *United States v. Fusero,* 106 F.Supp.2d 921, 925 (E.D.Mich.2000). The Government avows that it turned over all relevant portions of the IMF record. (Doc. 310 at 17). Quiel claims that there may be exculpatory evidence in the IMF, but he does not point to any specific evidence that may be in the file. (Doc. 301 at 9). Although not mentioned in Quiel's Motion, the Court notes that Quiel objected to the admission of IRS Form 4340 (Exhibit 263) and sought that the entire IMF file be disclosed at trial. (Doc. 258 at 102). This objection was overruled, and Quiel fails to establish evidence that would cause the Court to reconsider its prior decision. (*Id.* at 113). Accordingly, the Court denies Quiel's motion for judgment of acquittal or a new trial under this theory.

***14** Based on the foregoing, Quiel's Motion for a Judgment of Acquittal or for a New Trial is denied.

IV. Conclusion

Accordingly,

IT IS ORDERED that Kerr's Renewed Motion for Rule 29 Judgment of Acquittal or, in the alternative, a New Trial (Doc. 302) is denied.

IT IS FURTHER ORDERED that Quiel's Motion for a Judgment of Acquittal or for a New Trial (Doc. 301) is denied.

All Citations

Not Reported in F.Supp.2d, 2013 WL 4430917, 112 A.F.T.R.2d 2013-5772

Footnotes

[1] Quiel joined in Kerr's Renewed Motion for Rule 29 Judgment of Acquittal or, in the alternative, a New Trial. (*See* Doc. 304). Therefore, the Court's conclusions regarding Kerr's Motion apply to Quiel as well.

[2] This argument is addressed below in Quiel's Motion for a Judgment of Acquittal or for a New Trial, which Kerr joined in. (Doc. 314 at 15). Therefore, the Court's analysis of the issue applies equally to Kerr.

[3] Kerr fails to point to any part of the Record where the Court admitted Rusch's testimony pursuant to the crime-fraud exception.

[4] Quiel objected at trial that Rusch was testifying in violation of attorney-client privilege; however, the Court overruled the objection based on its previous rulings. (Doc. 331 at 36).

[5] The issue regarding the erroneous indictment has already been addressed above; accordingly, that analysis applies equally to Quiel.

[6] Furthermore, Rusch could be classified as a hostile witness or a witness identified as an adverse party under Federal Rule of Evidence 611(c)(2), allowing Defendants to use leading questions on direct examination.

[7] The Court addressed the crime-fraud exception issue in Kerr's Motion above. Accordingly, the Court will not readdress that issue here.

End of Document

522 B.R. 232
United States Bankruptcy Court,
C.D. California.

In re Saeed COHEN, Debtor.

No. 2:13–bk–26483–NB.
|
Signed Nov. 13, 2014.

Synopsis
Background: Chapter 11 debtor's former wife sought relief from automatic stay to continue her divorce litigation in state court. In addition, Internal Revenue Service (IRS) asserted claims against debtor's estate. Parties filed various objections.

Holdings: The Bankruptcy Court, Neal W. Bason, J., held that:

[1] judicial estoppel did not apply to statement in transcript in state court divorce proceedings by counsel for wife in which state court asked counsel to confirm that "the tax" was "a community property obligation" and he responded, "It has been paid" and "We're not disputing that it's a community property obligation";

[2] debts asserted in IRS's proof of claim were "incurred" before debtor's separation from wife, rather than when debtor reached a post-separation settlement agreement with the IRS, and thus, the community estate was liable for the debts;

[3] debtor's post-separation closing/settlement agreement with IRS did not violate automatic temporary restraining order (ATRO) under California statute restraining divorcing spouses from transferring community property; and

[4] wife did not have a prior, separate interest in interpled funds based on state court's award to her of one-half of monthly property rental proceeds pursuant to its order on temporary spousal support and child support.

Ordered accordingly.

Attorneys and Law Firms

***233** Ron Bender, Krikor J. Meshefejian, Kurt Ramlo, Beth Ann R. Young, Levene, Neale, Bender, Yoo & Brill L.L.P, Los Angeles, CA, for Debtor.

United States Trustee (LA), Dare Law, Hatty K. Yip, Office of the UST/DOJ, Los Angeles, CA, for Trustee.

MEMORANDUM DECISION ON "ISSUE 1" RELATED TO WHETHER IRS CLAIM IS A COMMUNITY CLAIM

NEAL W. BASON, Bankruptcy Judge.

I. INTRODUCTION

Tax debts that arise during marriage are "community claims" in bankruptcy parlance, and they are payable from community property. In this case the debtor's wife argues that her interest in community property somehow ceased to be liable for those tax debts because, after she separated from the debtor, he entered into a settlement with the Internal Revenue Service ("IRS"). She cites no authority that is on point, and this court rejects her arguments. This court also holds that certain entities in which the bankruptcy estate holds an interest are entitled to interpled funds in litigation to which the IRS is a party, and sustains in part and overrules in part various objections to the claims asserted by the IRS.

II. BACKGROUND [1]

In 1989 the debtor, Mr. Cohen ("Debtor"), was married to Ms. Fariba Cohen ("Ms.Cohen"). They separated in 2010 (the parties disagree on the precise separation date, but it makes no difference for purposes of this memorandum decision). *See* Dkt. 60 at 10:10–11; 97; 460 at 5:12. Just before their divorce trial was set to resume, Debtor filed his voluntary chapter 11 bankruptcy petition on June 25, 2013 (the "Petition Date"). Dkt. 60 at 10:16–19. It is undisputed that by this time Debtor and Ms. Cohen had already incurred an astounding total of more than *$13 million* in legal fees in connection with their divorce.

Ms. Cohen has sought relief from the automatic stay (Section 362(a)) to continue her divorce litigation in State court. She has also argued that the automatic stay does not apply to some of the divorce proceedings, and that this court must or should abstain. She now reiterates many of these arguments. *See, e.g.,* dkt. 242 at 15:18–21:12. The official committee of creditors holding unsecured claims (the ***234** "Committee") and Debtor oppose that relief.

This court has rejected Ms. Cohen's arguments before, and does so again. Those arguments are not properly raised at this time (*see* dkt. 256 at 13:1–16:21) (Committee's Brief) and alternatively this court rejects the arguments on the merits, for the same reasons as before. Among other things, the divorce trial would eat up more millions of dollars on litigation that very likely would be irrelevant, such as allocation of assets between Debtor and Ms. Cohen when, in all likelihood, there will be few or no assets left to allocate. *See, e.g.,* dkt. 60, 134, 135, 223, 256 at 16:22–18:14, *and* Adv. 2:14–ap–01484 dkt. 16 & 17.

On June 3, 2014, this court issued a scheduling order pursuant to a stipulation among Debtor, Ms. Cohen, the Committee, and the IRS. *See* Dkt. 375, 394, 407, 448. This memorandum decision addresses Issues 1(a), 1(b), and 1(c) in that scheduling order:

Issue # 1(a)—whether any of the claims asserted by the IRS against Debtor's estate are an allowed "community claim" as defined in Section 101(7), or if instead they are the separate debt of Debtor (or of Ms. Cohen) payable from property other than the kind identified in Section 541(a)(2);

Issue # 1(b)—resolution of two adversary proceedings: *Lighton Property, LLC v. Cohen,* 2:14–ap–01194–NB ("*Lighton* "), and *Nazarian v. Cohen,* 2:14–ap–01195–NB ("*Nazarian* "); and

Issue # 1(c)—resolution of the Committee's objection to the IRS claims asserted in its amended proof of claim 3–2 (the "IRS Claim").

In connection with the foregoing issues this court has reviewed the parties' briefs in the bankruptcy case (dkt. 460–467), the documents referenced therein including in the *Lighton* and *Nazarian* adversary proceedings, the documents referenced below, and all other documents that this court has deemed relevant. For the reasons set forth below this court is not persuaded that it is necessary to hold an evidentiary hearing on any of these issues.

Some issues have been presented through formal motions for summary judgment, and others are presented as claim objections, all as modified by the scheduling order. The parties are all familiar with the standards for determining if there are genuine issues of material fact (*see, e.g., Lighton Adv.* dkt. 10, Ex. 33), and this court will not repeat them here.

A. Facts underlying Issue 1(a)

The IRS Claim is for over $8 million. The IRS asserts that most of this is a community claim that arises from 2003 through 2008 when Debtor and Ms. Cohen were married.

There is no dispute that Amp Plus, Inc. dba Elco Lighting ("Elco") and the income from it are community assets and have been at all relevant times. *See Lighton Adv.* dkt. 10, Ex. 33 (ex. 2 & 3 thereto). During the marriage, multiple foreign bank accounts were used "to hold unreported income from [Elco]," aggregating approximately $35 million by 2008. Dkt. 461 at 6:7–14.

Taxpayers who have foreign bank accounts with over $10,000 at any time during a calendar year are required to disclose the existence of these accounts to the IRS on a foreign bank account report ("FBAR"). 31 U.S.C. § 5314. *See* dkt. 461 at 7:12–17. For 2003 through 2008, Debtor and Ms. Cohen failed to file FBARs. To the contrary, they filed joint income tax returns verifying—incorrectly—that they did not have any such accounts. According to Debtor, this subjected ***235** them to possible penalties of $58 million or more. Dkt. 461 at 8:24–25. [2]

In 2011, after Debtor and Ms. Cohen separated, he participated in a disclosure and settlement program, the Offshore Voluntary Disclosure Initiative ("OVDI"), and entered into a "closing" agreement (settlement) with the IRS for approximately $8.7 million. The IRS characterizes this as a "miscellaneous penalty" pursuant to 26 U.S.C. § 7121. Dkt. 245 at 5:6–12; *and see* Proof of Claim 3–2.

Ms. Cohen notified the IRS that she was opting out of the OVDI. Instead she has attempted (so far unsuccessfully) to assert an entitlement to an "innocent spouse" defense under 26 U.S.C. § 6015. *See Nazarian Adv.* dkt. 12 at 3:2–3 (Ms. Cohen's Brief); *see also* dkt. 465 at 6 n. 8 (Committee Brief) *and* dkt. 245 at 12:20–13:2 (IRS Brief).

Meanwhile, before this bankruptcy court, Ms. Cohen has argued that the IRS Claim arises not from the 2003 through 2008 failure to file FBARs and false statements on the joint tax returns, but instead from the post-separation OVDI agreement, and therefore, she asserts, the debt was not "incurred" during marriage and the community property of the bankruptcy estate is not liable for it. In support of this argument, she asserts among other things that there is no such thing as the "miscellaneous penalty" claimed by the IRS, so the debt allegedly must have been incurred when the post-separation OVDI contract became effective.

B. Additional facts underlying Issue 1(b)

The *Lighton* and *Nazarian* interpleader actions have been referred to this bankruptcy court. *See Lighton Adv.* dkt. 10, Ex. 60; *Nazarian Adv.* dkt. 10, Ex. 76. In *Lighton* the issue is who, as between the IRS, Ms. Cohen, and Debtor or his bankruptcy estate is entitled to rents paid by Elco to its landlord and affiliate, Lighton Property, LLC ("Lighton"). In *Nazarian* the issue is who is entitled to repayment of approximately $1 million that was loaned to plaintiff Nazarian in 2009, either from Elco or from Debtor or both. The IRS has filed motions for summary judgment in both actions. *See Lighton Adv.* dkt. 10, Ex. 33; *Nazarian Adv.* dkt. 10, Ex. 28.

C. Additional facts underlying Issue 1(c)

The IRS Claim consists of (1) a secured claim for $8,208,469.29 based on the OVDI settlement and (2) certain other unsecured claims relating to Ms. Cohen's tax liabilities for years 2009 through 2011 and Mr. Cohen's tax liability for tax year 2012. The Committee has objected to the IRS Claim on various grounds, the other parties have filed briefs, and some of the issues initially raised by the Committee are no longer contested by the IRS. *See* dkt. 219, 242, 245, 254, 256.

*236 III. JURISDICTION, AUTHORITY, AND VENUE

The Supreme Court has distinguished between (a) bankruptcy courts' broad subject matter jurisdiction and (b) their narrower constitutional and statutory "authority" to issue final judgments or orders. Whenever the bankruptcy court lacks such authority then its determinations constitute only proposed findings of fact and conclusions of law that are subject to *de novo* review by an Article III court. *See Stern v. Marshall,* 564 U.S. 2, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011); *Law v. Siegel,* —— U.S. ——, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014); *In re Bellingham Ins. Agency, Inc.,* 702 F.3d 553, 567 (9th Cir.2012), *aff'd sub nom Executive Benefits Ins. Agency v. Arkison,* —— U.S. ——, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014) *Executive Benefits Ins. Agency v. Arkison,* —— U.S. ——, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014). This court has an independent duty to examine these issues. *See In re Rosson,* 545 F.3d 764, 769 n. 5 (9th Cir.2008) (subject matter jurisdiction); *In re Pringle,* 495 B.R. 447, 455 (9th Cir. BAP 2013) (authority under *Stern*).

A. This court has subject matter jurisdiction

Bankruptcy courts are "units" of the federal district courts, to which all bankruptcy proceedings have been referred or local rule or standing order in each district. *See* 28 U.S.C. § 151; Cent. Dist. Cal. General Order No. 13–05; LBR 5011–1(a). As such, this court has jurisdiction over all civil proceedings (1) "arising under title 11," i.e., any proceedings to enforce rights created by the Bankruptcy Code, (2) "arising in" a bankruptcy case, i.e., other proceedings that would not exist outside a bankruptcy case, such as case administration, or (3) "related to" a bankruptcy case, i.e., any proceedings the outcome of which could conceivably have any effect on the bankruptcy estate. *See* 28 U.S.C. §§ 157(a), 1334(b); *In re Harris,* 590 F.3d 730, 737 (9th Cir.2009) (summarizing jurisdictional standards); *In re Marshall,* 600 F.3d 1037, 1054 (9th Cir.2010) (same); *In re Fietz,* 852 F.2d 455, 457 (9th Cir.1988) (adopting "related to" test of *Pacor, Inc. v. Higgins,* 743 F.2d 984 (3rd Cir.1984)).

The matters addressed in this memorandum decision are all quintessentially "arising under" and "arising in" proceedings because they consist of determining the parties' "hierarchically ordered claims to a pro rata share of the bankruptcy res." *Stern,* 131 S.Ct. at 2614 (quoting *Granfinanciera, S.A. v. Nordberg,* 492 U.S. 33, 56, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989)). (The quoted phrase is from the Supreme Court's discussion of a non-jurisdictional issue—what proceedings are "core"—but the same concept presumably applies to jurisdictional issues because the Court interpreted statutory "core" proceedings to be coterminous with statutory "arising in" and "arising under" jurisdiction. *Id.* at 2605.)

Alternatively, assuming for the sake of argument that there were any question on this point, this court at the very least has "related to" jurisdiction. In short, this bankruptcy court has subject matter jurisdiction.

B. This court has the authority to issue final judgments or orders

The bankruptcy courts' authority to issue final judgments or orders is governed both (1) by federal statute and (2) by the United States Constitution.

1. Statutory authority

Bankruptcy courts have the statutory authority to issue final judgments or orders in "core" proceedings. 28 U.S.C. § 157(b)(2). Congress used that terminology in an attempt to track the Supreme ***237** Court plurality's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50, 71, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982).

The statutory list is non-exclusive (28 U.S.C. § 157(b)(2)) but the courts have been careful to interpret the statute and its "catchall" provisions to stay within constitutional limits, and they have considered "factors such as whether the rights involved exist independent of title 11, depend on state law for their resolution, existed prior to the filing of a bankruptcy petition, or were significantly affected by the filing of the bankruptcy case." *In re Cinematronics, Inc.,* 916 F.2d 1444, 1450 n. 5 (9th Cir.1990). *See also In re Castlerock Prop's,* 781 F.2d 159 (9th Cir.1986). This court also bears in mind that a "determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law." 28 U.S.C. § 157(b)(3).

The issues addressed in this memorandum decision come within the statutory definition of core proceedings, including allowance or disallowance of the IRS claims (28 U.S.C. § 157(b)(2)(B)); determination of the extent and priority of its asserted liens and interests over the claims of Ms. Cohen and other parties in interest (*id.,* subpara. (K)); and adjustment of the debtor's financial relationships with the IRS and Ms. Cohen in her assertion of claims and interests in the bankruptcy *res (id.,* subpara. (O)). This court therefore has statutory authority to issue a final judgment or order.

2. Constitutional authority

To safeguard "individual liberty and separation of powers" there are constitutional limits on the authority of bankruptcy judges, who are not appointed pursuant to Article III of the Constitution, to issue final judgments and orders. *Stern,* 131 S.Ct. at 2615. In analyzing those limits the Supreme Court has focused primarily on whether the "public rights" exception to Article III applies. *See, e.g., id.* at 2611–15 & 2618–19 (plurality opinion).

One definition of "public rights" is that if "it depends upon the will of [C]ongress whether a remedy in the courts shall be allowed at all,' [then] Congress could limit the extent to which a judicial forum was available." *Stern* at 2612 (quoting *Murray's Lessee v. Hoboken Land & Improvement Co.,* 59 U.S. 272, 18 How. 272, 284, 15 L.Ed. 372 (1855)). For example, a bankruptcy discharge arguably is a matter of public rights because Congress need not provide any discharge at all.

The same reasoning arguably could apply more broadly, because Congress need not enact any bankruptcy laws at all. At one point the Supreme Court stated that "the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power ... may well be a 'public right.' " *Marathon,* 458 U.S. at 71, 102 S.Ct. 2858 (plurality opinion).

More recent decisions, however, have expressly declined to endorse such a general rule. *See Stern,* 131 S.Ct. at 2614 n. 7 (plurality opinion); *Bellingham,* 702 F.3d at 561 (acknowledging "demise" of general rule that controversies at the "core of the bankruptcy process implicated public rights"). Unfortunately, no alternative general rule has emerged. As the Supreme Court has acknowledged, its reasoning has not been "entirely consistent." *Stern,* 131 S.Ct. at 2611 (plurality); *and id.* at 2621 (Scalia, J., concurring).

Nevertheless, the *Stern* plurality has articulated two alternative tests to determine when a Bankruptcy Judge can issue a final judgment or order:

> ... Congress may not bypass Article III simply because a proceeding may have *some* bearing on a bankruptcy case; *the question is whether the action at issue* ***238** *[a] stems from the bankruptcy itself or [b] would necessarily be resolved in the claims allowance process. [Stern,* 131 S.Ct.

> at 2618 (underlining added, citation omitted)]

These two alternatives are examined below.

a. Constitutional authority to adjudicate claims that "stem[ ] from the bankruptcy itself"

This first test—whether the action at issue "stems from the bankruptcy itself" (*Stern,* 131 S.Ct. at 2618)—initially sounds very similar to the pre-*Stern* test—whether the controversy at issue is at the "core of the bankruptcy process." *Bellingham,* 702 F.3d at 561. Fortunately, the Ninth Circuit has explained, after a careful review of *Granfinanciera, Stern,* and other Supreme Court cases, that the difference is whether there is a jury right:

> *Stern* fully equated bankruptcy litigants' Seventh Amendment right to a jury trial in federal bankruptcy proceedings with their right to proceed before an Article III judge. [*Bellingham,* 702 F.3d 553, 563]

In other words, under *Stern's* first test, the statutory definition of core proceedings fails to meet constitutional muster when a party is entitled to have the proceeding heard by a jury.

In this case, the parties have not established that they are being deprived of any right to a jury as to any of the issues addressed in this memorandum decision. Therefore, under *Stern's* first alternative test, this bankruptcy court has the constitutional authority to issue a final judgment or order on all of the issues presented.

b. Alternative Constitutional authority to adjudicate matters that "would necessarily be resolved in the claims allowance process"

In referring to an action that "would *necessarily* be resolved in the claims allowance process" (*Stern,* 131 S.Ct. at 2618, emphasis added), the *Stern* plurality apparently means to encompass both (i) the adjudication of "hierarchically ordered claims to a pro rata share of the bankruptcy res" (*id.* at 2614) and (ii) the adjudication of constitutionally *non*-core issues that are *necessary* to the allowance or disallowance of filed claims. Under the latter principle, when a party has filed a proof of claim, then the bankruptcy court can issue a final judgment or order if the allowance or disallowance of that claim *necessarily* requires adjudication of issues that normally would require a jury or are not statutorily core. *See Stern,* 131 S.Ct. at 2615–18 (plurality opinion, Part III.C.2); *Langenkamp v. Culp,* 498 U.S. 42, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990) (although alleged recipient of avoidable preference normally is entitled to jury, there is no such right if creditor files proof of claim, because claims allowance process necessarily involves determination of preference issues); *Katchen v. Landy,* 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (bankruptcy referee could use summary proceeding without jury to determine preference claim, because preference issues necessarily had to be resolved in the course of claims-allowance process); *Bellingham,* 702 F.3d at 562, n. 7 (distinguishing final adjudication of fraudulent transfer action by bankruptcy court when creditor had filed a proof of claim and it was "not possible" to rule on allowance of the proof of claim without first resolving the fraudulent transfer issue) (citation omitted); *In re Deitz,* 760 F.3d 1038 (9th Cir.2014), *adopting In re Deitz,* 469 B.R. 11, 17–24 (9th Cir. BAP 2012) (bankruptcy court can enter final judgment on underlying non-core claims that necessarily are part of adjudicating nondischargeability action); ***239** *In re Wash. Coast I, LLC,* 485 B.R. 393, 406–07 (9th Cir. BAP 2012) ("[T]he determination of priority between two creditors ... is not only tied to the claims resolution process, but it also involves the adjudication of rights created by the Bankruptcy Code under § 506.... Accordingly, the bankruptcy court's exercise of power over the lien priority dispute was a constitutional delegation of power from Congress.") (citation omitted).

In this case, Issues 1(a), 1(b) and 1(c) are part of determining the "hierarchically ordered claims to a pro rata share of the bankruptcy res." *Stern,* 131 S.Ct. at 2614. In addition, supposing for the sake of discussion that some of the parties' *underlying* claims normally would have to be tried to a jury or are statutorily non-core, those underlying claims "would *necessarily* be resolved in the [bankruptcy] claims allowance process." *Id.* at 2618 (emphasis added). For each of these alternative reasons, this court has the constitutional authority to issue a final judgment or order on all of the issues presented.

c. Alternative constitutional authority to adjudicate pretrial matters

Even in a constitutionally non-core proceeding under Stern, the bankruptcy court can resolve pretrial matters, including case-dispositive motions that do not require factual findings. *See In re Professional Satellite and Communication, LLC,* 2012 WL 6012829, at *3 (S.D.Cal.); *In re Heller Ehrman, LLP,* 2011 WL 4542512, at *3 (Bankr.N.D.Cal.) (citing *In re Healthcentral.com,* 504 F.3d 775, 787 (9th Cir.2007)). *See also Arkison,* ––– U.S. ––––, 134 S.Ct. 2165, 189 L.Ed.2d 83 (district court's *de novo* review was same under appeal from summary judgment ruling as it would have been for proposed findings of fact and conclusions of law).

In this case, the issues can be determined on the uncontested facts and the law (with very limited exceptions, as to which this court is not ruling, as noted below). Therefore, this is an alternative reason why this court has the constitutional authority to issue a final judgment or order on all of the issues addressed below.

d. Alternative constitutional authority if parties have expressly or impliedly consented

At least under current the Ninth Circuit authority, parties can consent to final adjudication of claims that are constitutionally non-core, and such consent may be implied. *See Bellingham,* 702 F.3d 553 (litigant consented to adjudication by bankruptcy judge by failing timely to object), *aff'd on other grounds, Arkison,* ––– U.S. ––––, 134 S.Ct. 2165, 189 L.Ed.2d 83; *Pringle,* 495 B.R. 447 (rebuttable presumption that failure to challenge authority to issue final order is intentional and indicates consent). *See also Stern,* ––– U.S. ––––, 131 S.Ct. 2594, 2608, 180 L.Ed.2d 475 (if litigant "believed that the Bankruptcy Court lacked the authority to decide his claim ... then he should have said so—and said so promptly.").

In this case, Debtor and the Committee have expressly consented to this court's entry of final orders or judgments (*see* dkt. 394 at 25–27), but both the IRS and Ms. Cohen have expressly declined to provide such consent (dkt. 387, 419). Accordingly, this alternative ground for this court's authority to enter final orders or judgments is not available.

C. Conclusion as to jurisdiction, authority, and venue

For the reasons set forth above, this bankruptcy court has both subject matter jurisdiction and the authority to enter final judgments and orders on the issues addressed below. Venue is proper under 28 U.S.C. §§ 1408(1) and 1409(a).

*240 IV. DISCUSSION

[1] As a preliminary matter, the Committee argues (dkt. 465, 13:13–20 & n. 17) for judicial estoppel. The Committee cites a transcript (dkt. 257–2, Ex. B) in which the State court asks Ms. Cohen's counsel to confirm that "the tax" is "a community property obligation" and he responds, "It has been paid. We're not disputing that it's a community property obligation." *Id.* at 9:16–17 & 9:25–26. It is not clear what tax is "the tax" in this quoted colloquy, but the IRS claim in this case has not "been paid" so it appears that Ms. Cohen's counsel was referring to some other tax debt. In any event, the evidence is not sufficiently clear to apply judicial estoppel.

A few of Ms. Cohen's papers and arguments appear to have been presented without observing the normal procedural requirements do so (*see* dkt. 256 at 2:9–15 & 13:1–16:11) (Committee Brief). Nevertheless, this court has considered these documents and for the reasons set forth below, is unpersuaded.

One more preliminary issue is that prepetition the IRS filed five notices of federal tax liens with respect to its miscellaneous penalty of over $8 million. For most of the following discussion, that is irrelevant. The overriding issue is whether there is any claim at all against community property, not whether that claim is secured or unsecured.

For ease of discussion, the following analysis focuses first on Ms. Cohen's arguments regarding the IRS claim. Other issues are discussed thereafter.

A. Federal bankruptcy law

Community property:

> The commencement of a [bankruptcy] case ... creates an estate. Such estate is comprised of [in addition to other assets] [a]ll interests of the debtor and the debtor's

> spouse in community property as of the commencement of the case that is—
>
> (A) under the sole, equal, or joint management and control of the debtor; or
>
> (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable. [11 U.S.C. § 541(a)(2)]

Such property is referred to in this Memorandum Decision as "Estate Community Property."

Community claim:

> The term "community claim" means claim that arose before the commencement of the case concerning the debtor for which [Estate Community Property] is liable, whether or not there is an such property at the time of the commencement of the case. (11 U.S.C. § 101(7)]

Distributions. The Bankruptcy Code's distribution scheme regarding community property is generally intended to parallel state law. As discussed in more detail below, creditors are entitled to be paid first, and if there are any remaining assets in the bankruptcy estate then those assets are distributed to the equity owners, i.e., the spouses. If there are any differences between State law and the bankruptcy distribution scheme, then the state law scheme is preempted. *See, e.g.,* 6 *Collier on Bankruptcy* ¶ 726.04 & 726.05[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (State laws are preempted to extent of any inconsistency with Bankruptcy Code's "waterfall" of distributions out of "sub-estates").

In this case, Ms. Cohen has not asserted a claim for any prepetition support payments (as distinguished from any postpetition ***241** support payments that might be payable under 11 U.S.C. § 1129(a)(14)). Nor has Ms. Cohen asserted that most of the property at issue is her separate property. Nevertheless, some of her arguments presuppose that she is entitled to distributions on a par with creditors, or ahead of them. For the reasons discussed below, those arguments are contrary to California law, and alternatively they are contrary to the Bankruptcy Code's distribution scheme.

B. Issue 1(a): the bulk of the IRS Claim is a community claim

1. Governing law

[2] "Apart from [any provisions of federal bankruptcy that override State law], Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law." *Butner v. United States,* 440 U.S. 48, 54, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). *See also In re McCoy,* 111 B.R. 276, 279 (9th Cir. BAP 1990).

Under California law, it is helpful to distinguish between *in personam* liability and *in rem* liability. Creditors can reach community property to pay debts incurred by either spouse during marriage, regardless whether any right to reimbursement exists as between the spouses. *See Lezine v. Sec. Pac. Fin. Serv., Inc.,* 14 Cal.4th 56, 64, 58 Cal.Rptr.2d 76, 925 P.2d 1002 (1996). California Family Code section 910 codifies this *in rem* liability:

> Except as otherwise expressly provided by statute, *the community estate is liable for a debt incurred by either spouse before or during marriage,* regardless of which spouse has the management and control of the property and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt. [Cal. Fam. C. 910(a), emphasis added. *See also* Cal.Code Civ. P. § 695.028.]

The phrase, "during marriage" does not include "the period during which the spouses are living separate and apart before a judgment of dissolution of marriage or legal separation of the parties." Cal. Fam. C. § 910(b). Debtor and Ms. Cohen were separated in 2010. *See* dkt. 60 at 10:10–11; dkt. 97; dkt. 460 at 5:12.

Therefore the question is whether the debts asserted in the IRS proof of claim were "incurred" before or after the 2010 separation. California Family Code section 903 defines when an obligation is incurred:

> A debt is 'incurred' at the following time:
>
> (a) In the case of a *contract,* at the time the contract is made.
>
> (b) In the case of a tort, at the time the tort occurs.
>
> (b) *In other cases, at the time the obligation arises.*
>
> [Cal. Fam. C. § 903, emphasis added]

The IRS, the Committee and Debtor argue that, under subdivision "(c)" above, the debts were "incurred" before the 2010 separation when the tax obligations arose. That is either (i) in 2003 through 2008 when Debtor and Ms. Cohen, despite having FBAR accounts, represented on their tax returns that they had no such accounts, failed to file FBAR forms, and did not pay the associated taxes, or (ii) at the latest, in 2009 when the last of those forms and payments were due and that triggered associated penalties. The IRS briefs cite ample authority for this proposition. *See, e.g.,* dkt. 460 (citing, *inter alia, Espinosa v. Comm'r,* 24 Fed.Appx. 825, 826 (9th Cir.2001); *Edelson v. Comm'r,* 829 F.2d 828, 833–34 (9th Cir.1987); *Jeffries v. Comm'r,* 2010 T.C.M. 172 (2010)).

Ms. Cohen argues that the debt is actually a contract debt, created by Debtor's post-separation closing/settlement agreement with the IRS, and therefore the debt ***242** supposedly was "incurred" after the marriage. Ms. Cohen's arguments are unpersuasive.

2. The plain meaning of the statute is contrary to Ms. Cohen's argument

Ms. Cohen cites no authority that tax debts incurred pre-separation are somehow transformed by settlement into debts "incurred" post-separation. That is an unnatural reading of the statute. For these reasons alone this court rejects her argument.

3. Relevant cases are contrary to Ms. Cohen's argument

Although Ms. Cohen's (strained) argument is apparently unprecedented in any reported decisions, what authority does exist strongly supports the contrary conclusion. One such decision is *In re Marriage of Hirsch,* 211 Cal.App.3d 104, 259 Cal.Rptr. 39 (Cal.Ct.App.1989) (cited in Debtor's Brief, dkt. 461, 15:22–16:3).

The facts in *Hirsch* are very analogous to this case. During marriage the husband was a director of a failed bank and that failure led to lawsuits. After separation, the husband settled those lawsuits, although the wife refused to participate in any settlements. The wife argued that the debts under the settlements were not community debts, and the trial court agreed, but the court of appeal reversed. Ms. Cohen points out that the decision does not explicitly state that the obligations at issue were "incurred" during the marriage, but that is an essential prerequisite to that court's holding. The fact that this issue was not discussed only shows that the court of appeal viewed it as obvious: settlement of debts incurred pre-separation does not somehow convert them into debts "incurred" post-separation.

Another decision contrary to Ms. Cohen's argument is *In re Marriage of Hargrave,* 36 Cal.App.4th 1313, 43 Cal.Rptr.2d 474 (1995). In that case, tax debts incurred during the marriage were settled by the husband after the marriage had terminated, and the community property was still held liable for those debts even though the IRS had determined that the wife was an "innocent spouse."

Analogous authority in the bankruptcy context points to the same outcome. The Supreme Court has held that, although a settlement agreement and releases may have "worked a kind of novation," that did not convert nondischargeable tort liabilities into a dischargeable contract debt. *Archer v. Warner,* 538 U.S. 314, 323, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003).

4. Ms. Cohen's attempts to disregard the pre-separation tax debts are unconvincing

Ms. Cohen attempts to bolster her argument by citing numerous cases treating "closing agreements" with the IRS as contracts. *See* dkt. 242 at 14:11–22 *and* dkt. 466 at 7:12–26 (Ms. Cohen's Briefs). *But cf.* dkt. 461 at 13:16–14:20 (Debtor's Brief, citing authority that rejects the treatment of closing agreements as contracts).

From this premise Ms. Cohen appears to reason that the liability to the IRS was a purely contractual creation that sprang into existence and was "incurred" post-separation in 2010. This court agrees with the preliminary assessment by the State court (Hon. Mark A. Juhas):

> ... the fallacy of [Ms. Cohen's] argument is [that] the agreement that was made with the I.R.S. isn't a separate property agreement.... He [Debtor] didn't go out and cheat on his taxes after [the] date of separation. All of this arises from things that happened during marriage. [Dkt. 464, Ex. D at 28:9–16]

In a similar vein, Ms. Cohen makes numerous arguments to try to distance the liability under the closing agreement from ***243** any association with the 2003 through 2008 tax years. She argues (dkt. 466, 11:1–12:4) that there is no statute that authorizes the IRS to issue a "miscellaneous penalty," and that liability under the closing agreement was calculated not based on the FBAR penalty but instead based on a different formula used for OVDI agreements (*id.* and dkt. 254 at 5:3–7). She asserts that FBAR penalties only "arise" once the IRS brings a lawsuit, and that the IRS, having elected not to bring such a suit did not pursue FBAR penalties, forfeited the right to allege that the debts at issue were related to the 2003 through 2008 tax years, and instead elected a post-separation contractual liability. Alternatively, she cites authority that, at least for some purposes, FBAR penalties are not treated as "tax" penalties. Dkt. 466 at 11:7–19. Finally (at least as the Committee interprets Ms. Cohen's arguments, dkt. 256 at 9:7–21) she may be arguing that the penalty must be disallowed because it is unauthorized. These are all red herrings.

There is no evidence to contradict the statements in the closing agreement itself (*Nazarian Adv.* dkt. 10–2, Ex. 28 at PDF pp. 260–64) that it relates to the 2003 through 2008 tax years. Those were the years in which Debtor and Ms. Cohen failed to disclose their FBAR accounts and pay associated taxes, and the IRS has identified "11 different statutory penalties in each of the disclosed years" for which the "miscellaneous penalty" was a "proxy" (dkt. 460 at 11:25–26). The IRS has broad statutory authority to settle taxpayer disputes (26 U.S.C. §§ 7121, 7122) and its settlement prior to actually commencing suit does not take away from the fact that it was liabilities for the 2003 through 2008 tax years that were being settled. Nor is there anything inconsistent with the IRS using a settlement formula under the OVDI program that is similar to, but not as complex as, the calculus that would have actually been used in any FBAR lawsuit. Ms. Cohen has not cited any authority that would limit the IRS' ability to settle the pre-separation tax liabilities in this manner, or to include claims for several tax years within one settlement and label it a "miscellaneous penalty." Her attempt to characterize the pre-separation tax debts as post-separation contract debt is essentially sleight of hand.

5. Ms. Cohen's objection that the maximum liability would be $60,000 is unpersuasive

Ms. Cohen appears to take the position (dkt. 466 at 10:24–25, 13:4–5, and dkt. 245 Ex. 1 at 26 (letter to IRS)) that the maximum penalty that could have been asserted against Debtor was $10,000 per year for a total of $60,000. If that is so, the Committee argues (dkt. 256 at 7:21–9:6), then perhaps the closing agreement and IRS liens created an unwarranted advantage for the IRS over similarly situated creditors (although the Committee offers no independent argument in support of Ms. Cohen's position).

As Ms. Cohen concedes (dkt. 466 at 10:24–1), the $10,000 limit only applies if Debtor (and Ms. Cohen) acted without any willful intent to violate the FBAR requirements. She also concedes (*id.*) that if willfulness is shown then the penalties can greatly exceed the dollar amount of the closing agreement.

As a factual matter, Ms. Cohen disputes that she or Debtor had the willful intent to violate the FBAR statutes —she alleges that their tax advisor did not tell them about this obligation. But she does not dispute, and cannot dispute, the false statements on their tax returns that there were no foreign accounts over $10,000. In addition, Debtor recites a litany of facts (dkt. 461 at 15:5–17:22) that could readily result in a finding of willfulness if the ***244** dispute had ever gone to trial. Ms. Cohen has not disputed those underlying facts, and even if she did, Debtor has conceded them. Therefore, if the case had ever gone to trial, there would have been every reason for a finder of fact to conclude that Debtor, at least, acted willfully.

The IRS and Debtor also provide calculations showing that any finding of willfulness easily could have resulted in liability many times the roughly $8 million settlement, up to or exceeding, in different scenarios, $26.25 million (dkt. 460 at 12 n. 6) (IRS example) or $58 million (dkt. 461 at 8:24–25, Debtor example), or even $90 million (dkt. 461 at 4:18–26, Debtor example). Ms. Cohen has not disputed these examples.

6. Ms. Cohen's attempts to transform the community claim into Debtor's sole obligation are unavailing

Ms. Cohen appears to argue that, because Debtor and the IRS entered into the closing agreement without her, she and all community property are exonerated from any liability. She also asserts that Debtor should have litigated defenses that, she claims, would have either eliminated or reduced the penalties to a substantially lesser amount. Dkt. 466 at 10:24–11:6 & 14:7–16. Other parties disagree about her purported innocence (*see, e.g.,* dkt. 460 at 11:28–12:8 *and* dkt. 461 at 7:18–26, 8:24–25, & 11:17–18) but those disagreements raise factual issues that this court need not address because on the undisputed facts Ms. Cohen's arguments miss the mark.

The IRS concedes (dkt. 245 at 12:2 and 12:12–19) that its claim for the miscellaneous penalty is what it calls a "[s]eparate" debt of Debtor. In other words, although the IRS asserts *in personam* liability against Debtor and *in rem* liability against community property, the IRS is not asserting (at least in its claim filed in this bankruptcy case) *in personam* liability against Ms. Cohen. Therefore, to the extent that Ms. Cohen is raising defenses to her own *in personam* liability her arguments are irrelevant.

[3] Ms. Cohen apparently is also attempting to second-guess Debtor's settlement of his own liability. She claims that by entering into that settlement Debtor violated the automatic temporary restraining order ("ATRO") under California Family Code § 2040(a)(2). Among other things, the ATRO restrains both divorcing spouses from

> transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, whether real or personal, whether community, quasi-community, or separate, without the written consent of the other party or an order of the court, except in the usual course of business or for the necessities of life.... [Cal. Fam. C. § 2040(a)(2)]

It is difficult to see how Debtor's settlement of his own liability amounts to "transferring" any "property" (or any other violation of the ATRO). Ms. Cohen argues, however, that Debtor violated the ATRO by:

> retroactively impair[ing] the couple's interests in community property. *See, e.g., roeger* [*Roeger*] *v. Friedman, Sloan & Ross,* 54 Cal.3d 26 [283 Cal.Rptr. 584, 812 P.2d 931] (1991) (the transfer of community property realty during marriage, in violation of statute requiring spousal consent, may be invalidated in its entirety by non-consenting spouse). [Dkt. 242 at 14:27–28]

First, there was nothing "retroactive[ ]" about the liability under the closing agreement. That agreement was a settlement of the 2003–08 tax year debts that were incurred prior to separation.

Second, Ms. Cohen cites no authority that one spouse's post-separation settlement ***245** of his own liability amounts to a "transfer" of community property. The one case she does cite, *Droeger,* was decided under a different statute governing consensual liens, and has been distinguished by the California Supreme Court, which interpreted that statute *not* to limit the usual rule that community property is liable for the debts of either spouse incurred during marriage. *Lezine,* 14 Cal.4th 56, 58 Cal.Rptr.2d 76, 925 P.2d 1002.

Conceivably (although Ms. Cohen does not actually articulate this argument) a settlement that *exceeded* the liability to which community property was already exposed could be interpreted as the equivalent of a "transfer" of such property within the meaning of the ATRO statute. But Ms. Cohen offers no reason why Debtor would choose to settle in excess of his exposure to liability. To the contrary, as set forth above, his actual exposure was far greater than the settlement.

For all of these reasons, there is neither any legal authority nor any factual basis for Ms. Cohen's argument that

Debtor's settlement with the IRS somehow violated the ATRO and could be avoided.

7. Conclusion as to Issue 1(a): which portions of the IRS Claim constitute "community claims" under § 101(7)

By far the largest portion of the filed IRS Claim is for the miscellaneous penalty, which arises from the 2003 through 2008 tax years and is for debts that were incurred prior to separation. Ms. Cohen has not established that the settlement of those debts in 2010 somehow retroactively caused them to be "incurred" after separation. The IRS has a community claim for the miscellaneous penalty.

Another portion of IRS Claim is for unpaid taxes arising from Ms. Cohen's separately-filed 2009 tax return. The IRS has a community claim for this pre-separation debt, for essentially the same reasons that the miscellaneous penalty is a community claim. The Estate Community Property is liable for the debt of either spouse incurred prior to separation, so Ms. Cohen's pre-separation 2009 tax debts are properly characterized as "in rem" community claims. *See* 11 U.S.C. 102(2) (" 'claim against the debtor' includes claim against property of the debtor).

The IRS Claim also includes some of Ms. Cohen's *post*-separation tax debts for 2011 and 2012, and those do not qualify as community claims. As the Committee concedes, however, the IRS can attempt to collect any such debts from Ms. Cohen, based on her *in personam* liability, and in addition the IRS may be able to collect from any separate property interests that she has. This court agrees with the Committee (dkt. 256 at 7:10–14) that, to the extent that the IRS seeks to "garnish" any distributions to Ms. Cohen from this bankruptcy estate, simply filing a proof of claim is not sufficient; but no doubt the IRS can achieve the same result in various other ways.

The IRS claim with respect to Ms. Cohen's 2010 tax obligations falls somewhere in the middle of the foregoing analysis. That is the year when the spouses separated, and the parties have not specifically briefed how to treat the tax liabilities arising in that situation. The IRS has cited authority that taxes accrue at the end of the tax year (*see, e.g.,* dkt. 460) but that general rule may be subject to exceptions in the divorce situation, or perhaps taxpayers can make some sort of short year election or other options. In addition, the parties disagree about the precise date of separation. For all of these reasons, it is beyond the scope of this Memorandum Decision to determine whether certain portions of the IRS Claim arising from Ms. Cohen's 2010 tax year are or are not community claims. That issue is reserved for ***246** later determination, and if helpful the parties can address at a future status conference what procedures should apply to such determination.

The last component of the IRS Claim is for Debtor's 2012 tax year. That debt arose in the post-separation period, so it is not a community claim. It can be collected from separate property of Debtor, or from distributions, if any, that he receives on account of his equity ownership in property of the bankruptcy estate.

D. Issue 1(b): the interpled funds

1. Limits of IRS lien

As the Committee points out, the IRS has conceded that its "lien does not attach to property and earnings acquired post-petition by the estate." Dkt. 245 (IRS Opp. to Committee's Claim Obj.) at 11:1–2. *See also* dkt. 219 at 4:8–19 (Committee Obj. to IRS Claim). In addition, as Ms. Cohen points out (dkt. 467 at 7:20–8:2), there is no showing that any IRS lien extends beyond Debtor's own property to the revenues of entities in which Debtor holds an interest.

The IRS has not disputed these assertions, although it adds the caveat that it expects such property and earnings to be used to fund a chapter 11 plan, including payment of its claim, and "[t]o the extent future distributions from Elco and Lighton threaten [its] secured position in the value of the shares of stock and/or membership interests that are part of the estate, the [IRS] is entitled to adequate protection." Dkt. 245 at 11:3–10. Those issues are not before this court for decision at this time, and for present purposes the point is only that the IRS does not assert a lien on the interpled funds.

This moots the various arguments by Ms. Cohen (dkt. 467 at 8:3–27) and the Committee (dkt. 465 at 16:7–13) regarding whether Debtor was only a nominal payee, whether the IRS can rely on "reverse piercing," and the applicability of alter ego or similar doctrines. The remaining issue is whether Ms. Cohen has established any basis to receive distributions from the interpled funds ahead of the bankruptcy estate. She has not.

2. Limits of Ms. Cohen's interests

[4] Ms. Cohen asserts that she has a prior, separate interest in the interpled funds "by reason of the Superior Court's award to [her] of one-half of the monthly Lighton Property rental proceeds, pursuant to its 'Order on Temporary Spousal Support, Child Support, and Other Related Matters' filed on August 10, 2011." Dkt. 467, 6:21–26. This court does not agree.

As the Committee points out, that order is a *temporary* spousal support order that does not permanently define relative property interests. *See* dkt. 465, 20:16–23 (Committee Brief) *and Nazarian Adv.* dkt. 10–1, Ex. 16, at 156–59) (Order for temporary support). This temporary allocation has no binding effect and is not controlling. In any event, as the Committee argues (dkt. 465 at 16:15–28), once this bankruptcy case commenced the automatic stay superseded any temporary spousal support order insofar as any property division. *See In re Teel,* 34 B.R. 762, 764 (9th Cir. BAP 1983).

Ms. Cohen appears to assert (dkt. 467 at 6:13–7:14 & 9:19–21) that her claimed 50% interest in the Lighton interpled funds attached prior to the bankruptcy case. But her asserted interest in those funds was for purposes of paying support, and she has not argued that she was owed any unpaid support as of the petition date, so that argument is unavailing.

This leaves Ms. Cohen without a basis to assert a "claim" on a par with creditors, let alone a priority over creditors' claims (apart from any unpaid *postpetition* support ***247** payments). *See* 11 U.S.C. §§ 507(a)(1) *and* 1129(a)(14)). As noted above, this accords with the general rule that creditors are entitled to be paid first, and thereafter any distributions on account of equity ownership interests are made to the divorcing spouses.

For example, in the factually similar case of *Hirsch* the court of appeal applies the usual rules that "[i]n dividing the community property equally under the mandate of [California divorce law], the court must distribute both the assets and the obligations of the community so that the *residual* assets awarded to each party after the deduction of the obligations [to creditors] are equal." *Hirsch,* 211 Cal.App.3d 104, 108–09, 259 Cal.Rptr. 39 (citations and internal quotation marks omitted, emphasis altered). In addition, although a spouse may or may not have *in personam* liability for tortious conduct, creditors generally are "able to reach a community asset to satisfy a debt incurred by one spouse alone." *Id.* at 109, 259 Cal.Rptr. 39 (citations and internal quotation marks omitted, emphasis added). A separate issue is that "*[b]etween the spouses,* certain obligations which are properly characterized as separate may be assigned to the responsible person if unpaid, or reimbursement may be ordered in favor of the community if the debt was paid from community assets," but that does not diminish creditors' recoveries. *Id.,* 211 Cal.App.3d at 109, 259 Cal.Rptr. 39 (citations and internal quotation marks omitted, emphasis added).

The Committee (dkt. 465 at 11:18–12:8) cites numerous authorities that reiterate these principles. *See Lezine,* 14 Cal.4th 56, 64, 58 Cal.Rptr.2d 76, 925 P.2d 1002 (community property liable for debts of either spouse during marriage, and reimbursement obligations between spouses do not affect creditors' primacy in collecting from community property to satisfy debts); *United States v. Berger,* 574 F.3d 1202, 1203–06 (9th Cir.2009) (community property liable to satisfy husband's criminal restitution judgment, "including that portion of the property that otherwise would potentially be awarded upon dissolution of marriage to an innocent spouse who was not involved in the criminal activity"); *Ordlock v. Commr.,* 533 F.3d 1136, 1138–39 (9th Cir.2008) (wife was not entitled to refund of community property payments made on tax debts, because such property was liable for such debts notwithstanding any alleged "innocent spouse" status with respect to IRS); *In re McIntyre,* 222 F.3d 655, 658 (9th Cir.2000) (community property, including non-debtor spouse's share, was liable for husband's tax debts).

Any "bad acts" by Debtor against Ms. Cohen might be the basis to seek a reallocation of any property remaining *after* payment of creditors, but those acts would not be a basis for any claim competing on a par with creditors, let alone any sort or priority over such creditors. *See, e.g., Berger,* 574 F.3d 1202 (criminal restitution judgment); *Ordlock,* 533 F.3d 1136 (husband's tax debts, regardless of wife's alleged "innocent spouse" status); *In re Provenza,* 316 B.R. 177, 201 (para.90) & *passim* (Bankr.E.D.La.2003) (extensive wrongdoing by debtor both prior to and within bankruptcy).

Ms. Cohen cites California law that she implies is to the contrary, but as argued by Debtor (dkt. 461 at 10 n. 5) and the Committee (dkt. 465 at 9:19–11:17), those statutes address the allocation of responsibility as between the divorcing spouses, not the liability of community property for debts incurred during the marriage. Ms. Cohen cites no contrary authority.

Not only are creditors' rights superior under California law; but to the extent of any conflict between California law and the ***248** Bankruptcy Code the latter will control under the supremacy clause of the U.S. Constitution, Article VI, Clause 2. *Teel,* 34 B.R. 762, 764 (citations omitted). Under the Bankruptcy Code's distribution scheme, creditors have priority over equity interests. *See, e.g.,* 11 U.S.C. § 544 (estate has "strong arm" rights of hypothetical and actual creditors) and § 1129(b) (so called "absolute priority" of claims over interests). *In re General Teamsters, Warehousemen and Helpers Union, Local 890,* 265 F.3d 869, 873 (9th Cir.2001) ("The bankruptcy code establishes a strict priority for satisfaction of obligations of a debtor. Claims of equity holders are always junior to claims of both secured and unsecured creditors.") (internal citations omitted).

For all of these reasons, Ms. Cohen has not established any primacy of her interests with respect to the interpled funds. To the contrary, her interests are subordinate to those of creditors and the bankruptcy estate.

3. Conclusion regarding Issue 1(b): distribution of interpled funds

There is ambiguity about the proper recipient of some of the interpled funds because certain promissory notes (*Nazarian Adv.* dkt. 10–2, Ex. 28 at 89) were made payable to "Saeed Cohen *or* Elco Lighting" (emphasis added). Therefore, it appears that there is a genuine dispute of fact about where the funds came from, and to whom the interpled funds should be repaid as between Debtor and Elco (assuming that, as this court has ruled, the interests of those entities are superior to the interests of the IRS and Ms. Cohen in the interpled funds). The Committee suggests (dkt. 256 at 19 n. 14) that this issue can be deferred by ordering the distribution of the funds to Elco to hold pending further order of this court. The Committee suggests a similar solution (dkt. 465 at 16–17) with respect to distributing funds to Lighton. No party in interest has established any reason to do otherwise, so that is what this court will order.

E. Issue 1(c): resolution of the Committee's objection to the IRS claims

Most of the Committee's objections to the IRS claim are resolved above. The filed IRS Claim includes some debts that might not be fully liquidated and may be disputed on standard tax law grounds—Ms. Cohen's 2009 tax debt is listed as "Pending Examination" (Claim 3–2 at 3), Debtor notes that his 2012 tax liability has yet to be finalized (dkt. 461 at 17:23–18:16), and there may be other debts that are subject to revision. The Committee acknowledges that the IRS may need to amend its claim, and the rulings in this Memorandum Decision are without prejudice to the rights of the IRS to amend its claim as appropriate, and the rights of other parties in interest to object to amended claims.

V. CONCLUSION

This court anticipates directing counsel for the Committee to draft, circulate, and lodge separate orders implementing the decisions set forth above. Before that, this court intends to review with the parties at the next status conference whether to defer entry of any such orders so as to give all parties in interest at least a short "breathing spell" before having to litigate appeals. That time could be used for possible settlement discussions, agreements regarding procedures, or similar negotiations.

All Citations

522 B.R. 232, 114 A.F.T.R.2d 2014-6597, 2014-2 USTC P 50,507

Footnotes

[1] For brevity, filed documents are referred to by docket number ("dkt.") rather than their full title. Many arguments are repeated in numerous briefs, and this Memorandum Decision usually cites the briefs filed in the main bankruptcy case rather than the briefs in the adversary proceedings. Unless the context suggests otherwise, references to a "chapter" or

"section" (" § ") refer to the United States Bankruptcy Code, 11 U.S.C. § 101 et seq. (the "Code"), a "Rule" means one of the Federal Rules of Bankruptcy Procedure ("FRBP"), Federal Rules of Civil Procedure ("FRCP"), or other federal or local rule, and other terms have the meanings provided in the Code, the Rules, and the parties' briefs.

[2] Debtor provides an example of how the principal FBAR penalties work: "For willful failures to timely file FBARs occurring after October 22, 2004, the maximum civil penalty is the greater of $100,000 or 50 percent of the high balance in the account during the taxable year for each year for which there is a failure to timely file an FBAR. *See* 31 U.S.C. § 5321(a)(5). Thus, for example, if a taxpayer had a high balance in a foreign bank account of $30 million earning zero interest for six straight years and willfully failed to file FBARs for each of those six years, the taxpayer could be subject to maximum penalties of $90 million (50% x $30 million x 6 years), even though the account balance never exceeded $30 million. This failure to report penalty is completely separate from income tax penalties, and from any taxes and interest owed as the result of failing to report all income on a taxpayer's return." Dkt. 461 at 4:18–26.

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United States District Court, D. Connecticut.

UNITED STATES of America, Plaintiff,
v.
Diane M. GARRITY, Paul G. Garrity, Jr.,
and Paul M. Sterczala, as fiduciaries of the
Estate of Paul G. Garrity, Sr., Defendants.

No. 3:15-CV-243(MPS)
|
Signed 06/01/2018

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MEMORANDUM AND ORDER

Michael P. Shea, U.S.D.J.

I. Background

***1** Plaintiff, the United States of America ("the Government"), filed this suit to reduce to judgment a civil penalty that the Internal Revenue Service ("the IRS") assessed against Paul G. Garrity, Sr., under 31 U.S.C. § 5321(a)(5), for his alleged willful failure to report his interest in or authority over a foreign financial account in the 2005 tax year, in violation of 31 U.S.C. § 5314. The Government now moves *in limine* to preclude the opinion testimony of Defendants' proposed expert witness Howard Epstein. For the reasons discussed below, the motion to preclude Mr. Epstein's proposed testimony is GRANTED. I assume familiarity with the facts, the parties' arguments, and the Court's prior rulings, and recount only certain relevant facts below.

According to Defendants' expert disclosure, Mr. Epstein is a certified public accountant with over 25 years of experience. (Report of Howard B. Epstein, CPA, ECF No. 114-2 at 2.) His practice focuses on international tax planning and compliance for individual taxpayers and multi-national companies. (*Id.*) Defendants propose that Mr. Epstein will testify at trial on the following general subjects:

- "general reporting requirements as they related to Foreign Financial Accounts and Foreign Trusts"; and

- "general guidance published by the Internal Revenue Service, the Department of Treasury, and FinCen explaining the rules and reporting requirements to taxpayers and practitioners relating to such vehicles for the year the subject penalty is assessed (2005), as compared to years before and after." (ECF No. 114-2 at 2.)

More specifically, Mr. Epstein's proposed testimony includes opinions on:

- "the state of published guidance and public awareness of [foreign account] reporting requirements so as to provide an objective backdrop or perspective....";

- "how such guidance evolved in the years before and after the subject year [i.e., 2005], and how, in that climate, international tax compliance has been viewed and understood by practitioners and taxpayers...."; and

- "whether an individual taxpayer could have been unaware of his filing foreign income and asset reporting requirements." (ECF No. 114-2 at 3.)

Mr. Epstein's proposed testimony purports to answer the question, "Should Paul Garrity Sr. have known of his requirements to report the Stiftung [a Liechtenstein entity]?" (ECF No. 114-2 at 9.) He opines that "the IRS should not and does not determine—without specific supporting evidence—that a taxpayer should have known of his foreign bank account reporting requirements." (*Id.* at 10.)

II. Legal Standards

Federal Rule of Evidence 702 provides that a "witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if ... the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue," among other requirements. The Court must determine whether the proposed "expert testimony is relevant, i.e., whether it has any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." *Amorgianos v. Nat'l R.R. Passenger Corp.*, 303 F.3d 256, 265 (2d Cir. 2002) (internal quotation marks omitted). "In addition to the requirements of Rule 702, expert testimony is subject to Rule 403, and 'may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury.' " *Nimely v. City of New York*, 414 F.3d 381, 397 (2d Cir. 2005) (quoting Fed. R. Evid. 403).

III. Discussion

***2** The premise of Mr. Epstein's proposed testimony appears to be that the Government will attempt to prove that Mr. Garrity, Sr. "should have known" about his obligation to file an FBAR, i.e., to report his interest in or authority over a foreign financial account, for the 2005 tax year. (*See, e.g.*, ECF No. 122 at 9 (Defendants' argument that "the government is poised—if it fails to establish any improper motive or intent—to contend that ... if a taxpayer 'should have known' ... that he had to report the account then he is subject to the willfulness penalty."); ECF No. 114-2 at 3 (Mr. Epstein's statement that "[t]he government asserts that Mr. Garrity should have known of his filing requirements and willfully or recklessly ignored them.").) Whether Mr. Garrity "should have known" of the FBAR requirement is not part of the Government's burden of proof, however, as it does not reflect the standard applicable to this case.

Rather, the key question for the jury will be whether Mr. Garrity, Sr.'s failure to file an FBAR for the 2005 calendar year was willful. [1] As several courts have held, a defendant willfully violates the FBAR requirement when he "either knowingly or recklessly fails to file an FBAR." *Bedrosian v. U.S. Dep't of Treasury*, No. 15-5853, 2017 WL 4946433, at *3 (E.D. Pa. Sept. 20, 2017). *See also, e.g., United States v. Williams*, 489 Fed. Appx. 655, 658 (4th Cir. 2012); *United States v. Bohanec*, 263 F. Supp. 3d 881, 888-89 (C.D. Cal. 2016); *United States v. McBride*, 908 F. Supp. 2d 1186, 1204 (D. Utah 2012) (citing *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007)). Actual knowledge encompasses "willful blindness" to the obvious or known consequences of one's actions. *McBride*, 908 F. Supp. 2d at 1205 (citing *Global-Tech Appliances, Inc. v. SEB S.A.*, 563 U.S. 754, 767 (2011)). The government may prove willful blindness with evidence that Mr. Garrity, Sr. made a "conscious effort to avoid learning about reporting requirements." *Williams*, 489 Fed. Appx. at 659. Evidence of a taxpayer's negligence, however, is insufficient to prove willfulness. *See, e.g., Bedrosian*, 2017 WL 4946433, at *6 (finding that the defendant was not liable for willful failure to file an FBAR because his actions amounted to, at most, negligence).

Mr. Epstein's report does not, and does not purport to, address the subjective standard at issue here. Instead, Mr. Epstein speaks only to an objective standard—whether Mr. Garrity, Sr. "should have known" of the reporting obligation in light of the IRS's public education on the issue at the relevant time. What Mr. Garrity, Sr. should have known—i.e., whether Mr. Garrity, Sr. was negligent in his failure to file an FBAR—is not the issue in this case.

What Mr. Garrity, Sr. actually knew (or consciously chose to avoid learning) is the key issue, and there is no evidence linking that issue with Mr. Epstein's proposed testimony. Defendants point to no evidence in this case that Mr. Garrity, Sr. knew or believed that, for example, there was uncertainty about IRS guidance regarding the reporting of foreign financial accounts or about whether an account held in the name of a Liechtenstein *Stiftung*, such as the Lion Rock Foundation, had to be disclosed to the IRS. Indeed, defense counsel conceded during the pre-trial conference that there is no evidence that Mr. Garrity, Sr. was aware (or that he was unaware) of any IRS guidance and no evidence that he was certain or uncertain about any FBAR reporting obligation. For example, defense counsel acknowledged that there is no evidence that Mr. Garrity, Sr. had conversations about IRS guidance or any lack thereof, or even about the reporting requirement in general, with his accountant. In short, there is no evidence that Mr. Garrity, Sr.'s state of mind was influenced by any lack of IRS guidance.

***3** Because it bears no connection to Mr. Garrity, Sr., evidence about any uncertainty or lack of clarity in the IRS guidance is irrelevant. *See United States v. Ingredient Tech. Corp.*, 698 F.2d 88, 97 (2d Cir. 1983) (holding that the district court properly excluded expert testimony on the lack of clarity in the relevant legal obligations because "there was no evidence that [the defendants] genuinely thought that what they were doing was lawful and proper; on the contrary, their conduct indicated a subjective belief in the *un* lawfulness of the conduct"); *United States v. Curtis*, 782 F.2d 593, 599 (6th Cir. 1986) (holding that the district court properly excluded expert testimony on the unsettled nature of an area of tax law as evidence to negate willfulness). In disagreeing with the approach taken in *United States v. Garber*, 607 F.2d 92 (5th Cir. 1979), the Second Circuit noted in *Ingredient Technology* that "the *Garber* majority's approach permits juries to find that uncertainty in the law negates willfulness whether or not the defendants are actually confused about the extent of their tax liability." *Ingredient Tech.*, 698 F.2d at 97. Instead, the *Ingredient Technology* court sided with "prior cases on willfulness[, which] consistently require factual evidence of the defendants' state of mind to negate willfulness under any theory." *Id.* As the Sixth Circuit held in *Curtis*, "[w]illfulness is personal," and "relates to the defendant's state of mind.... Unless there is a connection between the external facts and the defendant's state of mind, the evidence of the external facts is not relevant." 782 F.2d at 599. *See also United States v. Banki*, No. S1 10 Cr. 08 (JFK), 2010 WL 1875690, at *2 (S.D.N.Y. May 10, 2010) (holding that "if, but only if, there [was] prior evidence in the record to establish a factual link between Defendant's state of mind and [the agency's] under-enforcement policy," would the expert witness's testimony about agency enforcement policy be relevant in aiding the jury in weighing the credibility of the defendant's "alleged lack of knowledge regarding the legality of his conduct"). After specifically inquiring of defense counsel at the pretrial conference, I remain unaware of any evidence in this case suggesting a "factual link" between Mr. Garrity, Sr.'s state of mind and the IRS's published guidance or enforcement policy (or lack thereof) concerning the reporting of foreign financial accounts.

Moreover, to the extent any evidence of general public uncertainty about the reporting of foreign financial accounts is relevant, whatever slight probative value it has is substantially outweighed by the danger of confusing the issues and misleading the jury. The jurors will be instructed that the Government must prove willfulness, but Mr. Epstein's testimony may lead them to conclude —incorrectly—that Mr. Garrity, Sr.'s willfulness depends on the degree to which the IRS enforced, publicized, or explained the reporting obligation—or the degree to which others were aware of it.

Further, to the extent that Mr. Epstein purports to opine on the legal requirements related to filing an FBAR, he will be attempting to "explain[ ] the tax law," which "is generally within the purview of the court, not expert witnesses." *United States v. Fletcher*, 928 F.2d 495, 503 (2d Cir. 1991). *See also Ingredient Tech.*, 698 F.2d at 97 ("[I]t would be very confusing to a jury to have opposing opinions of law admitted into evidence as involving a factual question for them to decide.... Questions of law are for the court."); *Banki*, 2010 WL 1875690, at *3 ("While [the expert]'s opinion that the law as written did not require action by a United States depository institution may be relevant to the Court's charge of law, it can have no bearing on any factual matter before the jury," as "the jury's task is only to determine whether Defendant's alleged conduct violates the law as laid out by the Court."). The Court notes that many of the exhibits Defendants apparently proposed to use with Mr. Epstein consist of rules, regulations, and internal IRS legal opinions, all of which set forth legal matters. The law is for the Court, rather than the jury, to decide.

I find that Mr. Epstein's testimony must be excluded under Rule 702, because it will not assist the jury to understand the evidence or to determine a fact in issue. I also find that the evidence is irrelevant to the question of willfulness and, even if it has some relevance, that it must be excluded under Rule 403, because allowing Mr. Epstein to testify on the proposed subjects would risk jury confusion and invade the province of the Court.

IV. Conclusion

For the reasons discussed above, the motion to preclude Mr. Epstein's testimony is GRANTED.

IT IS SO ORDERED.

All Citations

Slip Copy, 2018 WL 2465354

Footnotes

[1] The jury will also determine whether Mr. Garrity, Sr. had an interest in, or signatory or other authority over, a foreign bank account during the relevant time period. But Mr. Epstein's proposed testimony does not directly address that question, and Defendants have not suggested that they seek to offer his testimony on that question.

End of Document

2018 WL 2271381
United States District Court,
W.D. Texas, Austin Division.

UNITED STATES of America,
v.
Dominique G. COLLIOT, Defendant.

Cause No.: AU–16–CA–01281–SS
|
Signed 05/15/2018
|
Filed 05/16/2018

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ORDER

SAM SPARKS, SENIOR UNITED STATES DISTRICT JUDGE

***1** BE IT REMEMBERED on this day the Court reviewed the file in the above-styled cause, and specifically, Defendant Dominique Colliot's Motion for Summary Judgment [#52], the United States of America (the IRS)'s Response [#57] in opposition, Colliot's Reply [#58] in support, and the IRS's Surreply [1] [#59–2] in opposition as well as Colliot's Unopposed Motion to Modify Order on Prejudgment Writ of Garnishment to UBS [#61], Having reviewed the documents, the relevant law, and the case file as a whole, the Court now enters the following opinion and orders.

Background

In December 2016, the Internal Revenue Service (IRS) initiated this lawsuit to reduce to judgment outstanding civil penalties assessed against Colliot. Compl. [#1] at 1. The penalties were assessed for Colliot's repeated and willful failures to timely file Form TD F 90–22.1, entitled "Report of Foreign Bank and Financial Accounts" and commonly referred to as an "FBAR," from 2007 to 2010. Mot. Summ. J. [#52], For 2007, the IRS assessed penalties of $548,773 for four separate FBAR violations. Resp. Mot. Summ. J. [#57] at 15. For 2008, the IRS assessed penalties of $196,082 for another four FBAR violations. *Id.* at 16. The IRS also assessed smaller penalties in 2009 and 2010. *Id.* at 17. In forms provided to Colliot in connection with the assessment of these penalties, the IRS stated the penalties were authorized under 31 U.S.C. § 5321(a)(5) and 31 C.F.R. § 1010.820(g)(2). Mot. Summ. J. [#52–12] Ex. L at 2.

These underlying facts are not in dispute. Colliot now moves for summary judgment on the ground the IRS incorrectly applied the law when it calculated the monetary penalties assessed against Colliot. Mot. Summ. J. [#52], This pending motion is ripe for review.

Analysis

I. Motion for Summary Judgment

A. Legal Framework

To understand Colliot's argument, it is first necessary to briefly review the history of the provision used to impose civil penalties upon Colliot, 31 U.S.C. § 5321(a)(5). A previous version of § 5321(a)(5) allowed the Secretary of the Treasury to impose civil monetary penalties amounting to the greater of $25,000 or the balance of the unreported account up to $100,000. *See* Resp. Mot. Summ. J. [#57] at 2. A related regulation promulgated by the Department of the Treasury via notice-and-comment rulemaking, 31 C.F.R. § 103.57, reiterated that "[f]or any willful violation committed after October 26, 1986 ... the Secretary may assess upon any person, a civil penalty[ ] ... not to exceed the greater of the amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or $25,000." Amendments to Implementing Regulations Under the Bank Secrecy Act, 52 Fed. Reg. 11436, 11445–46 (1987).

***2** In 2002, the Treasury delegated the authority to assess penalties under § 5321(a)(5) to the Financial Crimes Enforcement Network (FinCEN). Treasury Order 180–01, 67 Fed. Reg. 64697 (2002). In addition to this delegation of enforcement authority, Treasury Order 180–

01 provided that related regulations were unaffected by this transfer of power and should continue in effect "until superseded or revised." *Id.* Roughly six months later, FinCEN redelegated the authority to assess penalties under § 5321(a)(5) and its related regulation, § 103.57, to the IRS. Mot. Summ. J. [#52–5] Ex. E (Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements).

In 2004, Congress amended § 5321 to increase the maximum civil penalties that could be assessed for willful failure to file an FBAR. 31 U.S.C. § 5321(a)(5); American Jobs Creation Act of 2004, Pub. L. No. 108–357, § 821, 118 Stat. 1418 (2004). Under the revised statute, the civil monetary penalties for willful failure to file an FBAR increased to a minimum of $100,000 and a maximum of 50 percent of the balance in the unreported account at the time of the violation. 31 U.S.C. § 5321(a)(5)(C).

Despite this change, the regulations promulgated in reliance on the prior version of the statute remained unchanged. Thus, § 103.57 continued to indicate the maximum civil penalty for willful failure to file an FBAR was capped at $100,000. FinCEN subsequently renumbered § 103.57—it is now 31 C.F.R. § 1010.820—as part of a large-scale reorganization of regulatory provisions. It also amended part of the regulation to account for inflation. Civil Monetary Penalty Adjustment and Table, 81 Fed. Reg. 42503, 42504 (2016). FinCEN did not, however, revise the regulation to account for the increased maximum penalty now authorized under § 5321(a)(5). 31 C.F.R. § 1010.820. Nevertheless, the IRS did not let § 103.57 (now § 1010.820) constrain its enforcement authority, and since 2004, the IRS has repeatedly levied penalties for willful FBAR violations in excess of the $100,000 regulatory cap. Resp. Mot. Summ. J. [#57] at 3.

B. Application

Under 5 U.S.C. § 706(2), a court must hold unlawful and set aside agency actions which are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."

Colliot argues the IRS acted arbitrarily and capriciously by assessing penalties against Colliot in excess of those allowed by § 1010.820. Mot. Summ. J. [#52] at 4–5 (arguing penalties imposed in excess of the $100,000 cap set forth in § 1010.820 are "not in accordance with the law"). In turn, the IRS argues § 1010.820 is inconsistent with the 2004 amendments to § 5321(a)(5)(C) and was therefore implicitly superseded or invalidated by those statutory revisions. Resp. Mot. Summ. J. [#57] at 5, 7 (arguing the IRS followed "the actual law" instead of the agency's superseded regulation); *see alsoUnited States v. Larionoff*, 431 U.S. 864, 873 (1977) ("[I]n order to be valid[,] [regulations] must be consistent with the statute under which they are promulgated."). If the amendments to § 5321(a)(5) vitiated the lower penalty threshold set out in § 1010.820, then the IRS cannot have acted arbitrarily or capriciously by failing to apply § 1010.820 to cap the penalties levied on Colliot.

Unfortunately for the IRS, there is little reason to believe § 5321(a)(5)(C) implicitly superseded or invalidated § 1010.820. Section 5321(a)(5) sets a ceiling for penalties assessable for willful FBAR violations, but it does not set a floor.[2] 31 U.S.C. § 5321(a)(5). Instead, § 5321(a)(5) vests the Secretary of the Treasury with discretion to determine the amount of the penalty to be assessed so long as that penalty does not exceed the ceiling set by § 5321(a)(5)(C). *Id.* And § 1010.820—a regulation validly issued by the Treasury via notice-and-comment rulemaking—purports to cabin that discretion by capping penalties at $100,000.[3] 31 C.F.R. § 1010.820. Thus, considered in conjunction with § 5321, § 1010.820 is consistent with § 5321's delegation of discretion to determine the amount of penalties to be assessed. *SeeU.S. Pipe & Foundry Co. v. Webb*, 595 F.2d 264, 272 (5th Cir. 1979) ("Regulations are presumed valid unless they are shown to be unreasonable or contrary to the provisions of the enabling statute."). Since § 1010.820 can be applied consistent with § 5321(a)(5), the Court concludes § 5321(a)(5) does not implicitly invalidate or supersede § 1010.820.

***3** In sum, § 1010.820 is a valid regulation, promulgated via notice-and-comment rulemaking, which caps penalties for willful FBAR violations at $100,000. 31 C.F.R. § 1010.820. Rules issued via notice-and-comment rulemaking must be repealed via notice-and-comment rulemaking. *SeePerez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1206 (2015) (requiring agencies to "use to the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance"). Section 1010.820 has not been so repealed and therefore remained good law when the FBAR penalties in question were assessed against Colliot. Consequently, the IRS acted arbitrarily and capriciously when it failed to apply the regulation to cap the penalties assessed against Colliot. 5 U.S.C. § 706(2) (requiring agency action to be "in accordance with law"); *see alsoRichardson v. Joslin*, 501 F.3d 415, (5th Cir. 2007) ("[A]n agency must abide by its own regulations.") (citing *United States ex rel. Accardi v. Shaughnessy*, 347 U.S. 260(1954)).

II. Motion to Modify Order on Prejudgment Writ of Garnishment

Colliot also asks the Court to modify its Order on Prejudgment Writ of Garnishment to UBS [#19]. Mot. Modify [#61]. Specifically, Colliot asks the Court modify the order to authorize the purchase and sale of U.S. Treasury bills with a maturity date of one year or less using funds withheld by the writ of garnishment. *Id.* [#61] at 2. The funds are otherwise to remain segregated with UBS under the terms of the original order. *Id.* The Court finds the terms of these proposed modifications to the order reasonable and unopposed by the IRS, and therefore the Court grants Colliot's request for the modifications specified above. However, the Court does not at this time consent to the transfer of increases in the segregated funds resulting from interest accruals or proceeds from the sale or maturity of the Treasury bills.

Conclusion

The Court agrees with Colliot that the IRS cannot assess penalties in excess of the threshold set by 31 C.F.R. § 1010.820. However, neither party has briefed the Court on what relief might be appropriately afforded Colliot in these circumstances, and at this time, the Court declines Colliot's unsupported request that the Court dismiss the entire action with prejudice. *See* Mot. Summ. J. [#52] at 11. Instead, the Court orders the parties provide additional briefing on the appropriate next steps in this case.

Accordingly,

IT IS ORDERED Colliot's Motion for Summary Judgment is GRANTED IN PART and DENIED IN PART as described in this opinion;

IT IS FURTHER ORDERED the parties shall within THIRTY (30) days file with the Court a brief memo of no more than TEN (10) pages regarding whether the Court should dismiss this case with prejudice and citing to legal authority in support; and

IT IS FINALLY ORDERED that Colliot's Unopposed Motion to Modify Order on Prejudgment Writ of Garnishment to UBS [#61] is GRANTED IN PART and DENIED IN PART as described in this opinion.

All Citations

Slip Copy, 2018 WL 2271381, 121 A.F.T.R.2d 2018-1834

Footnotes

[1] The Court herein considers the arguments raised in the surreply and the IRS's Motion for Leave to File Surreply [#59] is GRANTED. Additionally, the IRS's Motion for Extension of Time to File Response [#55] and Motion to Withdraw Motion for Extension of Time to File Response [#56] are both DISMISSED as moot.

[2] The IRS argues Congress clearly intended to increase penalties for willful FBAR violations when it amended § 5321(a)(5), and therefore, § 5321 implicitly supersedes § 1010.820. Resp. Mot. Summ. J. [#57] at 9. This argument is foreclosed by the unambiguous text of § 5321(a)(5), which allows the Secretary of the Treasury to assess larger penalties than those provided for by § 1010.820 but ultimately leaves the decision of whether or not to do so within the Secretary of the Treasury's discretion. *See*31 U.S.C. § 5321(a)(5) (providing the Secretary of the Treasury *"may* impose a civil penalty" falling within the penalty threshold set by § 5321(a)(5)(C) (emphasis added)).

[3] If FinCEN or the IRS wished to preserve their discretion to award the maximum possible penalty for willful FBAR violations under § 5321(a)(5), they might easily have written or revised § 1010.820 to do so. For example, § 1010.820 might have incorporated § 532***l***(a)(5)'s maximum penalty thresholds by reference, or alternatively, the IRS might have revised § 1010.820 to reflect the increased penalty limits. Instead, FinCEN and the IRS enacted and then left in place the $100,000 penalty cap.

End of Document

2011 WL 98948
Only the Westlaw citation is currently available.
United States District Court, D. Arizona.

TRIQUINT SEMICONDUCTOR, INC., a Delaware corporation, Plaintiff/Counterdefendant,
v.
AVAGO TECHNOLOGIES LIMITED, a Singapore corporation; Avago Technologies U.S., Inc., a Delaware corporation; Avago Technologies Wireless IP (Singapore Pte., Ltd., a Singapore corporation, Defendants/Counterclaimants.

No. CV–09–01531–PHX–JAT.
|
Jan. 12, 2011.

Go to Markman Construed Terms

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ORDER

JAMES A. TEILBORG, District Judge.

***1** Before the Court are the parties' proposed constructions of the claim terms of thirteen patents.[1] The Court constructs the disputed claim terms below.

I. Background

Plaintiff/Counterdefendant TriQuint Semiconductor, Inc. (“TriQuint”), sued Defendants/Counterclaimants Avago Technologies Limited, Avago Technologies U.S., Inc., and Avago Technologies Wireless IP (Singapore) Pte., Ltd. (collectively, “Avago”), for alleged infringement of three TriQuint patents and other related claims. Avago filed a counterclaim against TriQuint for alleged infringement of ten Avago patents and other related claims. The parties both design, manufacture and sell high-performance radio frequency filters, and power amplifier integrated circuits (chips) and modules (multiple chips on a circuit board) for use in wireless communications products, such as mobile telephone handsets.

The patents and technology at issue in this case concern bulk acoustic wave (“BAW”) filters used in mobile telephones to filter transmitted and received radio frequency signals. BAW filters are incredibly small, and as a result, manufacturing BAW filters is a highly technical process. The patents at issue in this case concern the construction and composition of BAW filters and the parts that make up BAW filters, such as resonators.

TriQuint and Avago have filed briefs supporting their proposed constructions of the disputed claim terms in the three TriQuint patents and the ten Avago patents at issue in this case. Pursuant to *Markman v. Westview Instruments, Inc.,* 517 U.S. 370, 116 S.Ct. 1384, 134 L.Ed.2d 577 (1996), the Court must construe the claims of the patents as a matter of law. On December 14, 2010, the Court held a *Markman* hearing during which the proposed constructions of the disputed claim terms were argued before the Court. Having considered the evidence presented in the parties' briefs, exhibits, and during the hearing, for the reasons set forth below, the Court construes the disputed claim terms as a matter of law as follows.

II. Legal Standard

“It is a ‘bedrock principle’ of patent law that ‘the claims of a patent define the invention to which the patentee is entitled the right to exclude.’ ” *Phillips v. AWH Corp.,* 415 F.3d 1303, 1312 (Fed.Cir.2005) (quoting *Innova/Pure*

Water, Inc. v. Safari Water Filtration Sys., Inc., 381 F.3d 1111 (Fed.Cir.2004)). Claim construction, which is the determination of the meaning of the terms in a patent, is a question of law, and exclusively within the province of the Court. *Markman,* 517 U.S. at 372. Thus,

> The determination of infringement is a two-step process. First, the court construes the claims to correctly determine the scope of the claims. Second, it compares the properly construed claims to the accused device. Claim construction is a matter of law.... However, a determination of infringement, both literal and under the doctrine of equivalents, is a question of fact.

Dow Chemical Co. v. Sumitomo Chemical Co., 257 F.3d 1364, 1372 (Fed.Cir.2001) (internal citations omitted).

***2** There is a specific order of evidence that the Court should consider in construing a claim. *See Vitronics Corp. v. Conceptronic, Inc.,* 90 F.3d 1576, 1582–83 (Fed.Cir.1996). First, the Court considers the patent itself. *Id.* at 1582. In construing the claims, the Court should "look to the words of the claims themselves" giving them "their ordinary and customary meaning" unless clearly stated otherwise. *Id.* Specifically, disputed claim terms are given "their ordinary and accustomed meaning as understood by one of ordinary skill in the art." *Dow Chem.,* 257 F.3d at 1372; *see Texas Digital Systems, Inc. v. Telegenix, Inc.,* 308 F.3d 1193, 1202 (Fed.Cir.2002) ("The terms used in the claims bear a 'heavy presumption' that they mean what they say and have the ordinary meaning that would be attributed to those words by persons skilled in the relevant art."). "Dictionaries are always available to the court to aid in the task of determining meanings that would have been attributed by those of skill in the relevant art to any disputed terms used by the inventor in the claims." *Texas Digital,* 308 F.3d at 1202 (citing *Vitronics,* 90 F.3d at 1584 n. 6).

Second, the Court looks at "the [patent] specification to determine whether the inventor has used any terms in a manner inconsistent with their ordinary meaning. The patent specification acts as a dictionary when it expressly defines terms used in the claims or when it defines terms by implication." *Vitronics,* 90 F.3d at 1582.

Third, the Court may consider the prosecution history of the patent. *Id.* at 1582. "[T]he record before the Patent and Trademark Office [("PTO")] is often of critical significance in determining the meaning of the claims. *Id.* at 1582–83. Specifically, reference may be made to the patent specifications, the prosecution history, prior art, and other claims in determining the proper scope of patent claims and the meaning of any terms in dispute. *Carroll Touch, Inc. v. Electro Mechanical Systems, Inc.,* 15 F.3d 1573, 1577 (Fed.Cir.1993). Thus,

> Prosecution history estoppel precludes a patentee from obtaining[,] in an infringement suit[,] patent protection for subject matter which it relinquished during prosecution in order to obtain allowance of the claims. It thus serves as a check on the applicability of the doctrine of equivalents.... The application of prosecution history estoppel is a question of law.

Mark I Marketing Corp. v. R.R. Donnelly & Sons Co., 66 F.3d 285, 291 (Fed.Cir.1995) (internal citations omitted). In other words,

> Prosecution history estoppel requires that the claims of a patent be interpreted in light of the proceedings in the PTO during the application process. Estoppel is a "rule of patent construction" that ensures that claims are interpreted by reference to those "that have been cancelled or rejected." The doctrine of equivalents allows the patentee to claim those insubstantial alterations that were not captured in drafting the original patent claim but which could be created through trivial changes. When, however, the patentee originally claimed the subject matter alleged to infringe but then narrowed the claim in response to a rejection, he may not argue that the surrendered territory comprised unforeseen subject matter that should be deemed equivalent to the literal claims of the issued patent.

***3** *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.,* 535 U.S. 722, 733–34, 122 S.Ct. 1831, 152 L.Ed.2d 944 (2002) (internal citations omitted). In reviewing the patent file history, it is appropriate to review the relevant patent file history for parent and grandparent applications. *Mark I,* 66 F.3d at 291.

Fourth, the Court may consider extrinsic evidence, such as expert testimony, only if the Court cannot resolve a disputed claim term based on the first three sources of evidence. *Vitronics,* 90 F.3d at 1583–84. In most situations, analysis of the patent and its prosecution history, *i.e.,* the intrinsic evidence, will resolve any ambiguity in a disputed claim term, and it is improper to rely on extrinsic evidence. *Id.* at 1583.

The disputed claims should be interpreted without reading in limitations from the patent specification. *Teleflex, Inc. v. Ficosa N. Am. Corp.,* 299 F.3d 1313, 1326 (Fed.Cir.2002) (citing *Comark Commc'ns, Inc. v. Harris Corp.,* 156 F.3d 1182, 1186 (Fed.Cir.1998)). In other words, if the patent specification discloses only one exemplary embodiment, that does not require that each claim be limited to that one embodiment. *SRI Int'l v. Matsushita Elec. Corp. of Am.,* 775 F.2d 1107, 1121 n. 14 (Fed.Cir.1985) (*en banc*).

Courts should not determine a claim to be indefinite without first making a reasonable attempt at construction. *Metabolite Lab ., Inc. v. Lab. Corp. of Am. Holdings,* 370 F.3d 1354, 1366 (Fed.Cir.2004) ("Only when a claim remains insolubly ambiguous without a discernable meaning after all reasonable attempts at construction must a court declare it indefinite."); *All Dental Prodx, LLC v. Advantage Dental Prods., Inc.,* 309 F.3d 774, 780 (Fed.Cir.2002) ("Only after a thorough attempt to understand the meaning of a claim has failed to resolve material ambiguities can one conclude that the claim is invalid for indefiniteness.").

Finally, "a dependent claim includes all the limitations of the claim from which it depends .... It is axiomatic that dependant claims cannot be found infringed unless the claims from which they depend have been found to be infringed." *Wahpeton Canvas Co. v. Frontier, Inc.,* 870 F.2d 1546, 1553 (Fed.Cir.1989).

III. Claim Construction

The following chart summarizes the Court's construction of the disputed claim terms. The full analysis supporting each construction is below.

Disputed Claim Term	**Construction**
TriQuint's Patents	
U.S. Patent No. 5,231,327	
the only connections to the [second/third] electrode (Claims 1, 4, 6 & 8)	no other electrical connections to the [second/third] electrode exist
U.S. Patent No. 5,894,647	
fabricating a substrate ... having a top electrode (Claims 1 & 5)	fabricating a substrate and adding a top electrode on the substrate; this step must precede the step of "removing from a top electrode ...."
top electrode	conducting material on the substrate that includes at least a portion that overlaps at least a portion of a paired electrode (bottom electrode)

(Claims 1–8)	
adding a differential layer of conducting material on top of the top electrode (Claims 1 & 5)	adding a differential layer of conducting material on top of the top electrode [*No construction is necessary.*]
removing from the top electrode portions of the top electrode that include, but are not necessarily limited to, those portions of the top electrode that overlap with a portion of the bottom electrode and that are not composed of a portion of both the primary layer of the conducting material and the differential layer of the conducting material (Claim 1)	removing the portions of the top electrode that both (1) overlap with a portion of the bottom electrode and (2) are not composed of a portion of both the primary layer of conducting material and the differential layer of conducting material; ”but are not necessarily limited to” means other portions of the top electrode may or may not be removed as well
the first top electrode additionally comprising a differential layer of conducting material (Claims 2 & 6)	in addition to a primary layer of conducting material, the first top electrode includes a differential layer of conducting material
fabricating a primary layer of conducting material on the top surface of the substrate to form first and second top electrodes (Claims 3, 4, 7 & 8)	fabricating a primary layer of conducting material on the top surface of the substrate to form first and second top electrodes [*No construction is necessary.*]
fabricating a differential layer of conducting material upon the first top electrode (Claims 3 & 7)	fabricating a differential layer of conducting material upon the first top electrode [*No construction is necessary.*]
U.S. Patent No. 6,114,635	
substantially non-conducting material (Claims 1–3 & 11)	largely but not wholly non-conducting material
bonding strip	a separately recognizable strip where bonding material joins a

(Claims 1 & 11)	portion of the lid to a portion of the die
bonding material (Claims 1, 3, 8 & 11)	material that bonds together the bonding strips
Avago's Patents	
U.S. Patent No. 7,365,619	
related to a common ground (Claim 1)	related to a common electrical ground
antiparallel (Claims 1 & 11)	the first electrode of the first resonator is electrically connected to the second electrode of the second resonator, and vice versa; where the first and second electrodes of a resonator are determined by the direction of polarization of the resonator
a polarization of the common piezo layer in the first area and a polarization of the common piezo layer in the second area are unidirectional (Claim 1)	a polarization of the shared layer of piezoelectric material in the first area and a polarization of the shared layer of piezoelectric material in the second area are in the same absolute direction
exhibit substantially identical shifts in terms of the amount and direction of the resonance frequency due to a Voltages Coefficient of Frequency (VCF) effect (Claims 3 & 13)	exhibit substantially identical shifts in terms of the amount and direction of the resonance frequency due to a Voltages Coefficient of Frequency (VCF) effect, *i.e.,* changes in the resonance frequency when the direct voltage varies, or is swept, within a wide range from high negative voltages to high positive voltages

architecture (Claims 6 & 16)	the number, composition, size, shape, and order of layers in the resonator
U.S. Patent 7,268,436	
wherein the bonding connections of the contact areas and the inner areas of external contacts each include a bonding arc (Claim 1)	wherein each bonding connection formed between the contact areas and the inner area of external contacts includes a bonding arc
bonding connections (Claim 1)	a connection that bonds two elements
bonding arc (Claim 1)	a bond formed by bonding the side of a bond wire to a contact area/inner area of external contact, forming an arc-like shape
U.S. Patent No. 6,841,922	
due to technological limitations in the manufacturing of this layer (Claim 1)	due to technological limitations in the manufacturing of this layer [*No construction is necessary.*]
the other layer (Claims 1–3)	the other layer [*No construction is necessary.*]
the acoustic reflector is a plurality of layers having a high acoustic impedance and comprises a plurality of layers having a low acoustic impedance (Claim 4)	the acoustic reflector comprises a plurality of layers having a high acoustic impedance and a plurality of layers having a low acoustic impedance
U.S. Patent No. 6,933,807	
wherein the performance of the acoustic reflector is determined by its reflectivity for a longitudinal wave existing	[*The disputed claim term is indefinite and incapable of construction.*]

in the BAW resonator at the resonance frequency of the BAW resonator and by its reflectivity for a shear wave existing in the BAW resonator at the resonance frequency of the BAW resonator (Claims 1 & 10)	
performance of the acoustic reflector (Claims 1 & 10)	the reflectivity for a longitudinal wave existing in the BAW resonator at the resonance frequency of the BAW resonator and the reflectivity for a shear wave existing in the BAW resonator at the resonance frequency of the BAW resonator
wherein areas with layers with high acoustic impedance and areas with layers with low acoustic impedance are alternately adjacently disposed (Claims 1 & 10)	wherein areas with layers with high acoustic impedance and areas with layers with low acoustic impedance are alternately adjacently disposed, with the term “areas” including a layer having a characteristic acoustic impedance (high or low) along with any connected thin intermediate layers
wherein the layers of the acoustic reflector and layers disposed between the acoustic reflector and the piezoelectric layer are selected, with reference to their number, material, and thickness, such that the transmissivity for the longitudinal wave and the transmissivity for the shear wave in the area of the resonance frequency is smaller than –10 dB (Claims 1 & 10)	the number, the material and the thickness of the layers of the acoustic reflector and the layers between the acoustic reflector and the piezoelectric layer must all be selected for the specific purpose of achieving (a) the transmissivity for the longitudinal wave in the area of the resonance frequency of less than –10dB, and (b) the transmissivity for the shear wave in the area of the resonance frequency of less than –10dB
layers of the acoustic resonator are selected such that the BAW resonator has an	the layers of the acoustic resonator must all be selected for the specific purpose of achieving an unambiguous

unambiguous and desired dispersion performance (Claim 4)	and desired dispersion performance
unambiguous and desired dispersion performance (Claim 4)	the first shear harmonic wave and the longitudinal main resonance of the BAW resonator are separated by at least a bandwidth of the resonator
[layers] are selected such that the distance between the longitudinal main resonance and the first shear harmonic wave is greater than the bandwidth of the longitudinal main resonance of the resonator (Claim 6)	the layers of the acoustic resonator must all be selected for the specific purpose of achieving a distance between the longitudinal main resonance and the first shear harmonic wave that is greater than the bandwidth of the longitudinal main resonance of the resonator
longitudinal main resonance [of the resonator] (Claim 6)	the primary resonant frequency at which the resonator resonates longitudinally (in the direction of the elastic deflection)
U.S. Patent No. 6,909,340	
A bulk acoustic wave filter, comprising: a plurality of bulk acoustic wave resonators (Claims 1 & 12)	A bulk acoustic wave filter having at least two bulk acoustic wave resonators. [*The preamble is not a limitation.*]
bulk acoustic wave resonator[s] (Claims 1–4 & 9–12)	a resonator comprised of a layer of piezoelectric material sandwiched between a top electrode and bottom electrode with a specific effective resonator surface
surface contents (Claims 1, 2, 5–8 & 12)	area

aspect ratios (Claims 1 & 12)	the smallest dimension of the resonator within the surface plane divided by the largest dimension of the resonator within the surface plane. The directions of these two dimensions need not be perpendicular to each other.
nonrectangular shape (Claims 3 & 4)	a shape where the angles between the boundary lines of the shape are not equal to 90 degrees where they meet, *i.e.,* any shape that is not a rectangle
stage of a conductor filter (Claim 9)	one series resonator and one parallel resonator connected in a ladder configuration
half-stage of a conductor filter (Claim 9)	one additional parallel or series resonator included within a ladder configuration

U.S. Patent No. 6,864,619

[a detuning layer sequence] arranged on the first piezoelectric resonator (Claims 1 & 12)	the detuning layer sequence is only applied to the first piezoelectric resonator
[the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance] in order to shift a resonance frequency of the first piezoelectric resonator relative to the resonance frequency of the second piezoelectric resonator (Claims 1 & 12)	the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance for the purpose of shifting the resonance frequency of the first piezoelectric resonator relative to the resonance frequency of the second piezoelectric resonator

U.S. Patent No. 6,812,619

the resonator is adapted in such a way that a width of the frame-like zone and acoustical property means of the layer structure in the frame-like zone are arranged so that displacement relating to the piezoelectrically excited strongest resonance mode is substantially uniform in the center area of the resonator (Claims 1 & 35)	the resonator is adapted in such a way that a width of the frame-like zone and acoustical property means of the layer structure in the frame-like zone are arranged so that displacement relating to the piezoelectrically excited strongest resonance mode is substantially uniform in the center area of the resonator [*No construction is necessary.*]
the resonator is adapted to operate in the thickness extensional wave mode as a TE mode (Claims 1 & 35)	the resonator is adapted to operate such that the displacement of the particles of the piezoelectrical material occurs in the direction of the applied electrical field
U.S. Patent No. 6,377,137	
removing material from a bottom surface of said substrate to reduce the thickness of the substrate and to reduce an electromagnetic influence in a resulting filter (Claim 1)	removing material from a bottom surface of said substrate to reduce the thickness of the substrate and to reduce the effects caused by currents flowing through the filter
reduce an electromagnetic influence (Claim 1)	reduce the effects caused by currents flowing through the filter
die cavity (Claims 5, 6, 14 & 16)	a hollow area in a package where the die is mounted
victim loop (Claims 7, 15 & 18)	a current path from the output pad to the ground pad such that the signal bypasses the filter elements
victimizer loop	a current path from the input signal pad to the ground pad

(Claims 7, 15 & 18)	such that the signal bypasses the filter elements
U.S. Patent No. 6,262,637	
film bulk acoustic resonator (FBAR) (Claims 1 & 20–22)	a bulk acoustic wave (BAW) resonator fabricated using thin film technology
a 90° phase shifter (Claim 1)	a phase shifter that shifts the phase of a signal by 90 degrees
in series with a second band-pass filter (Claim 1)	in series with a second band-pass filter [*No construction is necessary.*]
U.S. Patent No. 6,051,907	
Thin Film Bulk Acoustic Wave Resonators (FBARs) (Claims 1, 7 & 10)	a thin film bulk acoustic wave resonator (FBAR) comprised of a plurality of layers having respective thicknesses, and exhibiting at least one of a series resonance and a parallel resonance at respective frequencies that are a function of the thickness of at least one of the layers
calculating an average of the measured frequencies (Claim 10)	calculating a mean of the measured frequencies
simultaneously altering the thickness of each of the plurality of the FBARs [by the amount (A)] (Claim 10)	altering the thickness of each film bulk acoustic resonator to be detuned on a wafer by the same amount (A) at the same time

A. TriQuint's U.S. Patent No. 5,231,327—"the only connections to the [second/third] electrode" (Claims 1, 4, 6 & 8)

***4** TriQuint acquired U.S. Patent No. 5,231,327, titled "Optimized Piezoelectric Resonator–Based Networks" (the "#327 patent"), through its acquisition of TFR Technologies, Inc. ("TFR"). The #327 patent describes a way of designing a piezoelectric resonator so that electrical connections are more conveniently located. The #327 patent describes two top resonators, each with their own top electrode, that are electrically connected to each other by one shared bottom electrode. (*See* Doc. # 196–1, Ex. A at Fig. 4B.)

TriQuint's proposed construction for "the only connections to the [second/third] electrode" is "no other conductive electrical connections to the [second/third] electrode exist." Avago's proposed construction for this disputed claim term is "the [second/third] electrode is not electrically connected to any other component of the circuit." [2]

Based on the disputed claim term, which appears in four of the patent claims, if the bottom electrode of a resonator is connected to another component or device, then it is not covered by the #327 patent. TriQuint contends that the relevant connections are *conductive* electrical connections; whereas, Avago contends that the electrode may not have *any* electrical connections to any other component in the circuit. Avago's proposed construction is more closely supported by the patent or the plain meaning of the term "connections" as used in the relevant art.

TriQuint argues that the "connections" described in the disputed claim term refer to electrical connections. The #327 patent supports this construction, and Avago does not disagree. Avago argues, and the Court agrees, that the disputed claim term is not limited to *conductive* electrical connections as proposed by TriQuint. Claims 1 and 4 refer to electrical connections: "a pair of series connected piezoelectric resonators sharing a first electrode"; "a shunt element connected to the first electrode and to a signal ground"; and "a first pair of resonators sharing a first electrode for connection to other circuitry." (Doc. # 196–1, Ex. A. at 11:37–38, 11:39–40, 12:6–7.) Figure 4B of the #327 patent shows the primary preferred embodiment for the invention. (*Id.* at 3:11–14.) The patent specification describes electrode M2 as "a floating electrode that does not connect to other circuitry." (*Id.* at 6:25–26.) The patent compares electrode M2 to electrodes M1 and M3, which "are referred to as connecting electrodes since they connect the network to other circuitry, such as resistors." (*Id.* at 5:67–68, 6:1–2.)

As understood by a person of ordinary skill in the art, the term "connections" in the disputed claim term refers to electrical connections, but not specifically *conductive* electrical connections. An industry dictionary defines a "floating network or component" as "having no terminal at ground potential." IEEE STANDARD DICTIONARY OF ELECTRICAL & ELECTRONIC TERMS 380 (4th ed.1988).

***5** The Court finds the ordinary and customary meaning of the term "connections" as understood by person of ordinary skill in the art, *see Phillips,* 415 F.3d at 1313, means electrical connections. TriQuint seeks to limit the disputed claim term to "conductive" electrical connections. There is no support in either the #327 patent, or TriQuint's brief, to limit the construction to "conductive" electrical connections. Accordingly, the Court construes the disputed claim term as "no other electrical connections to the [second/third] electrode exist."

B. TriQuint's U.S. Patent No. 5,894,647

TriQuint acquired U.S. Patent No. 5,894,647, titled "Method for Fabricating Piezoelectric Resonators and Product" (the "#647 patent"), through its acquisition of TFR. The #647 patent describes how to shift a resonator's resonant frequency by a small amount by adding layers of material to the top electrode. However, the layers may not be aligned perfectly creating "parasitic" resonators. The #647 patent describes the removal of the portions of the top electrode that overlap the bottom electrode.

1. "fabricating a substrate ... having a top electrode" (Claims 1 & 5)

TriQuint's proposed construction for "fabricating a substrate ... having a top electrode" is "fabricating a substrate and adding a top electrode on the substrate; this step must precede the step of 'removing from a top electrode ....' " Avago's proposed construction for this disputed claim term is "fabricating a substrate and defining [3] on the substrate a top electrode; this step must precede the step of 'removing from a top electrode....' " The parties agreed that the top electrode must be initially added on the substrate before portions are removed in the "removing" step. The parties dispute whether an "electrode," as used in the #647 patent, means a defined electrode of an individual resonator, or whether it refers to a general layer of the conducting material in which an electrode is later etched out.

The #647 patent teaches various ways of removing the portions of the top electrode that overlap the bottom electrode and that are not composed of both primary and differential layers. The first method is to deposit primary and differential layers in areas slightly larger than the ultimately desired electrodes, and then to remove the excess strips. (Doc. # 196–1, Ex. B at 5:33–6:17.) The second method is to deposit a primary layer on the substrate and then to deposit a differential layer in the general area to be occupied by the electrode, and then to use a masking and etching process to remove material so as to leave the desired two electrodes. (*Id.* at 6:38–49.) The Court finds the claims in the #647 patent are broad enough to include both methods. The #647 patent uses the term "top electrode" to refer to electrode layers during the manufacturing process, as well as after that process has been completed (after "the step of removing"). Avago argues that this second method was disclaimed in the prosecution history; however, it appears that the inventor's alleged disclaimer is taken out of context. (Doc. # 197–2, Ex. B.2 at p. 5–6) (distinguishing the claimed invention from prior art stating that the "essence" of the invention is the removal of narrow strips of metal along the edges of the electrode, and not disavowing the scope of the relevant claims).

***6** Based on the foregoing fabrication methods, the Court finds Avago's proposed construction that the top electrode must be defined on the substrate is misleading. The parties agree that a removing step occurs after the top electrode is added. As described above, there is no specific "defining" of the top electrode, other than to add layers to the substrate, prior to the removal process. The outer limits of the top electrode are not fixed or defined until after the "removing" step, which both parties agree follows the addition of the primary and differential layers on the substrate.

Therefore, the Court construes the disputed claim term as "fabricating a substrate and adding a top electrode on the substrate; this step must precede the step of 'removing from a top electrode ....' "

2. "top electrode" (Claims 1–8)

TriQuint's proposed construction of "top electrode" is "conducting material on the substrate that includes at least a portion that overlaps at least a portion of a paired electrode (bottom electrode)." Avago's proposed construction of this disputed claim term is "a top electrode of an individual resonator."

The #647 patent supports Avago's proposed construction of the disputed claim term to the extent that the overlapping portions of the top electrode and bottom electrode define the resonator. (Doc. # 196–1, Ex. B at 7:8–10.) The patent describes a device comprised of two resonators, with the claims describing the fabrication of the electrodes on the device. The claims repeatedly describe a top electrode overlapping with a portion of a bottom electrode to define an individual resonator. (*See e.g., id.* at 7:8–10, 7:40–45, 8:54–60.) The patent provides that the two top electrodes are components of a first and second resonator. (*Id.* 7:40–45.) The #647 patent also describes the addition of "a differential layer of conducting material to the first top electrode so as to shift the resonant frequency of the first resonator relative to the resonant frequency of the second resonator." (*Id.* at 9:11–14.) However, the claim term "top electrode" does not need to be constructed in a manner that takes into account its formation of a resonator.

The claims clearly describe a device comprised of two resonators with each resonator having its own top electrode. In support of its position that a top electrode is split among two or more resonators, TriQuint directs the Court to the #327 patent. Upon reviewing the claims in the #647 patent at issue here, the Court does not find support for the contention that "top electrode" in the #647 patent is not limited to an individual resonator. However, the Court does not find it necessary to read "an individual resonator" into the construction of "top electrode," because the claims clearly states how the resonator is formed.

For the foregoing reasons, the Court construes "top electrode" as "conducting material on the substrate that includes at least a portion that overlaps at least a portion of a paired electrode (bottom electrode)."

3. "adding a differential layer of conducting material on top of the top electrode" (Claims 1 & 5)

***7** TriQuint proposes that no construction is necessary, because "adding a differential layer of conducting material on top of the top electrode" is clear on its face. Avago's proposed construction for this disputed claim term provides that "this step [adding a differential layer of conducting material on top of the top electrode] must come after the step of fabricating the top electrode as it requires that the differential layer be formed 'on top of the top electrode.' "

While it is clear from the disputed claim term that the top electrode exists prior to adding a differential layer, the #647 patent does not explicitly include a prior step of "fabricating the top electrode." The patent requires "fabricating a substrate having a top and bottom surface and having a top electrode on the top surface." (*Id.* at 7:1–2.) Adding the implicit step "fabricating the top electrode" would only add ambiguity to the disputed claim term.

Avago's proposed construction also appears to require that the boundaries of the top electrode must be fixed before adding the differential layer to the top electrode. Such a construction is not supported by the patent claims. Claims 1 and 5 describe fabricating a piezoelectric resonator by, among other steps, "adding a differential layer of conducting material on top of the top electrode." (Doc. # 196–1, Ex. B at 7:11–12, 8:26–27.) Then, "removing from the top electrode portions of the top electrode that ... overlap with a portion of the bottom electrode that are not composed of a portion of both the primary layer ... and the differential layer." (*Id.* at 7:16–21, 8:31–35.) Before these two steps occur, the top electrode already exists on the substrate, and is comprised of "a primary layer of conducting material." (*Id.* at 7:5–6.)

Avago's proposed construction muddles a claim term that is clear on its face when read in context. Accordingly, the Court finds that no further construction is required.

4. "removing from the top electrode portions of the top electrode that include, but are not necessarily limited to, those portions of the top electrode that overlap with a portion of the bottom electrode and that are not composed of a portion of both the primary layer of the conducting material and the differential layer of the conducting material" (Claim 1)

TriQuint's proposed construction for "removing from the top electrode portions of the top electrode that include, but are not necessarily limited to, those portions of the top electrode that overlap with a portion of the bottom electrode and that are not composed of a portion of both the primary layer of the conducting material and the differential layer of the conducting material" is "removing from the portions of the top electrode that both (1) overlap with a portion of the bottom electrode and (2) are not composed of a portion of both the primary layer of conducting material and the differential layer of conducting material." TriQuint also proposes that "but are not necessarily limited to" means "other portions of the top electrode may or may not be removed as well." Avago proposes that "but not necessarily limited to" is vague and renders the claim indefinite.

***8** Avago argues that because the patent examiner originally found the use of the phrase "... but not necessarily limited to ..." vague in light of the preceding word "including" (Doc. # 197–2, Ex. B–3 at p. 2), the Court should strike claim 1 of the #647 patent as invalid. The inventors attempted to amend the claims to remove "but are not necessarily limited to" from claim 1. (Doc. # 197–2, Ex. B–4 at p. 2.) However, the PTO issued the #647 patent with the phrase still contained in claim 1, which is likely the result of a ministerial error. While perhaps not an example of superbly concise writing, the Court does not find the use of the phrase "but not necessarily limited to" renders the entire claim indefinite.

A person of ordinary skill in the art would understand the phrase "including, but not necessarily limited to, X" means the category includes X, but may also contain Y and Z. In fact, as TriQuint points out, Avago uses the phrase "including, but not limited to" in discussing its proposed construction of a subsequent disputed claim term. (*See* Doc. # 197 at p. 35.) Additionally, TriQuint's brief cites a patent statute that contains the allegedly indefinite phrase. *See* 35 U.S.C. § 210(a) ("This chapter shall take precedence over any other Act ... including, but not necessarily limited to the following:") Clearly, the phrase is not insolubly ambiguous.

TriQuint's proposed construction rearranges the disputed claim term to remove the phrase "but not necessarily limited to," and adds a provision to define the meaning of that phrase. The Court will adopt TriQuint's proposed construction and construe the disputed claim term as "removing the portions of the top electrode that both (1) overlap with a portion of the bottom electrode and (2) are not composed of a portion of both the primary layer of conducting material and the differential layer of conducting material; 'but are not necessarily limited to' means other portions of the top electrode may or may not be removed as well."

5. "the first top electrode additionally comprising a differential layer of conducting material" (Claims 2 & 6)

TriQuint's proposed construction for "the first top electrode additionally comprising a differential layer of conducting material" is "in addition to a primary layer of conducting material, some or all of the first top electrode includes a differential layer of conducting material." Avago's proposed construction for this disputed claim term is "a differential layer of conducting material is added only to the first top electrode of an individual first resonator."

In its brief, Avago states that its proposed construction requires that the differential layer of conducting material is applied only to the first electrode (not to the second electrode). TriQuint understands Avago's proposed construction to also require that the differential layer may be added only *after* the primary layer has been deposited, which is inconsistent with the patent. The #647 patent permits the sequence to be reversed and the differential layer could be deposited on the substrate followed by the primary layer. (Doc. # 196–1, Ex. B. at 6:20–25, 8:11–13, 10:4–6.) Accordingly, the Court finds Avago's proposed construction to be ambiguous and potentially in conflict with other claims in the #647 patent.

***9** TriQuint's proposed construction states that the differential layer may be added to "some or all" of the first top electrode. However, the Court does not find it necessary to read this phrase into the disputed patent claim. For the foregoing reasons, the Court construes the disputed claim term as "in addition to a primary layer of conducting material, the first top electrode includes a differential layer of conducting material."

6. "fabricating a primary layer of conducting material on the top surface of the substrate to form first and second top electrodes" (Claims 3, 4, 7 & 8)

TriQuint proposes that no construction is necessary, because "fabricating a primary layer of conducting material on the top surface of the substrate to form first and second top electrodes" is clear on its face. Avago's proposed construction for this disputed claim term is "fabricating a primary layer of conducting material on the top surface of the substrate to form the first top electrode of a first resonator and to form the second top electrode of a second resonator."

Avago's only construction of the disputed claim term is the addition of "of a first resonator" and "of a second resonator." It is not necessary to introduce the concept of individual resonators into the construction of this disputed claim term, as Avago proposes. The disputed claim term concerns the formation of the electrodes upon the substrate, and does not reference the formation of resonators or the composition of resonators. As noted above, the #647 patent often uses the term "electrode" to refer to the electrode layer before the final electrode boundaries are carved out. Therefore, the Court agrees with TriQuint that the disputed claim term is clear on its face, and no construction is necessary.

7. "fabricating a differential layer of conducting material upon the first top electrode" (Claims 3 & 7)

TriQuint proposes that no construction is necessary, because "fabricating a differential layer of conducting material upon the first top electrode" is clear. Avago's proposed construction for this disputed claim term is "fabricating a differential layer of conducting material only upon the first top electrode" and that "this step must come after the step of fabricating the first top electrode as it requires that the differential layer be formed 'upon the first top electrode.' " TriQuint argues that there is no "step of fabricating the first top electrode."

Avago seeks to add the word "only" into the claim term. The Court finds no reason for this addition. As TriQuint points out in its brief, some of the differential layer may be deposited onto the substrate during the fabrication process. The #647 patent teaches a fabrication method in which primary and differential layers are deposited in areas slightly larger than the ultimately desired electrodes, and then the excess strips are removed, (Doc. # 196–1, Ex. B at 5:33–6:17), and a fabrication method in which the primary layer is deposited on the substrate and then the differential layer is deposited in the general area to be occupied by the electrode, and then a masking and etching process is used to leave the desired two electrodes (*id.* at 6:38–49). Adding "only" to the disputed claim term would render the construction inaccurate. Avago argues that "only" is required to clarify that the differential layer is applied *only* to the first electrode, and not to the second electrode. The claim term clearly states "upon the first top electrode." The Court does not find it necessary to clarify that "first top electrode" does not mean "first top electrode *and* second top electrode."

***10** Finally, and as stated above, it is clear from the disputed claim term that the top first electrode exists prior to adding a differential layer. Contrary to Avago's proposed construction, the #647 patent does not explicitly include a prior step of "fabricating the top electrode." The patent requires "fabricating a substrate having a top and bottom surface and having a top electrode on the top surface." (*Id.* at 7:1–2.) Adding the implicit step "fabricating the first top electrode," as Avago proposes, would only add ambiguity to the disputed claim term and conflict with the patent specification.

Based on the foregoing, the Court finds that it is not necessary to construct the disputed claim term.

C. TriQuint's U.S. Patent No. 6,114,635

TriQuint acquired U.S. Patent No. 6,114,635, titled "Chip–Scale Electronic Component Package" (the "#635 patent"), through its acquisition of TFR. The #635 patent describes a compact package for an acoustic wave device located on a substrate or a die. The package includes a lid that covers part of the die, which is made of a "substantially nonconducting material," and provides space above the acoustic device so that it can deform or vibrate. The lid and the die are connected with "bonding strips" by "bonding material."

1. "substantially non-conducting material" (Claims 1–3 & 11)

The #635 patent calls for "a lid made out of substantially non-conducting material." (Doc. # 196–1, Ex. C at 4:14, 4: 36–37, 4:46–47, 5:24.) TriQuint's proposed construction for "substantially non-conducting material" is "a material with sufficient resistivity to prevent significant electrical conduction in areas between conducting structures at operating conditions (not limited to insulators)." Avago's proposed construction for this disputed claim term is "insulators (*e.g.,* sapphire or alumnia)."

As an initial matter, Avago's proposed construction conflates "substantially" with "not at all." "Substantially" is defined as "largely but not wholly that which is specified." MERRIAM–WEBSTER'S COLLEGIATE DICTIONARY 1174 (10th ed.1993). In its reply brief, Avago acknowledges that the term "substantially" by itself means "largely but not wholly that which is specified." (Doc. # 213–1 at p. 10 n. 9.) The patent specification supports this reading: "a lid [ ] made out of alumnia, sapphire or other suitable material." (*Id.* at 2:58–59 .) As TriQuint points out in its brief, alumnia and sapphire are insulators, but "other suitable material" leaves open the possibility of a lid made out of a non-insulating material, so long as that material is substantially non-conducting. The prosecution history confirms that "substantially non-conducting material" is not limited to insulators. (*See* Doc. # 196–3, Ex. 4 at p. 3) (referring to U.S. Patent No. 4,905,075 in which a lid made of substantially nonconducting material was made of a silicon wafer, a semiconducting material.) The Court finds that insulators form a subset of "substantially non-conducting materials," but the plain meaning of "substantially non-conducting materials" can include other materials, such as semiconductors.

***11** The Court also finds that those of ordinary skill in the art would not limit the disputed claim term to "insulators." However, TriQuint's proposed construction is not without issues. Avago speculates that the terms "sufficient" and "significant" in TriQuint's proposed construction will raise new construction claims, and the Court agrees. Accordingly, the Court construes the disputed claim term as "largely but not wholly non-conducting material."

2. "bonding strip" (Claims 1 & 11)

TriQuint's proposed construction for "bonding strip" is "strip where bonding material joins a portion of the lid to a portion of the die." Avago's proposed construction for this disputed claim term is "a strip, distinct from the die or lid itself, that has a given thickness and is capable of being bonded." The parties disagree as to whether the bonding strips must be separate and distinct from the die, the lid, and the bonding material.

The #635 patent provides that the bonding strip "may be used simply to provide a surface to which lid 6 is bonded." (Doc. # 196–1, Ex. C at 3:52–53.) The patent also provides that the bonding strip must be "electrically conducting" (*id.* at 2:64). Therefore, it must be distinct from the lid, which is made of "substantially non-conducting material" (*id.* at 4:46–47). TriQuint acknowledges that the bonding strip must be distinct, in that it is separately recognizable, from the die and the lid, but that the bonding strip, the lid and the die can be comprised of similar base material. TriQuint argues that the bonding strips and the bonding material (discussed below) are separately recognizable *at some point* during the manufacturing process, but not at all times.

The #635 patent provides that the bonding strips and the bonding material must have a thickness to "provide sufficient free space above the surface of the die." (*Id.* at 3:13–14.) Avago's proposed construction of "bonding strips" requires the bonding strips to have "a given thickness." However, the term "a given thickness" is nonspecific and unhelpful. The patent specification does not provide that each layer must have a characteristic, or given, thickness. The Court finds no reason to import a "given thickness" limitation into the claims.

Based on the foregoing, the Court construes the disputed claim term as "a separately recognizable strip where bonding material joins a portion of the lid to a portion of the die."

3. "bonding material" (Claims 1, 3, 8 & 11)

TriQuint's proposed construction for "bonding material" is "material that bonds together the bonding strips." Avago's proposed construction for this disputed claim term is "material, separate and distinct from the bonding strips, capable of bonding together the bonding strips and having a given thickness."

The patent specification provides that "bonding strip 5 on die 1 and bonding strip 8 on lid 6 are joined together in the package of this invention by a thin layer of bonding material 9." (Doc. # 196–1, Ex. C at 3:2–4.) The patent specification makes it clear that bonding material is distinct from the bonding strips; however, contrary to Avago's proposed construction, the bonding material does not need to have a different composition from the bonding strips. As TriQuint states in its brief, the preferred bonding material, a gold/tin alloy (*id.* at 3:4–5), can be used for both the bonding material and the bonding strips, and the separation between the bonding material and the bonding strips may not be observed in a final bonded package. During the *Markman* hearing, TriQuint argued that *at some point* in the manufacturing process the bonding material is separately recognizable from the bonding strips.

***12** As described above, the use of the phrase "a given thickness" in Avago's proposed construction is likely to cause confusion. The #635 patent provides that the bonding strips and the bonding material must have a thickness to "provide sufficient free space above the surface of the die." (*Id.* at 3:13–14.) That the bonding material has an observable thickness is made clear by the patent's description of the assembly of the invention. However, the patent specification does not provide that each layer must have a characteristic, or given, thickness. The Court finds no reason to import a "given thickness" limitation into the claims.

For the foregoing reasons, the Court construes the disputed claim term as "material that bonds together the bonding strips."

D. Avago's U.S. Patent No. 7,365,619

Avago is the owner by assignment of U.S. Patent No. 7,365,619, titled "BAW Apparatus" (the "#5,619 patent"). The #5,619 patent describes a method of reducing "non-linear" properties of BAW resonators used in communications filters. According to the #5,619 patent, the resonance frequency will shift upward and downward when a direct voltage is applied across the resonator, and this effect is referred to as the voltages coefficient of frequency effect or VCF effect. The #5,619 patent teaches that by subdividing a resonator into two separate resonators and connecting them in "antiparallel," the non-linear effects can be reduced.

1. "related to a common ground" (Claim 1)

Avago proposes that no construction is necessary, because "related to a common ground" is clear on its face. TriQuint's proposed construction for this disputed claim term is "using a shared terminal within the filter that electrically connects the reference voltages of the input and output signals to the device's ground voltage."

TriQuint argues the disputed claim term requires construction because "its meaning and limits are not plain to a layperson." (Doc. # 196 at p. 12.) However, the Court is required to construct claims in the manner in which a person of ordinary skill in the art would understand the disputed claim term. *See Phillips,* 415 F.3d at 1313 (stating that "the ordinary and customary meaning of a claim term is the meaning that the term would have to a person of ordinary skill in the art in question at the time of the invention"); *Dow Chem.,* 257 F.3d at 1372.

"Ground" is defined as "[a] conducting connection to a structure that serves a function similar to that of an earth ground." IEEE 100: THE AUTHORITATIVE DICTIONARY OF IEEE STANDARD TERMS 489 (7th ed.2000). Accordingly, "related to a common ground" means related to a common conducting connection to a structure. The patent specification provides: "Both signal input 102E (IN) and signal output 102A (OUT) relate to the common electrical ground 102G (GND)." (Doc. # 196–1, Ex. D at 6:25–26.) This specification refers to Figure 2, which provides an illustration of how the signals relate to the common electrical ground.

***13** As TriQuint notes in its brief, each system has only one ground voltage. However, TriQuint's proposed construction introduces concepts such as "shared terminal," "reference voltages," and ultimately refers back to "the device's ground voltage." Introducing these additional concepts into the disputed claim term would only require further construction. A person of ordinary skill in the art would understand "related to a common ground" to mean "related to a common electrical ground." Accordingly, the Court construes the disputed claim term as "related to a common electrical ground."

2. "antiparallel" (Claims 1 & 11)

"Antiparallel" was term coined by the inventors; therefore, the definition in the patent specification controls. *Edwards Lifesciences LLC v. Cook Inc.,* 582 F.3d 1322, 1329 (Fed.Cir.2009) (adopting a definition different from the ordinary meaning when "the patentee acted as his own lexicographer and clearly set forth a definition of the disputed claim term in either the specification or prosecution history") (quoting *CCS Fitness, Inc. v. Brunswick Corp.,* 288 F.3d 1359, 1366 (Fed.Cir.2002)). Avago's proposed construction for "antiparallel" is:

> the first electrode of the first resonator is electrically connected to the second electrode of the second resonator, and vice versa; where the first and second electrodes of a resonator are determined by the direction of polarization of the resonator. [4]

Avago argues that its proposed construction is supported by the definitions in the specification of the #5,619 patent.

TriQuint's proposed construction for this disputed claim term is "a parallel connection with mutually inverse polarization." TriQuint further proposes the claim term be constructed as follows:

> A parallel connection means that the resonators are connected between two common points in the circuit, but along different branches.
>
> Mutually inverse polarization requires a connection such that (a) the electric field applied to the first area of piezoelectric layer is in the same direction as the polarization of first area, and (b) the electric field applied to the second area is in the opposite direction of the polarization of the second area. [5]

TriQuint defines "polarization" in the claim construction below. TriQuint's proposed construction is derived from the patent specification, which provides "the present invention is based on the findings that harmonic waves of the two BAW resonators mutually reduce one other and ... cancel one other out because of the antiparallel connection, *i.e.,* their parallel connection with mutually inverse polarization." (Doc. # 196–1, Ex. D at 3:25–29.) Avago argues that this phrase was not intended to provide a substantive definition of "antiparallel," which is evidenced by TriQuint's need to further define terms in its own construction. Avago also argues that TriQuint's proposed construction departs from the patent specification and improperly relies on extrinsic evidence.

***14** The patent specification describes the antiparallel connection of the BAW resonators, depicted by Figure 2 of the #5,619 patent, as the exchange of the first electrode of a second BAW resonator with the first electrode of a first BAW resonator; thus, *"first electrode* 84T, 90T, 96T *of first BAW resonator* 84, 90, 96 of BAW apparatus 82, 88, 94 *is electrically connected to second electrode* 86B, 92B, 98B *of second BAW resonator* 86, 92, 98 of BAW apparatus 82, 88, 94, and vice versa." (Doc. # 196–1, Ex. D at 6:31–45) (emphasis added). The patent specification also describes, with reference to Figure 1, a BAW resonator pair connected antiparallel as:

> The only thing that is essential for the inventive BAW apparatus and/or antiparallel connections of the two BAW resonators 72, 74 is that *the polarizations* 72R, 74R *of the two BAW resonators* 72, 74 *have the same direction with regard to the first electrode* 72T, 74T *and the second electrode* 72B, 74B. Alternatively, for example, the polarization of both BAW resonators 72, 74 may also be pointing in the direction from the second electrode 72B, 74B to the first electrode 72T, 74T.

(*Id.* at 5:32–39) (emphasis added). The Court finds Avago's proposed construction is consistent with the patent specification.

Avago revised its proposed construction of the disputed claim term so that it no longer requires the resonators to be on opposing surfaces of a piezoelectric layer. TriQuint argued that the use of "the piezoelectric layer" in Avago's proposed construction rendered the term "common piezo layer" in claim 1 superfluous is without merit. Based on Avago's revised construction, the Court does not have to resolve this dispute. Avago's description of the first BAW resonator and second BAW resonator connected antiparallel does not conflict with the second part of claim 1 stating that the resonators comprise a common piezo layer, nor does it conflict with claim 11, which does not explicitly require a "common piezo layer."

Based on the foregoing, the Court construes "antiparallel" as:

> The first electrode of the first resonator is electrically connected to the second electrode of the second resonator, and vice versa; where the first and second electrodes of a resonator are determined by the direction of polarization of the resonator.

3. "a polarization of the common piezo layer in the first area and a polarization of the common piezo layer in the second area are unidirectional" (Claim 1)

The parties have stipulated that "unidirectional" means "in the same absolute direction," and "common piezo layer" means "a shared layer of piezoelectric material." (*See* Doc. # 209 at p. 2.) With respect to the disputed claim term, Avago proposes that no construction is necessary, because "a polarization of the common piezo layer in the first area and a polarization of the common piezo layer in the second area are unidirectional" is clear on its face. TriQuint's proposed construction for this disputed claim term is:

> ***15** absent application of an electric field, the first and second areas of the piezoelectric layer exhibit significant net electric dipole moments that point in the same direction. An electric dipole moment is a value representing the nonuniform distribution of positive and negative electrical charges within a material. [6]

TriQuint's proposed construction of the disputed claim term focuses on the physics of polarization, which is a level of detail Avago contends is not necessary to understand the invention. Avago argues that it is the direction of the polarization that is relevant to understanding of the invention, not the physics or the process by which material is polarized. The Court agrees, and finds that TriQuint's proposed construction with "net electric dipole moments" and "non-uniform distribution" of electrical charges serves to obfuscate meaning of the disputed claim term.

The #5,619 patent uses polarization as a directional concept. (Doc. # 196–1, Ex. D at 5:28–32.) The patent specification states that polarization is a property "impressed upon the BAW resonator during manufacturing." (*Id.* at 1:54–56.) The patent specification also states that the BAW resonators exhibit electric polarization, and "[t]he direction of mechanical deformation, expansion or contraction, of the BAW resonator depends on the direction of the electric field applied to first electrode T and second electrode B and on the direction of polarization of BAW resonator 30." (*Id.* at 1:59–64.) According to the #5,619 patent, "if the polarization of the BAW resonator and the direction of the electric field are pointing in the same direction, BAW resonator 30 contracts, whereas BAW resonator

30 expands when the polarization of BAW resonator 30 and the direction of the electric field are pointing in the opposite direction." (*Id.* at 1:64–2:2.)

Avago argues that the effect of the polarization on the resonator (expansion or contraction) is the important concept with regard to the invention, not the physics describing polarization. The Court does not find it necessary to define polarization in the manner proposed by TriQuint in order to construct how polarization is used in the disputed claim term. Further, the Court finds a person of ordinary skill in the art, *see Texas Digital,* 308 F.3d at 1202, understands the meaning of polarization as it relates to the distribution of positive and negative electrical charges.

Applying the stipulated terms, the Court constructs the disputed claim term as "a polarization of the shared layer of piezoelectric material in the first area and a polarization of the shared layer of piezoelectric material in the second area are in the same absolute direction."

4. "exhibit substantially identical shifts in terms of the amount and direction of the resonance frequency due to a Voltages Coefficient of Frequency (VCF) effect" (Claims 3 & 13)

Avago proposes that no construction is necessary, because "exhibit substantially identical shifts in terms of the amount and directions of the resonance frequency due to a Voltages Coefficient of Frequency (VCF) effect" is clear on its face. Alternatively, Avago proposes the disputed claim term means "exhibit substantially identical shifts in terms of the amount and direction of the resonance frequency due to a Voltages Coefficient of Frequency (VCF) effect, *i.e.,* changes in the resonance frequency when the direct voltages varies, or is swept, within a range from negative to positive voltages." TriQuint's proposed construction for this disputed claim term is "during the operation of the BAW filter, the voltages applied to the first and second resonators cause the resonant frequencies of those resonators to simultaneously shift in the same direction by insignificantly different amounts due to something called the Voltages Coefficient of Frequency effect." TriQuint argues that the term "due to a Voltages Coefficient of Frequency effect" is indefinite because there is no way to tell when a resonance frequency shift is "due to a VCF effect" or due to some other cause.

***16** As stated above, a court should declare a claim term indefinite "[o]nly when a claim remains insolubly ambiguous without a discernable meaning after all reasonable attempts at construction." *Metabolite,* 370 F.3d at 1366. Contrary to TriQuint's assertion, the VCF effect is not insolubly ambiguous. The term is explained in the patent specification:

> It has been proven that the resonance frequency changes upward and downward in an almost linear manner, while the direct voltage varies, or is swept, within a wide range from high negative voltages to high positive voltages. This effect is referred to as VCF effect (VCF = voltages coefficient of frequency)

(Doc. # 196–1, Ex. D at 3:53–58.) Avago's proposed construction takes into account this explanation of the VCF effect. TriQuint argues that the #5,619 patent does not explain how to distinguish between frequency shifts caused by the VCF effect and frequency shifts caused by other factors. However, the patent specification makes it clear that the VCF effect occurs when direct voltage varies across a resonator. Accordingly, the Court finds the term "VCF effect" is capable of construction.

TriQuint's proposed construction, notwithstanding its argument that the claim term is indefinite, contains limitations not found in the plain language of claims 3 and 13. Specifically, TriQuint reads into the claim term that the shifts occur "during the operation of the BAW filter." This limitation is unnecessary. The patent specification explains that the VCF effect occurs when direct voltage is applied to the resonator. TriQuint also seeks to add the limitation that shifts in resonator frequency occur "simultaneously ." There is nothing in the #5,619 patent requiring the shifts to occur simultaneously. Finally, TriQuint seeks to introduce the concept that the resonators shift in the same direction "by insignificantly different amounts." This phrase is in lieu of the claim term's "substantially identical shifts." The Court finds no reason to redefine a phrase that is already clear.

For the foregoing reasons, the Court construes the disputed claim term as "exhibit substantially identical shifts in terms of the amount and direction of the resonance frequency due to a Voltages Coefficient of

Frequency (VCF) effect, *i.e.,* changes in the resonance frequency when the direct voltage varies, or is swept, within a wide range from high negative voltages to high positive voltages."

5. "architecture" (Claims 6 & 16)

Avago proposes that no construction is necessary, because "architecture" is clear on its face. Alternatively, Avago proposes the disputed claim term means "the number, composition, and order of layers in the resonator." TriQuint's proposed construction for this disputed claim term is "the overlap of piezoelectric layer and the top and bottom electrodes is substantially identical in geometric shape and size in both resonators, and the composition and thickness of each layer is the same in both resonators."

***17** Claims 6 and 16 require the two BAW resonators to be "substantially identical in architecture." The term "architecture" is used only once outside of claims 6 and 16 where the patent specification provides that "[p]referably, BAW resonators 72, 74 having the same architecture are used for an inventive BAW apparatus." (Doc. # 196–1, Ex. D at 5:59–61.)

TriQuint points out that Avago's alternate proposed construction (considering number, composition and order of layers) makes sense if only the side view of the resonators is taken into account. However, because resonators are three-dimensional objects, the size and shape of the resonators must be considered in addition to the layer structure. This is supported by the prosecution history of the #5,619 patent, in which the patent examiner stated, "the BAW resonators have the same architecture because they are made of the same materials, have the same size electrodes and the same thickness of electrode layers and piezoelectric layers." (Doc. # 196–3, Ex. 11 at p. 4–5) (parentheticals omitted). For the foregoing reasons, the Court construes the term "architecture" as "the number, composition, size, shape, and order of layers in the resonator."

E. Avago's U.S. Patent No. 7,268,436

Avago is the owner by assignment of U.S. Patent No. 7,268,436, titled "Electronic Device with Cavity and a Method for Producing the Same" (the "#436 patent"). The #436 patent describes an acoustic wave filter device in a compact package that includes a semiconductor chip with the filter itself, a cavity frame positioned on top of the chip, and a cavity cover on top of the frame. Because the cavity frame on the semiconductor chip surrounds the region of the circuit structure, the device can be reduced in size.

1. "wherein the bonding connections of the contact areas and the inner areas of external contacts each include a bonding arc" (Claim 1)

Avago proposes that no construction is necessary, because "wherein the bonding connections of the contact areas and the inner areas of external contacts each include a bonding arc" is clear on its face. Alternatively, Avago proposes the disputed claim term means "wherein each connection between the contact areas and the inner areas of external contacts includes a bonding arc." TriQuint's proposed construction for this disputed claim term is "each connection between the bond wire and a contact area or inner area of external contact includes a bonding arc. In other words, there is a bonding arc at each end of the bonding wire."

The parties' disagreement concerns whether there is a "bonding arc" at each connection area, or whether there is a single bonding arc in the connection of two areas. The first interpretation (TriQuint's) does not permit the use of thermocompression heads in the bond wire; whereas, the second interpretation (Avago's) permits a thermocompression head at one end of the bond wire and a bonding arc at the other end of the bond wire. The plain meaning of the disputed claim term is unclear: "each" could refer to each connection area (requiring a bonding arc at each connection area), or "each" could refer more generally to each bonding connection between two connection areas (requiring only one bonding arc).

***18** Figure 1 of the #436 patent is unsupportable under TriQuint's proposed construction of the disputed claim term, because this depiction of the electronic device shows a thermocompression head at the contact area, and a bonding arc at the inner area of the external contact. TriQuint's proposed construction of the disputed claim term only supports the depiction of the electronic device in Figure 2 of the #436 patent, in which there are two bonding arcs in the bond wire. However, Avago's proposed construction supports the depiction of the invention in both Figure 1 and Figure 2. Where the proposed embodiments of the invention permit Avago's broader construction of the disputed claim terms, and the claims do not explicitly exclude both embodiments, the Court will not limit unnecessarily the invention.

The patent specification also supports Avago's proposed construction of the disputed claim term: "The contact areas 12 can be connected via thermocompression head 24 and bonding wires 22 to a bondable coating 25 on inner areas 13 of the external contacts 14. *The entire bonding connection 11 can be embedded* in the plastics housing composition 18." (Doc. # 196–1, Ex. E at 4:46–50) (emphasis added). Based on the Figures and the patent specification, a "bonding connection" does not refer to each point where the bond wire is connected to a connection site. Rather, a bonding connection has three components: (1) a bond at a contact area; (2) a bond wire; and (3) a bond at the inner area of an external contact. The disputed claim term requires only that each bonding connection have a bonding arc. The #436 patent clearly permits thermocompression heads at a connection site, provided that the other connection site has a bonding arc, and the plain language of the disputed claim term can be constructed to support this interpretation.

TriQuint directs the Court to the patent examiner's original rejection of certain claims. (*See e.g.,* Doc. # 196–3, Ex. 17 & 18.) However, as Avago discusses in its reply brief, the patent examiner's rejection of certain claims concerned a patent reference unrelated to the types of bonds formed at the connection sites. (Doc. # 213–1 at p. 17.) The Court does not find the prosecution history to be elucidating in construing the disputed claim term.

Based on the foregoing, the Court adopts Avago's understanding of "wherein the bonding connections of the contact areas and the inner areas of external contacts each include a bonding arc." The Court construes the disputed claim term as "wherein each bonding connection formed between the contact areas and the inner area of external contacts includes a bonding arc."

2. "bonding connections" (Claim 1)

Avago proposes that no construction is necessary, because "bonding connections" is clear on its face. Alternatively, Avago proposes the disputed claim term means "a connection that bonds two elements." TriQuint argues the construction of the disputed claim term is apparent from the construction of the claim term above: a connection between the bond wire and a contact area.

***19** Based on the Court's construction of the disputed claim term above, the Court finds that "bonding connections" are formed by a bond wire between the contact areas and the inner areas of external contacts of an electronic device. The Court does not find support in the #436 patent for TriQuint's proposed construction without reading out certain preferred embodiments of the invention. Accordingly, the Court construes the disputed claim term as "a connection that bonds two elements."

3. "bonding arc" (Claim 1)

Avago's proposed construction for "bonding arc" is "a bond formed at least partially by mechanical deformation of a portion of the bond wire, on its side, against the contact area/inner area of external contact." TriQuint's proposed construction for this disputed claim term is "a bonding connection formed by bonding the side of the bond wire to a contact area/inner area of external contact, forming an arc-like shape." TriQuint also proposes the disputed claim term be constructed to provide that: "A 'bonding arc' does not include a 'thermocompression head' or ball bond."

Avago argues that while a bonding arc is distinguishable from a thermocompression head, the patent specification does not require the bonding arc to have any particular shape or geometry. The Court disagrees. TriQuint's proposed construction states the bond wire forms an "arc-like shape." The Court does not think this is an additional limitation on the disputed claim term. The particular shape or geometry, "an arc-like shape," is implicit in the claim term "bonding *arc."* The Figures in the #436 patent depicting the electronic device support a construction that requires a bonding arc to be in the shape of an arc.

For the foregoing reasons, the Court construes the disputed claim term as "a bond formed by bonding the side of a bond wire to a contact area/inner area of external contact, forming an arc-like shape."

F. Avago's U.S. Patent No. 6,841,922

Avago is the owner by assignment of U.S. Patent No. 6,841,922, titled "Piezoelectric Resonator Apparatus with Acoustic Reflector" (the "#922 patent"). To reflect leaked sound waves at the operating frequency back into the piezoelectric layer, the thickness of the layers of the acoustic mirror should be¼ the acoustic wavelength of the BAW resonator's operating frequency. This thickness is known as #/4 thickness or¼ lambda thickness. The #922 patent describes how to construct an acoustic mirror with non-#/4 thick layers that is capable of reflecting the sound waves.

1. "due to technological limitations in the manufacturing of this layer" (Claim 1)

Avago proposes that no construction is necessary, because "due to technological limitations in the manufacturing of this layer" is clear on its face. TriQuint's proposed construction for this disputed claim term is "the layer is manufactured at a thickness different from¼ of the wavelength in this layer at the operating frequency because technological limitations make it difficult to manufacture the layer at a thickness of¼ of the wavelength." [7]

***20** The claim term plainly states layers are "set different from a quarter of the acoustic wavelength" due to "limitations" in technology, and not due to an inability of technology. The patent specification supports a plain reading of the claim term, and provides that realization of the¼ wavelength thickness *"may be* problematic for technological reasons," and "[m]etal layers with such thickness can be realized technologically *only with difficulty."* (Doc. # 196–1, Ex. I at 2:21, 30–33) (emphasis added).

The disputed claim term explicitly provides that the technological limitations relate to the *manufacturing* of this layer. TriQuint argues that Avago deems non-manufacturing processes, such as parasitic capacitances and different temperature coefficients of the layers, to be technological limitations referred to in the claim. Because the disputed claim term plainly states that the technological limitations relate to the manufacturing of the layer, the Court agrees with TriQuint's line of reasoning. However, the manufacturing limitation (as opposed to operational limitations) is explicit in the claim, and it is not necessary to read extraneous manufacturing-related limitations into the disputed claim term.

A person having ordinary skill in the art would understand the disputed claim term to mean that the technological limitations in the manufacturing process referred to in the #922 patent make #/4 thick layers difficult to manufacture, but not impossible to manufacture. Accordingly, the Court gives "due to technological limitations in the manufacturing of this layer" its plain and ordinary meaning.

2. "the other layer" (Claims 1–3)

Avago proposes that no construction is necessary, because "the other layer" is clear on its face. TriQuint proposes that "the other layer" is insolubly ambiguous and renders the claim indefinite, because it lacks antecedent basis.

The #922 patent describes "an acoustic reflector comprising a sequence of stacked layers having alternating high and low acoustic impedance." (Doc. # 196–1, Ex. I at 6:13–15.) Therefore, where one layer has a high acoustic impedance, *the other layer* has a low acoustic impedance. This sequence can repeat to create a stack of layers, or as the patent describes "a plurality of layers." It is clear that, because each layer alternates in terms of high or low impedance, the reference to "the other layer" refers to the next layer in the stack having the opposite impedance (*high v. low*) as the previous layer (*low v. high*). For example, Claim 3 of the #922 patent provides "wherein the one layer is the layer having a low acoustic impedance, and wherein the other layer is the layer having a high acoustic impedance." (*Id.* at 6:32–35.) The Court does not find this disputed claim term is insolubly ambiguous as TriQuint proposes. The claim term "the other layer" is clear on its face and does not need to be construed by the Court.

3. "the acoustic reflector is a plurality of layers having a high acoustic impedance and comprises a plurality of layers having a low acoustic impedance" (Claim 4)

***21** Avago proposes that no construction is necessary, because "the acoustic reflector is a plurality of layers having a high acoustic impedance and comprises a plurality of layers having a low acoustic impedance" is clear, because the use of "is" and "comprises" is an obvious typographical error. Alternatively, Avago proposes the disputed claim term means "the acoustic reflector comprises a plurality of layers having a high acoustic impedance and a plurality of layers having a low acoustic impedance." TriQuint proposes that the disputed claim term is unconstruable and must be struck down as indefinite, because the acoustic reflector cannot be (consist of) layers having high acoustic impedance, and also comprise layers with low acoustic impedance.

TriQuint asks the Court to find the disputed claim term is indefinite due to the use of "is" and "comprises" in the same sentence. TriQuint argues that it is not an obvious typographical error, and that Avago is stuck with any purported drafting errors in a patent. *See Chef Am., Inc. v. Lamb–Weston, Inc.,* 358 F.3d 1371, 1374 (Fed.Cir.2004) ("Thus, in accord with our settled practice we construe the claim as written, not as the patentees wish they had written it. As written, the claim unambiguously requires that the dough be heated to a temperature range of 400° F. to 850° F ."). However, the Court finds the word "is" used in the context of the disputed claim term is synonymous with the term "comprises." The use of "is" and "comprises" is not insolubly ambiguous. Accordingly, the disputed claim term is not indefinite, because the meaning discernible after a reasonable attempt at construction. *See Metabolite,* 370 F.3d at 1366.

The patent specification makes it clear that the acoustic reflector is made up of a "sequence of stacked layers having alternating low and high impedance." (Doc. # 196–1, Ex. I at 3:14–15.) Claim 1 of the #922 patent similarly states that the resonator apparatus is comprised of "an acoustic reflector comprising a sequence of stacked layers having alternating low and high acoustic impedance." (*Id.* at 6:13–15.) The Court construes this disputed claim term as "the acoustic reflector comprises a plurality of layers having a high acoustic impedance and a plurality of layers having a low acoustic impedance."

G. Avago's U.S. Patent No. 6,933,807

Avago is the owner by assignment of U.S. Patent No. 6,933,807, titled "Acoustic Reflector for a BAW Resonator Providing Specified Reflection of Both Shear Waves and Longitudinal Waves" (the "#807 patent"). The #807 patent teaches reducing a BAW resonator's energy loss by building an acoustic mirror that reflects both shear and longitudinal waves back into the piezoelectric mirror. The #807 patent describes the proper materials, number of layers, and thickness of layers to make an acoustic mirror that minimizes longitudinal and shear waves.

1. "wherein the performance of the acoustic reflector is determined by its reflectivity for a longitudinal wave existing in the BAW resonator at the resonance frequency of the BAW resonator and by its reflectivity for a shear wave existing in the BAW resonator at the resonance frequency of the BAW resonator" (Claims 1 & 10)

***22** Avago proposes that no construction is necessary, because the following disputed claim term is clear:

> [W]herein the performance of the acoustic reflector is determined by its reflectivity for a longitudinal wave existing in the BAW resonator at the resonance frequency of the BAW resonator and by its reflectivity for a shear wave existing in the BAW resonator at the resonance frequency of the BAW resonator.

TriQuint proposes that the disputed claim term is unconstruable and must be declared invalid, because the "wherein the performance" limitation is fatally indefinite.

As stated throughout this Order, courts should not determine a claim to be indefinite without first making a reasonable attempt at construction. *Metabolite,* 370 F.3d at 1366. Avago's brief offers no elucidation on the proper construction of the claim term. Rather, Avago directs the Court to the patent specification, in which the disputed claim term appears verbatim, and without further elaboration. (Doc. # 196–1, Ex. F at 6:23–28.)

TriQuint argues that the claim is indefinite, because it is unclear how and when the limitation is satisfied. The Court agrees. The disputed claim term appears as a limitation, set apart from other clauses of claims 1 and 10; however, the claim term states that the performance of the acoustic reflector is determined by longitudinal and shear wave reflectivity at the acoustic resonator's resonance frequency. This claim term does not add to the invention, or describe the construction or functionality of the invention. Further, the claim term does not describe how, when or what happens as a result of its reflectivity of longitudinal and shear waves in the claimed invention.

Similar to the analysis of whether a preamble is limiting, *Biolitec,* 618 F.3d at 1358–59 (considering whether deletion of the preamble phrase affects the structure or steps of the claimed invention), deletion of the disputed claim term from claims 1 and 10 does not affect the remaining terms, claims or invention.

Accordingly, the Court finds the disputed claim term is indefinite and incapable of construction. The disputed claim term is invalid and must not be considered in determining whether the #807 patent has been infringed.

2. "performance of the acoustic reflector" (Claims 1 & 10)

Avago's proposed construction for "performance of the acoustic reflector" is "the acoustic reflector's reflectivity of both the longitudinal and shear waves at the resonance frequency of the resonator." TriQuint proposes that the disputed claim term is indefinite.

Avago directs the Court to the patent specification for a definition of the "performance of the acoustic reflector":

> [W]herein the performance of the acoustic reflector is determined by its reflectivity for a longitudinal wave existing in the BAW resonator at the resonance frequency of the BAW resonator and by its reflectivity for a shear wave existing in the BAW resonator at the resonance frequency of the BAW resonator.

***23** (Doc. # 196–1, Ex. F at 6:23–28.) Although the Court agrees that Avago's proposed construction is the correct construction for the disputed claim term, the Court has already determined, in Section III(G)(1) of this Order, that the disputed claim term embodying the construction of "performance of the acoustic resonator" is fatally indefinite.

Therefore, to the extent the disputed claim term is required to determine whether the #807 patent has been infringed, the Court construes the disputed claim term as "the reflectivity for a longitudinal wave existing in the BAW resonator at the resonance frequency of the BAW resonator and the reflectivity for a shear wave existing in the BAW resonator at the resonance frequency of the BAW resonator." However, the Court's construction of "performance of the acoustic reflector" does not alter the Court's earlier conclusion that the disputed claim term that embodies this construction is indefinite, and must be excluded from claims 1 and 10 of the #807 patent.

3. "wherein areas with layers with high acoustic impedance and areas with layers with low acoustic impedance are alternately adjacently disposed" (Claims 1 & 10)

Avago proposes that "wherein the areas with layers with high acoustic impedance and areas with layers with low acoustic impedance are alternately adjacently disposed" should be constructed to provide that " 'areas' includes a layer having a characteristic acoustic impedance (high or low) along with any connected thin intermediate layers." TriQuint's proposed construction for this disputed claim term is that " 'areas' includes a layer having a characteristic acoustic impedance (high or low) along with any connected thin intermediate layers that do not need to be taken into account acoustically." The parties agree that "areas" can include "connected thin intermediate layers," but disagree as to whether these intermediate layers may be taken into account acoustically.

In each of their briefs, the parties draw the Court's attention to the same description of the connected thin intermediate layers in the patent specification:

> With respect to the electrode materials ... single layer electrodes or other combinations of materials with high acoustic impedance and materials with low acoustic impedance may also be used. Furthermore, it is to be understood that between the layers there may also be thin intermediate layers, as they are conventional in semiconductor technology for priming, as seed layers, or as etch stop. These have not been mentioned here, because *they are typically so thin they do not have to be taken into account acoustically.*

(Doc. # 196–1, Ex. F at 10:41–52) (emphasis added). Avago argues that although the thin intermediate layers are "typically" so thin they do not have to be taken into account, typically does not mean these layers are *never* taken into account acoustically. TriQuint argues to the contrary. According to TriQuint, the disputed claim term means the thin intermediate layers do not have to taken into account acoustically. TriQuint ignores the word "typically" in the patent specification, and takes the position that the thin intermediate layers "must be thin enough to be acoustically insignificant." (Doc. # 196 at p. 31.)

***24** The Court finds TriQuint's proposed construction of the disputed claim term goes too far in stating that the thin intermediate layers do not need to be taken into account acoustically. While the thin intermediate layers "typically" do not need to be taken into account, the patent does not state they are *never* taken into account acoustically. TriQuint's limitation contradicts the patent specification.

Accordingly, the Court construes the disputed claim term as "wherein areas with layers with high acoustic impedance and areas with layers with low acoustic impedance are alternately adjacently disposed, with the term 'areas' including a layer having a characteristic acoustic impedance (high or low) along with any connected thin intermediate layers."

4. wherein the layers of the acoustic reflector and layers disposed between the acoustic reflector and the piezoelectric layer are selected, with reference to their number, material, and thickness, such that the transmissivity for the longitudinal wave and the transmissivity for the shear wave in the area of the resonance frequency is smaller than –10 dB" (Claims 1 & 10)

Avago proposes that no construction is necessary, because the following disputed claim term is clear:

> [W]herein the layers of the acoustic reflector and layers disposed between the acoustic reflector and piezoelectric layer are selected with reference to their number, material, and thickness, such that the transmissivity for the longitudinal wave and the transmissivity for the shear wave in the area of the resonance frequency is smaller than –10 dB.

Avago also proposes an addition to the disputed claim term's plain meaning:

> With the understanding that the layers need not all be selected for the specific purpose of achieving (a) a transmissivity for the longitudinal wave in the area of the resonance frequency of less than –10dB and (b) a transmissivity for the shear wave in the area of the resonance frequency of less than –10 dB.

TriQuint's proposed construction for this disputed claim term is:

> [T]he number, the material and the thickness of the layers of the acoustic reflector and the number, the material and the thickness of the layers between the acoustic reflector and the piezoelectric layer must all be selected for the specific purposes of achieving (a) a transmissivity for the longitudinal wave in the area of the resonance frequency of less than –10 dB and (b) a transmissivity for the hear wave in the area of the resonance frequency of less than –10dB, and must achieve those effects.

The parties main disagreement concerns whether the layers "need not all," as Avago proposes, or "must all," as TriQuint proposes, be selected for the two specific purposes outlined in the proposed claim constructions. TriQuint argues that the phrasing "are selected ... such that" indicates that the selection of layers must be designed to achieve the transmissivity result specified in the disputed claim term. The Court agrees with TriQuint that some design intent is required, because the inventors included the phrase "are selected with reference to their number, material and thickness" in claims 1 and 10 of the # 807 patent. This phrase emphasizes how the BAW resonator is constructed to achieve longitudinal and shear wave transmissivities of less than –10dB.

***25** Throughout its brief and reply, Avago argues that intent to infringe is irrelevant, and that it is improper to construe a claim to require a design intent. This is incorrect. First, Avago conflates an intent to infringe with an intent to assemble an invention in a certain manner or an intent to select certain materials. Second, intent may be an element of a claim when a claim reflects a design purpose, and that purpose is treated as a limitation of the claim. *Jansen v. Rexall Sundown, Inc.,* 342 F.3d 1329 (Fed.Cir.2003) ("[The preamble] is a statement of the intentional purpose for which the method must be performed."); *Koito Mfg. Co. v. Turn–Key–Tech, LLC,* 381 F.3d 1142, 1150 n. 2 (Fed.Cir.2004) (constructing the term "predetermined general direction," and finding that the "designer must be aware of the flow direction that will result upon an injection of plastic so that he can assure himself that the next flow direction will be different ."). While intent may not be automatically imputed into claims, an applicant is not prevented from include an intent element in the claims. *See Paragon Solutions, LLC v. Timex Corp.,* 566 F.3d 1075, 1091 (Fed.Cir.2009) ("Absent an express limitation to the contrary, any use of a device that meets all of the limitations of an apparatus claim written in structural terms infringes that apparatus claim.").

Contrary to Avago's proposed construction that "the layers need not all" be selected with the specific purposes in mind, the disputed claim term states *"the layers* of the acoustic reflector and *layers* disposed between the acoustic reflector and the piezoelectric layer." As TriQuint points out, the disputed claim term does not state "some of the layers" or "most of the layers." The disputed claim term states *"the* layers," which implies *all* of the layers. This understanding of the disputed claim term is confirmed by the patent specification in which "all layers below the piezoelectric layer ... are to be taken into account in their effect as acoustic reflector," (*id.* at 4:28–31), and " 'reflectivity' can only be associated with the entirety of all layers lying beneath the piezoelectric layer" (*id .* at 4:35–37).

TriQuint also directs the Court's attention to the portions of the patent specification, where the specific numbers, materials, and thicknesses of the layers are described in detail. (Doc. # 196–1, Ex. F at 8:4–27, 9:58–66, 10:20–30.) The specification of the material and thickness of the individual layers and the number of the individual layers supports TriQuint's proposed construction that all the layers are selected to achieve the desired transmissivity.

Avago argues that the patent does not require "that each layer individually must be selected with the intent of achieving the desired transmissivity." (Doc. # 197 at p. 40.) The Court agrees. However, TriQuint's proposed construction does not require *each* layer individually be selected to achieve the desired result. Rather, TriQuint's proposed construction requires that each layer is selected such that, when combined or stacked, the layers achieve the desired transmissivity. The patent specification discloses the number material and thickness of each layer in order to achieve the desired transmissivity. This, of course, does not mean the layers cannot be selected for, or achieve, other results.

***26** For the foregoing reasons, the Court construes the disputed claim term as:

> The number, the material and the thickness of the layers of the acoustic reflector and the layers between the acoustic reflector and the piezoelectric layer must all be selected for the specific purpose of achieving (a) the transmissivity for the longitudinal wave in the area of the resonance frequency of less than –10dB, and (b) the transmissivity for the shear wave in the area of the resonance frequency of less than –10dB.

5. "layers of the acoustic resonator are selected such that the BAW resonator has an unambiguous and desired dispersion performance" (Claim 4)

Avago proposes that no construction is necessary, because "layers of the acoustic resonator are selected such that the BAW resonator has an unambiguous and desired dispersion performance" is clear "with the understanding that the layers of the acoustic resonator need not be selected for the specific purpose of achieving an 'unambiguous and desired dispersion performance' for the BAW resonator." TriQuint's proposed construction for this disputed claim term is "the layers of the acoustic resonator must each be selected for the specific purpose of achieving a predetermined and unambiguous dispersion performance for the BAW resonator and have that effect."

The parties' disagreement over the construction of this disputed claim term is similar to their disagreement over the prior disputed claim term. Specifically, TriQuint argues that each layer must be selected for the specific purpose set forth in the claim term, and Avago argues that the layers do not need to be selected for the specific purpose. Again, the phrase "are selected such that" is at the core of the parties' disagreement.

Avago's proposed construction conflicts with the plain meaning of the disputed claim term. Avago proposes that "the layers of the acoustic resonator *need not be selected* for the specific purpose of achieving an 'unambiguous and desired dispersion performance' for the BAW resonator." However, the claim term explicitly states that the layers *"are selected"* to achieve the specified result. The Court finds Avago's proposed construction is inconsistent with the plain meaning of the disputed claim term.

Avago argues that *each and every* layer does not need to be selected for the specified result. The Court disagrees. The disputed claim term states "the layers," not "some of the layers" or "most of the layers." As stated above, the use of *"the* layers" in the disputed claim term implies *all* of the layers. Similar to the Court's discussion of the disputed claim term above, even though all of the layers are selected for a specific result, that does not mean the layers cannot be selected for, or achieve, other results, as well.

For the foregoing reasons, the Court construes the disputed claim term as "the layers of the acoustic resonator must all be selected for the specific purpose of achieving an unambiguous and desired dispersion performance."

6. "unambiguous and desired dispersion performance" (Claim 4)

***27** Avago's proposed construction for "unambiguous and desired dispersion performance" is "the first shear harmonic wave and the longitudinal main resonance are separated by at least a bandwidth of the resonator." TriQuint's proposed construction for this disputed claim term is "the layers are selected such that the first shear harmonic wave and the longitudinal main resonance of the BAW resonator are separated by at least the bandwidth of the longitudinal resonance." TriQuint's proposed construction reads into this disputed claim term the limitations of the prior disputed claim term: that the layers "are selected such that ...." It is not necessary to construe this disputed claim term with this extraneous limitation, because the Court has addressed the issue in the preceding claim construction.

The patent specification provides that "unambiguous and desired dispersion performance" occurs when "the distance between the longitudinal main resonance and the first shear harmonic wave is greater than a bandwidth of the resonator, preferably greater than the bandwidth of the longitudinal main resonance of the resonator." (Doc. # 196–1, Ex. F at 6:52–56.) A subsequent definition in the patent specification describes the unambiguous and desired dispersion performance as "the frequency distance of first shear harmonic wave and longitudinal main resonance is greater than the bandwidth of the longitudinal main resonance." (*Id.* at 9:47–51 .)

The parties' proposed constructions reflect the definition in the patent specification. However, TriQuint requires that the bandwidth distance be at least the distance of the bandwidth of the longitudinal resonance. The patent specification initially states that this bandwidth is "preferable," and the subsequent definition describes the bandwidth as greater than that of the longitudinal main resonance. The Court will apply the less specific definition in constructing the disputed claim term. *See Teleflex,* 299 F.3d at 1326 (citing *Comark Commc'ns,* 156 F.3d at 1186). Accordingly, the Court construes the disputed claim term as "the first shear harmonic wave and the longitudinal main resonance of the BAW resonator are separated by at least a bandwidth of the resonator ."

7. "[layers] are selected such that the distance between the longitudinal main resonance and the first shear harmonic wave is greater than the bandwidth of the longitudinal main resonance of the resonator" (Claim 6)

Avago proposes that no construction is necessary, because "[layers] are selected such that the distance between the longitudinal main resonance and the first shear harmonic wave is greater than the bandwidth of the longitudinal main resonance of the resonator" is clear. TriQuint's proposed construction for this disputed claim term is "the layers of the acoustic resonator must each be selected for the specific purpose of achieving a distance between the longitudinal main resonance and the first shear harmonic wave that is greater than the bandwidth of the longitudinal main resonance of the resonator and have that effect."

***28** Again, the parties' disagreement concerns whether there is an element of intent in the phrase "are selected such that...." However, this time Avago argues that the disputed claim term is clear and does not require construction, rather than arguing, as it does in prior constructions, that the phrase "are selected such that" does not require each layer to be selected with the specific purpose in mind.

The Court agrees with TriQuint's construction that the layers are *selected* for the purpose of achieving a specific result, namely a certain distance between the longitudinal main resonance and the first shear harmonic wave. Further, the use of *"the layers* of the acoustic resonator" implies that all of the layers, not some or most of the layers, are selected to achieve a specific result. Again, the Court finds that even though all of the layers are selected for a specific result, that does not mean the layers cannot be selected for, or achieve, other results, as well.

Based on the foregoing, the Court construes the disputed claim term as "the layers of the acoustic resonator must all be selected for the specific purpose of achieving a distance between the longitudinal main resonance and the first shear harmonic wave that is greater than the bandwidth of the longitudinal main resonance of the resonator."

8. "longitudinal main resonance [of the resonator]" (Claim 6)

Avago's proposed construction for "longitudinal main resonance" is "the primary resonant frequency of the resonator in the direction of the applied electrical field." TriQuint's proposed construction for this disputed claim term is "the primary frequency at which the resonator resonates longitudinally (in the same direction as its elastic deflection)." The parties agree that this claim term relates to the primary resonant frequency, but disagree on how to construct "longitudinal."

Longitudinal waves shown in Figure 1 B of the #807 patent are labeled as 204 and 210. The patent specification provides that, as illustrated in Figure 1B, "the longitudinal waves 210 moving in a direction not exactly perpendicular to the substrate plans (*see* Fig. 1B) are at least partly converted to shear waves 212." (Doc. # 196–1, Ex. F at 4:4–6.) TriQuint proposes that longitudinal waves travel in the same direction as the resonator's elastic deflection. Avago argues that TriQuint's proposed construction directly contradicts the patent specification, because the resonator's elastic deflection is perpendicular to the substrate, but the longitudinal waves do not always move exactly perpendicular to the substrate; therefore, the longitudinal waves cannot travel in the same direction as the resonator's elastic deflection. Although Avago is correct that the longitudinal waves and the elastic deflection may not both be exactly perpendicular to the substrate, TriQuint's proposed construction is taken directly from the patent specification.

The patent specification defines longitudinal waves as "waves propagating in the direction of the elastic deflection." (*Id.* at 3:26–27.) The Court does not find that TriQuint is seeking to add a limitation to the disputed claim term by defining "longitudinal" as the same direction of elastic deflection. Rather, the Court finds TriQuint has applied the definition of longitudinal waves contained in the #807 patent to its proposed construction of the disputed claim term.

***29** For the foregoing reasons, the Court construes the disputed claim term as "the primary resonant frequency at which the resonator resonates longitudinally (in the direction of the elastic deflection)."

H. Avago's U.S. Patent No. 6,909,340

Avago is the owner by assignment of U.S. Patent No. 6,909,340, titled "Bulk Acoustic Wave Filter Utilizing Resonators with Different Aspect Ratios" (the "#340 patent"). The #340 patent describes a design for BAW filters that allow for the suppression of "spurious modes" by designing each resonator in the BAW filter to have a different "surface shapes," "surface contents," and "aspect ratios" to wash out the effect of the spurious modes.

1. "A bulk acoustic wave filter, comprising: a plurality of bulk acoustic wave resonators" (Claims 1 & 12)

The parties agree that "a plurality of bulk acoustic wave resonators" means "at least two bulk acoustic wave resonators." Avago proposes that "[a] bulk acoustic wave filter, comprising: a plurality of bulk acoustic wave resonators," which is the preamble to claims 1 through 12, is limiting. TriQuint disagrees and asks the Court to find the preamble is not limiting.

"Whether to treat a preamble as a claim limitation is determined on the facts of each case in light of the claim as a whole and the invention described in the patent." *Storage Tech. Corp. v. Cisco Sys., Inc.,* 329 F.3d 823, 831 (Fed.Cir.2003) (citing *Catalina Mktg. Int'l v. Coolsavings.com, Inc.,* 289 F.3d 801, 808 (Fed.Cir.2002)). Generally, the preamble does not limit the claims. *Am. Med. Sys., Inc. v. Biolitec, Inc.,* 618 F.3d 1354, 1358 (Fed.Cir.2010) (citing *Allen Eng'g Corp. v. Bartell Indus., Inc.,* 299 F.3d 1336, 1346 (Fed.Cir.2002)). The preamble may be construed as limiting "if it recites essential structure or steps, or if it is 'necessary to give life, meaning and vitality' to the claim." *Catalina Mktg.,* 289 F.3d at 808 (quoting *Pitney Bowes v. Hewlett–Packard Co.,* 182 F.3d 1298, 1305 (Fed.Cir.1999)). However, a preamble is not limiting "when the claim body describes a structurally complete invention such that deletion of the preamble phrase does not affect the structure or steps of the claimed invention." *Biolitec,* 618 F.3d at 1358–59 (citing *Catalina Mktg.,* 289 F.3d at 809).

Avago relies on *Poly–America, L.P. v. GSE Lining Technology, Inc.,* 383 F.3d 1303 (Fed.Cir.2004), to support its position that the preamble is limiting. The preamble at issue in *Poly–America* was the phrase "blown-film." In *Poly–America,* the Federal Circuit agreed with the district court's conclusion that "blown-film" disclosed a fundamental characteristic of the claimed invention, rather than state a purpose or an intended use of the invention. *Id.* at 1310.

In this instance, the preamble "[a] bulk acoustic wave filter, comprising: a plurality of bulk acoustic wave resonators" does not affect the structure of the claimed invention. *See Biolitec,* 618 F.3d at 1358–59. The preamble does not recite an essential structure, because the claims are written in terms of the structure and characteristics of bulk acoustic wave resonators, and not bulk acoustic wave filters. Accordingly, the deletion of the preamble phrase does not affect the structure or steps of the bulk acoustic wave resonators with different aspect ratios. The Court finds the preamble states the purpose or intended use of the invention, and is not necessary to give meaning to the claims.

***30** Based on the foregoing, the Court finds the preamble to claims 1 through 12 is not limiting.

2. "bulk acoustic wave resonator[s]" (Claims 1–4 & 9–12)

The parties agree that a "bulk acoustic wave resonator" or BAW resonator must include a layer of piezoelectric material between two electrodes. Avago's proposed construction for "bulk acoustic wave resonator[s]" is "an electromechanical resonator comprising a layer of piezoelectric material sandwiched between a top electrode and bottom electrode, wherein the active portion of the piezoelectric material is generally confined to the region of the piezoelectric material defined by the overlap of the top and bottom electrodes." TriQuint's proposed construction for this disputed claim term is that "bulk acoustic wave resonators include a layer of piezoelectric material arranged between two electrodes," and "need not be manufactured on-chip in a very-large scale integration (VLSI) process, and include, but are not limited to, various designs such as thin film resonators (TFR), semiconductor bulk acoustic resonators (SBAR), and film bulk acoustic resonators (FBAR)."

The #340 patent states that "[b]ulk acoustic wave resonators typically include two electrodes and a piezoelectric layer, which is arranged between the two electrodes." (Doc. # 196–1, Ex. G at 1:19–21.) TriQuint seeks to limit this construction by describing the manufacturing process. As TriQuint notes in its brief, the patent itself does not state that the chips are manufactured using the VLSI process. Further, the Court does not find any support in the patent to construe the disputed claim term as explicitly including or excluding TFRs, SBARs, or FBARs. The Court does not find it necessary to either include, or exclude, the additional limitations in TriQuint's proposed construction concerning the method of manufacture of the resonators.

Avago states that its proposed construction includes a clause that reflects the description in the #340 patent that "the 'effective resonator surface' is regarded as the surface of the electrodes which results from the overlapping area of the electrodes when the two electrodes are projected in a plane." (*Id.* at 2:16–19.) The parties have stipulated that the "effective resonator surfaces" means "the overlapping area of the electrodes when the two electrodes are projected onto a plane." (Doc. # 209 at p. 3.) However, the Court does not find the second part Avago's proposed construction consistent with the # 340 patent. Accordingly, the Court construes the disputed claim term as "a resonator comprised of a layer of piezoelectric material sandwiched between a top electrode and bottom electrode with a specific effective resonator surface."

3. "surface contents" (Claims 1, 2, 5–8 & 12)

Avago's proposed construction for "surface contents" is "area." TriQuint proposes that "surface contents" is insolubly ambiguous and renders the claim indefinite. However, TriQuint concedes in its brief that "the [patent] specification is consistent with Avago's construction."

***31** As set forth above, in construing a disputed claim term, the Court must first consider the words of the claim term itself. Next, the Court looks at "the [patent] specification to determine whether the inventor has used any terms in a manner inconsistent with their ordinary meaning." *Vitronics,* 90 F.3d at 1582. The meaning of "surface contents" is not readily apparent from the words themselves. Claim 1 states that bulk acoustic wave resonators have “different surface shapes and/or different surface contents.” (Doc. # 196–1, Ex. G at 6:61–62.) Accordingly, surface shapes and surface contents are different concepts.

While the patent claims make it clear that “surface contents” are not the same as “surface shapes,” the patent specification indicates that “surface contents” is properly construed as “area.” The patent specification states that Figure 5 “is a plan view of an inventive two-stage conductor filter formed from bulk acoustic wave resonators with the effective resonator surfaces *having different surface contents.”* (*Id.* at 5:40–43) (emphasis added). Figure 5 is a depiction of four resonators each with a different area, that is each with a different length and different width.

Avago further supports its proposed construction with reference to its German patent application. The term “surface contents” in the #340 patent corresponds to the German word “Flächeninhalt” in the German patent application. Flächeninhalt translates to “area.” (Doc. # 197–2, Ex. H–2, HARRAP'S CONCISE GERMAN & ENGLISH DICTIONARY (1982).)

Based on the foregoing, the Court finds that the claim term “surface contents” is not insolubly ambiguous, as TriQuint contends. Rather, the Court construes the disputed claim term to mean “area.”

4. “aspect ratios” (Claims 1 & 12)

The parties agree that the term “aspect ratios” is defined in the patent specification. However, the parties disagree as to whether the claim can be constructed. Avago's proposed construction for “aspect ratios” is “the smallest dimension of the resonator within the surface plane divided by the largest dimension of the resonator within the surface plane,” and that “[t]he directions of these two dimensions need not be perpendicular to each other.” TriQuint proposes that “aspect ratios” is insolubly ambiguous and renders the claim indefinite.

During the examination of the #340 patent application, the examiner stated, “[t]he specification needs to define ‘aspect ratio’ at the first occurrence thereof.” (Doc. # 198–1, Ex. H.3 at ¶ 2.) The patent examiner further stated, “if ‘aspect ratio’ is considered to be width: length, then the specification is unclear ... as to how one would determine the ‘aspect ratio’ when the effective resonator surface is ‘nonrectangular.’ “ (*Id.*) Avago responded to the patent examiner by adding Avago's proposed construction of the disputed claim term to the patent specification. (Doc. # 196–1, Ex. G at 3:50–54.) The patent specification also offers an example for calculating the aspect ratio of a non-rectangular shape: “For a parallelogram, for instance, the aspect ratio would be the distance between the two opposing acute-angled corners divided by the distance between the two long opposing sides.” (*Id.* at 3:53–54–57.) This example provides an aspect ratio in which the two dimensions are not perpendicular to each other, as described in the patent specification and in the proposed construction. The patent examiner accepted this definition and example, and issued a “Notice of Allowance.”

***32** The Court disagrees with TriQuint that the disputed claim term is indefinite. The term “aspect ratio” is properly given its meaning that the inventors of the #340 patent provided, and that the patent examiner found acceptable. Accordingly, the Court construes “aspect ratio” as “the smallest dimension of the resonator within the surface plane divided by the largest dimension of the resonator within the surface plane. The directions of these two dimensions need not be perpendicular to each other.”

5. “nonrectangular shape” (Claims 3 & 4)

Avago's proposed construction for “nonrectangular shape” is “a shape where the angles between the boundary lines of the shape are not equal to 90 degrees where they meet, *i.e.,* any shape that is not a rectangle.” TriQuint's proposed construction for this disputed claim term is “a shape whose outer adjacent boundary lines are all at 90° angles to each other.” TriQuint argues that “[w]here the corners of an object are rounded, its rectangularity is determined by examining the angles where the boundary lines would intersect if extended in a straight line. Thus, a rectangle with rounded corners qualifies as rectangular.” TriQuint proposes a construction in which the rectangularity of a shape is determined by examining the angles where the boundary lines *would* intersect if extended in a straight line, and not where the boundary lines actually intersect, as Avago's proposed construction states. The dispute over this claim term exists because Avago asserts that TriQuint's resonators are “nonrectangular” because they have rounded corners. (*See* Doc. # 196 at p. 40.)

In order to construct the meaning of “nonrectangular shape,” the Court must first understand what constitutes a rectangular shape. The *American Heritage Science Dictionary* defines "rectangle" as "a four-sided plane figure with four right angles." Accordingly, a shape that does not have four 90 degree angles (right angles) is not a rectangular shape.

The #340 patent specification provides: "A nonrectangular shape ... means a shape in which the angles between the boundary lines of the effective resonator surface are not equal to 90°." (Doc. # 196–1, Ex. G at 4:4–7.) The patent specification further provides that "the individual resonators have a nonrectangular shape (the angles between the boundary lines of the effective resonator surfaces of the individual resonators are not equal to 90°)." (*Id.* at 6:47–50.) The patent specification makes it clear that the angles of the shape are measured "between the boundary lines," and not beyond the boundary lines as TriQuint proposes.

In further support of its proposed construction, Avago directs the Court's attention to the prosecution history. During the examination, the patent examiner found the shapes in a prior patent were "nonrectangular resonators because the corners are cut away." (Doc. # 197–2, Ex. H.3 at p. 8.) Applying TriQuint's proposed construction, a rectangle without corners would constitute a rectangular shape, because its outer adjacent boundary lines would intersect at 90 degree angles. Instead, the patent examiner applied the same understanding of a nonrectangular shape as Avago proposes.

***33** The Court finds a plain meaning of the term "nonrectangular shape," together with the definitions in the patent specification, requires construction of the claim term such that the angles between boundary lines of the effective resonator are not all equal to 90 degrees. TriQuint's proposed construction narrows the plain meaning of the term "nonrectangular shape" to an extent that permits plainly nonrectangular shapes to be considered rectangular. There is no support in the patent or the prosecution history for this construction.

Based on the foregoing, the Court construes the claim term as "a shape where the angles between the boundary lines of the shape are not equal to 90 degrees where they meet, *i.e.,* any shape that is not a rectangle."

6. "stage of a conductor filter" (Claim 9)

The parties have stipulated that the claim term "conductor filter" means "ladder filter." (*See* Doc. # 209 at p. 3.) Avago proposes that no construction is necessary, because the meaning of "stage of a conductor filter" when used with reference to a ladder filter is readily apparent. Alternatively, Avago proposes the disputed claim term means "one series segment and one parallel segment of a ladder filter." TriQuint's proposed construction for this disputed claim term is "one series resonator and one parallel resonator connected in a ladder configuration." In the industry, "stage" can refer to either of the parties' proposed constructions; therefore, the Court must look to the #340 patent in construing the disputed claim term.

In support of its proposed construction that a stage constitutes one series and one parallel resonator, TriQuint relies on Figures 9 through 12 of the # 340 patent. Each of these figures shows a "stage" that has exactly one series resonator and exactly one parallel resonator. Avago, in contrast, argues that in addition to the stages shown in the Figures 9 through 12 of the #340 patent, a stage also can be a series branch combined with a parallel branch, and can include two resonators in parallel. To support this proposition, Avago cites to Figure 2 in the #5,619 patent. The Court does not find it necessary to look to another patent in construing the claim terms of the #340 patent.

In further support of its proposed construction, TriQuint quotes the patent specification, which states that a 2–stage conductor filter has four resonators and a 3–stage conductor filter has six resonators:

> [Bulk acoustic wave filters] are connected in the form of a one and half-stage conductor filter, *in the form of a two-stage conductor filter,* in the form of a two and a half-stage conductor filter, *in the form of a three-stage conductor filter* or in the form of a three and a half-stage conductor filter, with three, *four,* five, *six* or seven bulk acoustic wave resonators being interconnected.

(Doc. # 196–1, Ex. G at 5:2–8) (emphasis added). The patent specification does not support Avago's proposed construction that multiple resonators may be included in each branch of the stage.

***34** The Court finds TriQuint's proposed construction of the disputed claim term is consistent with the patent. Accordingly, the Court will construe "stage of a conductor filter" to mean "one series resonator and one parallel resonator connected in a ladder configuration."

7. "half-stage of a conductor filter" (Claim 9)

As stated above, the parties agree that a "conductor filter" is a "ladder filter." Avago proposes that no construction is necessary, because the meaning of "half-stage of a conductor filter" when used with reference to a ladder filter is readily apparent. Alternatively, Avago proposes the disputed claim term means "a parallel or series segment of a ladder filter." TriQuint's proposed construction for this disputed claim term is "one additional parallel or series resonator included within a ladder configuration."

As stated above, TriQuint relies on Figures 9 through 12 of the #340 patent to support its proposed construction of the disputed claim term. TriQuint also quotes the patent specification, which states that a 1 ½-stage conductor filter has three resonators, a 2 ½-stage conductor filter has five resonators, and a 3 ½-stage conductor filter has seven resonators:

> [Bulk acoustic wave filters] are connected *in the form of a one and half-stage conductor filter,* in the form of a two-stage conductor filter, *in the form of a two and a half-stage conductor filter,* in the form of a three-stage conductor filter or *in the form of a three and a half-stage conductor filter,* with *three,* four, *five,* six or *seven* bulk acoustic wave resonators being interconnected.

(Doc. # 196–1, Ex. G at 5:2–8) (emphasis added). Avago's proposed construction that a stage may refer to a parallel or series segment, and that a segment may comprise multiple resonators is not supported by the #340 patent. Accordingly, the Court construes "half-stage of a conductor filter" as "one additional parallel or series resonator included within a ladder configuration."

I. Avago's U.S. Patent No. 6,864,619

Avago is the owner by assignment of U.S. Patent No. 6,864,619, titled "Piezoelectric Resonator Device Having Detuning Layer Sequence" (the "#4,619 patent"). The #4,619 patent describes a detuning layer sequence of at least a first layer having a high acoustic impedance and a second layer having a low acoustic impedance. This sequence of layers shifts the resonant frequency of a resonator as compared to other resonators in the filter, and allows for trimming without significantly affecting the frequency difference between the detuned and non-detuned resonators.

1. "[a detuning layer sequence] arranged on the first piezoelectric resonator" (Claims 1 & 12)

Avago's proposed construction for "[a detuning layer sequence] arranged on the first piezoelectric resonator" is "the detuning layer sequence is only added to the first piezoelectric resonator." TriQuint's proposed construction of this disputed claim term is "a sequence of detuning layers is only applied to the first piezoelectric resonator and is arranged above and in contact with the first piezoelectric resonator." The parties main disagreement concerns the scope of "arranged on."

***35** TriQuint's proposed construction conforms with Avago's proposed construction to the extent that first resonator has a detuning layer sequence while the second resonator does not have a detuning layer sequence. However, TriQuint's proposed construction requires that the detuning layer sequence is not only arranged *above* the piezoelectric resonator, but is also *in contact with* the piezoelectric resonator. TriQuint argues that Avago's proposed construction fails to account for the use of "on" in the disputed claim term.

In support of its proposed construction, TriQuint cites to Figure 4A of the # 4,619 patent. The patent specification provides that "[p]referably, layers of the electrodes [28 and 30] and layers of the detuning layer sequence 52 which basically have the same acoustic properties are abutting." (Doc. # 196–1, Ex. H at 7:39–41 .) However, the depiction of the detuning layer sequence between two top electrode layers of the first piezoelectric resonator in Figures 3 and Figure 4A is not the only location where the detuning layer sequence can be arranged on the resonator. (*Id.* at 9:16–28.) In fact, in its reply brief, TriQuint states that "Avago is correct that the specification indicates that a detuning layer sequence could be located in various places." (Doc. # 208 at p. 26 .)

The parties disagree whether it is proper to state the detuning layer sequence must be in contact with the piezoelectric resonator. The Court finds this limitation is obvious from the claim term itself, which requires the detuning layer sequence to be arranged on the first piezoelectric resonator. While the Court does not find TriQuint is attempting to impose an extraneous limitation to the disputed claim term, the Court finds TriQuint's proposed construction with the "clarifications" creates confusion, rather than alleviates ambiguity. The patent specification makes it clear where and how the detuning sequence is arranged on the first piezoelectric resonator. Further, using TriQuint's proposed term "applied," the *Random House Dictionary* defines "applied" as "to place in contact with."

For the foregoing reasons, the Court construes the disputed claim term as "the detuning layer sequence is only applied to the first piezoelectric resonator."

2. "[the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance] in order to shift a resonance frequency of the first piezoelectric resonator relative to the resonance frequency of the second piezoelectric resonator" (Claims 1 & 12)

Avago proposes that no construction of the bracketed language is necessary, because "the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance" is clear on its face. Avago's proposed construction for "[the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance] in order to shift a resonance frequency of the first piezoelectric resonator relative to the resonance frequency of the second piezoelectric resonator" is "the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance to change the resonant frequency of the first resonator so that it is different than the resonant frequency of the second resonator which does not have a detuning layer." TriQuint's proposed construction of this disputed claim term, including the construction of the bracketed language, is "the first layer of the detuning sequence has a first acoustic impedance and the second layer has a second acoustic impedance for the purpose and effect of causing a shift in the resonance frequency of the first piezoelectric resonator relative to the resonance frequency of the second piezoelectric resonator."

***36** TriQuint argues that its proposed construction construes the phrase "in order to" consistent with its plain meaning "for the purpose of." *See* AMERICAN HERITAGE DICTIONARY 1273 (3d ed.1992) (defining "in order to" as "for the purpose of"). However, in constructing the disputed claim term, TriQuint further construes "in order to" as "for the purpose *and effect* of." The Court finds the additional limitation goes beyond the plain meaning of the phrase. Contrary to TriQuint's proposed construction, Avago's proposed construction does not even address the phrase "in order to ." Rather, Avago's proposed construction focuses on construing the phrase "shift a resonance frequency."

The #4,619 patent provides that the detuning layer sequence has advantages "when trimming, that is when fine-adjusting the resonance frequency." (Doc. # 196–1, Ex. H at 7:54–46.) It is clear that the detuning layer sequence serves a *purpose,* which purpose is described in the disputed claim term as shifting the resonance frequency of the first detuned resonator relative to the second resonator in an advantageous manner. The Court agrees with TriQuint that "in order to" is an important phrase in the disputed claim term, because intent can be a requirement of the claims when they are drafted in such a manner. *See Combined Sys., Inc. v. Defense Tech. Corp. of Am.,* 350 F.3d 1207, 1214 (Fed.Cir.2003) (affirming the district court's construction of "forming folds ..." as requiring a "deliberate and systematic" construction).

Avago also argues that TriQuint's proposed construction reads out the phrase "at least" in the disputed claim term. The disputed claim term explicitly provides that the detuning layer sequence has *at least* a first and second layer of material. In its reply brief, TriQuint states that it will not object if the Court changes TriQuint's proposed construction to read "have at least" rather than "have." (Doc. # 208 at p. 27.)

For the foregoing reasons, the Court construes the disputed claim term as "the detuning layer sequence comprises at least a first layer having a first acoustic impedance and a second layer having a second acoustic impedance for the purpose of shifting the resonance frequency of the first piezoelectric resonator relative to the resonance frequency of the second piezoelectric resonator."

J. Avago's U.S. Patent No. 6,812,619

Avago is the owner by assignment of U.S. Patent No. 6,812,619, titled "Resonator Structure and a Filter Comprising Such a Resonator Structure" (the "#2,619 patent"). The #2,619 patent describes a BAW resonator that includes a "frame-like zone" on the top of the BAW resonator to suppress unwanted resonances by causing the piezoelectric material to expand and contract more consistently over the surface of the center region of the resonator.

1. "the resonator is adapted in such a way that a width of the frame-like zone and acoustical property means of the layer structure in the frame-like zone are arranged so that displacement relating to the piezoelectrically excited strongest resonance mode is substantially uniform in the center area of the resonator" (Claims 1 & 35)

***37** Avago proposes that no construction is necessary, because the following claim term is clear:

> [T]he resonator is adapted in such a way that a width of the frame-like zone and acoustical property means of the layer structure in the frame-like zone are arranged so that displacement relating to the piezoelectrically excited strongest resonance mode is substantially uniform in the center area of the resonator.

TriQuint's proposed construction for this disputed claim term is "the resonator is specifically designed so that the width of the frame-like zone and the 'acoustical property means' cause particles in the center area of the resonator to exhibit uniform displacement at all times during operation of the resonator."

Avago argues that TriQuint's proposed construction adds limitations that are not present in the disputed claim term. Specifically, Avago notes that the disputed claim term provides for displacement that "is substantially uniform." TriQuint's proposed construction provides that particles must "exhibit uniform displacement at all times." However, in its reply brief, TriQuint agrees that the displacement should be "substantially uniform," not "uniform," and amends its brief accordingly.

TriQuint argues that the use of "adapted" and "arranged" in the disputed claim term indicates that the results of the resonator being *adapted* and the frame-like zone and acoustical property means being *arranged* are intentional. In further support of its argument, TriQuint cites the patent specification, which provides "[t]he acoustical properties and width of the frame-like zone in a resonator ... *are chosen* so that ... the displacement ... is substantially uniform in the center area of the resonator ." (Doc. # 196–1, Ex. J at 5:40–44) (emphasis added). The Court agrees that the use of these terms indicates purposeful construction of the device to achieve the result described. However, the Court does not find it necessary to combine and construe the terms "adapted" and "arranged" as "specifically designed," as TriQuint proposes.

TriQuint also argues that it is necessary to construe the disputed claim term to resolve the issue of when the substantially uniform displacement occurs. In support of this time limitation, TriQuint cites the patent specification, which provides, "[w]hen the piezoelectrically excited wave is a thickness extensional wave, this means that the thickness of the center area varies as a function of time so that *at each time instance* the thickness of the center area, at substantially each point of the area, is the same." (*Id.* at 5:57–62) (emphasis added). Based on the language in the #2,619 patent, the Court finds support for TriQuint's proposed time limitation of "at all times." However, because the patent specification is clear as to when the displacement is substantially uniform at the center area of the resonator, the Court does not find it necessary to read this limitation into the disputed claim term.

***38** In construing the disputed claim term, the Court looks to the words of the claims themselves and gives them their ordinary and customary meaning, unless clearly stated otherwise. *Vitronics,* 90 F.3d at 1582. There is nothing in the #2,619 patent that requires the Court to give the words in the disputed claim term anything but their ordinary and customary meaning. Accordingly, the Court finds that no construction is necessary.

2. "the resonator is adapted to operate in the thickness extensional wave mode as a TE mode" (Claims 1 & 35)

Avago proposes that no construction is necessary, because "the resonator is adapted to operate in the thickness extensional wave mode as a TE mode" is clear. TriQuint's proposed construction for this disputed claim term is "the resonator is specifically designed to operate such that the displacement of the particles of the piezoelectric material occurs only in the direction of the applied electrical field."

As argued with respect to the prior disputed claim term, TriQuint argues that "adapted" should be construed as "specifically designed." The Court does not find the term "adapted" to be confusing or ambiguous. However, the Court does agree that the phrase "TE mode" requires construction.

The patent specification distinguishes between TE modes and shear modes:

> In the presence of a piezoelectrically excited thickness extensional wave [,] the particles of the piezoelectrical material experience displacement in the vertical direction, in other words in the direction of the applied electrical field. In the presence of a piezoelectrically excited shear wave [,] the particles of the piezoelectrical material experience displacement in the horizontal direction, in other words in a direction perpendicular to the applied electric field.

(Doc. # 196–1, Ex. J at 5:47–54.) The inventors were required to amend the claims "to emphasize that the claimed device is actually operating in the TE mode." (Doc. # 196–4, Ex. 28 at p. 11.) This amendment was required in light of prior art. The patent examiner noted that "if the claims were limited to a device actually operating in the TE mode, then the claims would be allowable." (*Id.*) The Court finds the disputed claim term is clearly limited to operation in TE mode, and does not provide that the resonator is adapted to operate in shear modes.

Based on the foregoing, the Court construes the disputed claim term as "the resonator is adapted to operate such that the displacement of the particles of the piezoelectrical material occurs in the direction of the applied electrical field."

K. Avago's U.S. Patent No. 6,377,137

Avago is the owner by assignment of U.S. Patent No. 6,377,137, titled "Acoustic Resonator Filter with Reduced Electromagnetic Influence Due to Die Substrate Thickness" (the "#137 patent"). The #137 patent describes a method for reducing electromagnetic influence in a BAW resonator filter circuit by reducing the substrate upon which the BAW resonators are formed. By reducing the substrate, the distance between magnetic fields is reduced, which reduces the current induced by the magnitude of the magnetic fields.

1. "removing material from a bottom surface of said substrate to reduce the thickness of the substrate and to reduce an electromagnetic influence in a resulting filter" (Claim 1)

***39** Avago's proposed construction for "removing material from a bottom surface of said substrate to reduce the thickness of the substrate and to reduce an electromagnetic influence in a resulting filter" is "removing material from a bottom surface of said substrate to reduce the thickness of the substrate and to reduce the effects caused by currents flowing through the filter." TriQuint's proposed construction of this disputed claim term is "removing material from the bottom surface of the substrate for the purposes of and with the effects of (a) reducing the thickness of the substrate and (b) reducing an electromagnetic influence in the filter."

Avago's proposed construction provides for an explanation of "an electromagnetic influence," while keeping the remaining disputed claim term in tact. TriQuint argues that Avago's proposed construction would leave the jury confused and misdirected. As stated throughout this Order, the Court does not construe the claim terms in a manner to be understood by a juror. Rather, disputed claim terms are given "their ordinary and accustomed meaning as understood by one of ordinary skill in the art." *Dow Chem.,* 257 F.3d at 1372; *see also Phillips,* 415 F.3d at 1313.

TriQuint's seeks to construe "to reduce" as "for the purposes of and with the effects of [reducing]." The disputed claim term explicitly states "removing material ... to reduce." The Court finds the purpose of removing material from the substrate is clear in the disputed claim term without further construction. It is not necessary to construe the claim term in the manner proposed by TriQuint.

According to the patent specification, electromagnetic influence is "caused by the currents flowing through FBAR filter 226." (Doc. # 196–1, Ex. K at 7:2–4.) Avago's proposed construction of the disputed claim term reflects this explanation of electromagnetic influence.

For the foregoing reasons, the Court construes the disputed claim term as "removing material from a bottom surface of said substrate to reduce the thickness of the substrate and to reduce the effects caused by currents flowing through the filter."

2. "reduce an electromagnetic influence" (Claim 1)

Avago's proposed construction for "reduce an electromagnetic influence" is contained in Avago's proposed construction of the prior claim term. Avago proposes that the disputed claim term means "reduce the effects caused by currents flowing through the filter." TriQuint's proposed construction of this disputed claim term is "reduce the effects caused by currents flowing on alternate paths from input to output such that the signal bypasses the filter elements."

Because the disputed claim term currently at issue is contained in the prior construction, the Court must construe these claim terms consistently. As stated above, an electromagnetic influence is "caused by the currents flowing through FBAR filter 226." (Doc. # 196–1, Ex. K at 7:2–4.) Avago argues that TriQuint's proposed construction of the disputed claim term confuses electromagnetic influence with victimizer loop and victim loop. (*Id.* at 7:9–17.) Victimizer loop and victim loop are both disputed claim terms and subject to construction below.

***40** The Court finds Avago's proposed construction is consistent with the patent specification, and construes the disputed claim term as "reduce the effects caused by currents flowing through the filter."

3. "die cavity" (Claims 5, 6, 14 & 16)

Avago proposes that no construction is necessary, because "die cavity" is clear. TriQuint's proposed construction for this disputed claim term is "a recess in a support structure, positioned to receive a die."

In support of its proposed construction, TriQuint argues that the disputed claim term has no plain meaning to jurors. However, the Court is not required to construe a disputed claim term in a manner that can easily be understood by jurors. Rather, the Court is required to construe the disputed claim term in a manner that would be understood by a person of ordinary skill in the art. *Dow Chem.,* 257 F.3d at 1372.

Both parties cite to the same description in the patent specification: "The die with FBAR resonators ... form a single FBAR filter 226. FBAR filter 226 may then be mounted into a die cavity 229 with a ceramic package 288, as shown in Figs. 9–10." (Doc. # 196–1, Ex. K at 6:38–43.) Figure 10 shows a cross-section of the device, in which die cavity 229 is a hollow space in which the filter is mounted. According to Avago's brief, a "die cavity" is "an area in a package where the die is mounted." (Doc. # 197 at p. 56.) Avago argues that TriQuint's proposed construction should be rejected, because it introduces concepts such as "recess" and "support structure," which are not found in the patent specification. However, Avago's proposed construction does not attribute for the term "cavity" in the claim term. "Cavity" is defined in the *American Heritage Science Dictionary* as a "hollow area."

Because TriQuint's proposed construction lacks support in the #137 patent, and the disputed claim term is not entirely clear on its face, the Court construes the disputed claim term as "a hollow area in a package where the die is mounted."

4. "victim loop" (Claims 7, 15 & 18)

Victim loop is a term coined by the inventors, and does not have a plain meaning outside the #137 patent. Avago's proposed construction for "victim loop" is "a current path from the output pad to the ground pad."[8] TriQuint's proposed construction of this disputed claim term is "a current path formed by an output signal pad and a ground pad." TriQuint further defines the relationship between the victim and victimizer loops in the proposed claim construction below. The parties agree that the victim loop is formed on the output side.

The patent specification explains that the victim loop is on a path "such that the signal bypasses the filter elements." (Doc. # 196–1, Ex. K at 7:8–11.) Figure 9 of the #137 patent depicts the victim loop as the current path between an output pad (240c) and a ground pad (240d). Therefore, the Court construes the disputed claim term as "a current path from the output pad to the ground pad such that the signal bypasses the filter elements."

5. "victimizer loop" (Claims 7, 15 & 18)

***41** Victimizer loop, like the prior disputed claim term, is a term coined by the inventors, and does not have a plain meaning outside the #137 patent. Avago's proposed construction for "victimizer loop" is "a current path from the input signal pad to the ground pad."[9] TriQuint's proposed construction of this disputed claim term is "a current path formed by an input signal pad and a ground pad." TriQuint also proposes the Court construct the relationship between the victim loop and the victimizer loop as follows: "Current passing along the victimizer loop must create an image current in a ground plane beneath the victimizer loop. The image current and the victimizer loop current must together generate a current in the victim loop that is measurably reduced as a result of thinning the substrate." The parties agree that the victimizer loop is formed on the input side.

TriQuint's proposed construction attempts to explain the relationship between the victim loop and the victimizer loop as current paths formed by an output/input signal pad and a ground pad. Avago argues that TriQuint's proposed construction of the relationship between the claim terms is incorrect, and that output/input signal pads and ground pads can not form current pads. Rather, the patent specification provides that the current paths are formed by the "mutual inductance" between the victim loop and the victimizer loop and form between the output/input signal pads and the ground pads. (Doc. # 196–1, Ex. K at 7:8–16.) The Court does not find it necessary to read TriQuint's proposed limitation into the construction of either "victim loop" or "victimizer loop ." The relationship between these two loops is explained in the patent specification. (*Id.* at 7:19–8:18.)

The patent specification also explains that the victimizer loop is on a path "such that the signal bypasses the filter elements." (*Id.* at 7:8–11.) Figure 9 of the #137 patent depicts the victimizer loop as the current path between an input pad (240a) and a ground pad (240b). For the foregoing reasons, the Court construes the disputed claim term as "a current path from the input signal pad to the ground pad such that the signal bypasses the filter elements."

L. Avago's U.S. Patent No. 6,262,637

Avago is the owner by assignment of U.S. Patent No. 6,262,637, titled "Duplexer Incorporating Thin–Film Bulk Acoustic Resonators (FBARs)" (the "#637 patent"). A duplexer allows a device to receive signals within one band of frequencies and to transmit them at another band of frequencies while preventing the device's transmit signal from overloading the receive filter. The #637 patent describes a 90° phase shifter in series with either the transmit or receive filter to effectively decouple the transmit signal from the receive signal in a BAW duplexer. The 90° phase shifter protects the receive filter from being overloaded by the transmit signal by raising the impedance (flow resistance) of the receive path to block the transmit signal from following the receive path.

1. "film bulk acoustic resonator (FBAR)" (Claims 1 & 20–22)

***42** Avago's proposed construction for "film bulk acoustic resonator (FBAR)" is "a bulk acoustic wave (BAW) resonator fabricated using thin film technology." TriQuint's proposed construction of this disputed claim term is "a piezoelectric resonator comprising a layer of piezoelectric material sandwiched between a top electrode and bottom electrode and suspended at its edges over a well in the substrate." TriQuint argues that Avago's proposed construction is intentionally vague with respect to thin-film technology. However, TriQuint acknowledges that the #637 patent describes thin-film technology in detail and explains its importance to the invention.

The patent specification supports Avago's proposed construction of the disputed claim term. The patent specification repeatedly defines FBAR as "a thin-film bulk acoustic resonator." (Doc. # 196–1, Ex. L at 4:25–26, 4:45–46.)

TriQuint argues the FBAR must be suspended at its edges over a well in the substrate. However, there are multiple types of FBARs. The #637 patent incorporates U.S. Patent No. 5,5867,602. (*Id.* at 4:45–49.) Because this patent was expressly incorporated by referenced into the patent specification of the #637 patent, the Court may rely on the incorporated patent in constructing the disputed claim term. *See Advanced Display Sys., Inc. v. Kent State Univ.,* 212 F.3d 1272, 1282 (Fed.Cir.2000) ("Incorporation by reference provides a method for integrating material from various documents into a host document ... by citing such material in a manner that makes clear that the material is effectively party of the host document as if it were explicitly contained therein."). The incorporated patent describes FBARs suspended over air (Doc. # 198–1, Ex. L. 1 at 1:23–26), and also FBARs constructed on a membrane (*id.* at 2:45–47, 3:31). Accordingly, the inventor did not depart from the broad or generic meaning of FBAR, which is understood by a person of ordinary skill in the art to be a thin-film bulk acoustic resonator.

The Court finds the claim term "FBAR" does not necessarily mean a resonator suspended over a well in the substrate. The #637 patent may further limit the construction of the particular FBAR described in the patent; however, the Court does not find it necessary to limit the claim term as narrowly as TriQuint proposes. When a term is known in the art and is used in the patent consistent with the known meaning, then the Court will not redefine the term, unless term is redefined in the patent specification. *See Carroll Touch,* 15 F.3d at 1577. The #637 patent specification does not redefine FBAR.

Further, it is a general principle of claim construction that while "a claim must be read in view of the specification," a court "may not read a limitation into a claim from the specification." *Innova/Pure Water,* 381 F.3d at 1117. The patent specification repeatedly describes FBAR as "a thin-film bulk acoustic resonator," and the Court does not find there is a clear intention to limit the scope of the claims to a resonator suspended over a well in the substrate, as TriQuint proposes.

***43** Accordingly, the Court construes "film bulk acoustic resonator (FBAR)" as "a bulk acoustic wave (BAW) resonator fabricated using thin film technology."

2. "a 90° phase shifter" (Claim 1)

Avago's proposed construction for "a 90° phase shifter" is "a phase shifter that shifts the signal by approximately 90°." TriQuint's proposed construction of this disputed claim term is "a circuit that is designed to cause and does cause a 90° (quarter wavelength) phase shift at the center frequency of the other band pass filter" in which "[t]he 'other band pass filter' is the transmit or receive filter with which the circuit is not in series." TriQuint also proposes that the 90° phase shifter is located "between (1) the junction of the transmit path and the receive path and (2) either the transmit filter or the receive filter." However, during the *Markman* hearing, TriQuint acknowledged that the term "90° phase shifter" would be clear to someone of ordinary experience in the art.

A 90° phase shifter is something that shifts a signal's phase by 90 degrees or¼ of a wavelength. TriQuint argues that the 90° phase shifter must cause a 90° phase shift at the center frequency of the other band pass filter, because that is the logical place to measure the phase shift. Avago argues that the patent does not indicate that the 90° phase shift must occur at the center frequency of the other band pass filter.

Claim 1 describes a duplexer comprising, among other things, "a series circuit connected between the second port and the third port, the series circuit including a 90° phase shifter in series with a second band-pass filter." (Doc. # 196, Ex. L at 14:64–66.) Claim 1 clearly states that the 90° phase shifter is located between the second port and the third port. The Court does not find it necessary to limit the location of the 90° phase shifter in the manner proposed by TriQuint. The patent specification states: "Circuits suitable for use as the 90° phase shifter are known in the art. For example, the 90° phase shifter may be composed of lumped inductors and capacitors or a #/4 transmission line." (*Id.* at 7:5–8.) Although the patent provides little detail about the 90° phase shifter in the patent specification, TriQuint acknowledges that "those skilled in the art understood what 90° phase shifters do and why." (Doc. # 196 at p. 59.)

TriQuint also proposes to add an intent limitation to the claim term. The Court does not find any reason to read "designed to cause and does cause" into the claim term. A 90° phase shifter is an object that shifts the phase of a signal. The verb "shifts" is sufficient to describe what the object does without adding further intent qualifiers. It is not necessary to read additional limitations into the #637 patent.

For the foregoing reasons, the Court construes "a 90° phase shifter" as "a phase shifter that shifts the phase of a signal by 90 degrees."

3. "in series with a second band-pass filter" (Claim 1)

***44** Avago proposes that no construction is necessary, because "in series with a second band-pass filter" is clear. TriQuint's proposed construction for this disputed claim term is "the circuit is located between (1) the junction of the transmit path, the receive path and the antenna port and (2) either the transmit filter or the receive filter."

TriQuint states that its proposed construction will be helpful to the jury to specify the location of the 90° phase shifter using language enabling the jury to locate it in the circuit. However, the Court does not construct claims so that the claim terms may be understood by potential jurors. *Dow Chem.,* 257 F.3d at 1372 (stating that disputed claim terms are given "their ordinary and accustomed meaning as understood by one of ordinary skill in the art").

Figure 4 in the #637 patent shows the location of the 90° phase shifter (labeled as number 134), the transmit band-pass filter (130), and the second band-pass filter (132). Arrows in Figure 4 indicate the direction of the current. The numbered components in Figure 4 are explained clearly in the patent specification. (Doc. # 196–1, Ex. L at 5:61–67, 6:1–7.) The Court does not find it necessary to define the claim term "in series with a second band-pass filter" when Figure 4 depicts the location of the claim term precisely. TriQuint's description could only serve to confuse the jury, and add unnecessary limitations to the claim term. Therefore, the Court finds that no construction is necessary.

M. Avago's U.S. Patent No. 6,051,907

Avago is the owner by assignment of U.S. Patent No. 6,051,907, titled "Method for Performing On–Wafer Tuning of the Thin Film Bulk Acoustic Wave Resonators (FBARS)" (the "#907 patent"). The #907 patent describes a method for tuning multiple BAW resonators in one processing step by adjusting the thickness of multiple resonators on a semiconductor wafer by determining the average frequency across the resonators and adding or removing material from the resonators to reach the desired resonant frequency.

1. "Thin Film Bulk Acoustic Wave Resonators (FBARs)" (Claims 1, 7 & 10)

Avago's proposed construction for "Thin Film Bulk Acoustic Wave Resonators (FBARs)" is "a bulk acoustic wave (BAW) resonator fabricated using thin-film technology." TriQuint's proposed construction of this disputed claim term is "a FBAR is a Thin Film Bulk Acoustic Resonator that includes multiple layers having respective thicknesses, and exhibits series and/or parallel resonance at frequencies that are a function of the thickness of at least one of the layers."

The disputed claim term is defined in the patent specification as: "The [Thin Film Bulk Acoustic Wave Resonator] FBAR comprises a plurality of layers having respective thicknesses, and exhibits at least one of a series resonance and parallel resonance at respective frequencies that are a function of the thickness of at least one of the layers." (Doc. # 196–1, Ex. M at 2:16–19.)

***45** Avago proposes the same construction for the disputed claim term as it proposed for the same claim term in the #637 patent. As Avago argues in its brief, when a term is known in the art and is used in the patent consistent with the known meaning, then the Court should not redefine the term, unless term is redefined in the patent specification. *See Carroll Touch,* 15 F.3d at 1577 ("[T]he words of a claim are generally given their ordinary and accustomed meaning, unless it appears from the specification or the file history that they were used differently by the inventor."). Here, the disputed claim term is defined in the patent specification, and the Court finds the inventor intended to apply this specific definition to the disputed claim term. *Vitronics,* 90 F.3d at1582 ("The patent specification acts as a dictionary when it expressly defines terms used in the claims or when it defines terms by implication."). There is no evidence in the #907 patent that the inventor intended the disputed claim term to have a broad or more generic meaning.

The #637 patent and the #907 patent are unrelated; neither patent incorporates the other patent, nor refers to the other in any manner. The # 907 patent provides its own definition for "Thin Film Bulk Acoustic Wave Resonators (FBARs)," which the Court will apply in constructing the disputed claim term. The Court finds no reason to bind itself, with respect to the # 907 patent, to the definition of "film bulk acoustic wave resonator (FBAR)" contained in the #637 patent.

Based on the foregoing, the Court construes the term as it was used in the # 907 patent: "a thin film bulk acoustic wave resonator (FBAR) comprised of a plurality of layers having respective thicknesses, and exhibiting at least one of a series resonance and a parallel resonance at respective frequencies that are a function of the thickness of at least one of the layers."

2. "calculating an average of the measured frequencies" (Claim 10)

Avago proposes that no construction is necessary, because "calculating an average of the measured frequencies" is clear. TriQuint's proposed construction for this disputed claim term is "calculating a mean of all the measured frequencies."

The Court finds that a person of ordinary skill in the art would calculated the average of the measured frequencies by calculating the sum of the measured frequencies and then dividing that sum by the number of measured frequencies. However, the term "average" can generically refer to the arithmetic mean, the median, or the mode. Avago acknowledged, during the *Markman* hearing, that an average can be determined in a number of ways. TriQuint's proposed construction reflects the most common usage of the word "average." The *American Heritage Science Dictionary* defines average as "[a] number, especially the arithmetic mean, that is derived from and considered typical or representative of a set of numbers." The claim term expressly requires calculations, which involves performing a mathematical function. Merely selecting an intermediate value does not involve "calculating an average." During the *Markman* hearing, Avago argued that a person of ordinary skill in the art would know how to calculate the average, and would know to disregard any outlying measured frequencies. This restriction on outliers is not apparent from either the disputed claim term, or the patent specification. Contrary to Avago's position, the disputed claim term is not clear on its face. Accordingly, the term "average" as used in the #907 patent shall be construed as the "mean."

***46** TriQuint further proposes to construe the disputed claim as *"all* measured frequencies." The Court finds no support in the #907 patent for this limitation. The Court therefore construes "calculating an average of the measured frequencies" as "calculating a mean of the measured frequencies."

3. "simultaneously altering the thickness of each of the plurality of the FBARs [by the amount (A)]" (Claim 10)

Avago's proposed construction for "simultaneously altering the thickness of each of the plurality of the FBARs by the amount (A)" is "altering the thickness of each film bulk acoustic resonator to be detuned on a wafer in one continuous processing step by the amount (A)." TriQuint's proposed construction of this disputed claim term is "changing the thickness of all the FBARs by the same amount (A) at the same time." The parties' primary dispute is whether "simultaneously" means "in one continuous processing step" or "at the same time."

The term "simultaneous" is defined as "existing, occurring, or operating at the same time." RANDOM HOUSE WEBSTER'S COLLEGE DICTIONARY 1205 (2d ed.1997). There is nothing in the patent specification that supports constructing the term "simultaneously" in a manner other than the plain meaning. Avago cites to the patent specification for support that the thickness of the plurality of each resonator is altered in one processing step; however, the Court finds this citation supports TriQuint's proposed construction. The patent specification provides that "the reduction of the top electrode thicknesses of the FBARs ... causes the respective FBARs to yield series resonant frequencies that are substantially equal to the design series resonant frequency.... In this manner, each of the FBARs on the wafer is tuned simultaneously." (Doc. # 196–1, Ex. M at 6:35–45.) Accordingly, the Court will construct the term "simultaneously" as "at the same time."

TriQuint's proposed construction provides for the changing of the thickness of "all the FBARs." However, the disputed claim term states that the thickness of "the plurality of the FBARs" will be simultaneously altered. Plurality of the resonators does not mean *all* of the resonators, and in this manner, TriQuint's proposed construction contains an extraneous limitation. *See York Prods. v. Cent. Tractor Farm & Family Ctr.,* 99 F.3d 1568, 1575 (Fed.Cir.1996) ("The term [plurality] means, simply, 'the state of being plural.' ") (quoting AMERICAN HERITAGE DICTIONARY SECOND COLLEGE EDITION 955 (2d ed.1982)). The Court will not construct the term "plurality" to mean "all."

Based on the foregoing, the Court construes the disputed claim term as "altering the thickness of each film bulk acoustic resonator to be detuned on a wafer by the same amount (A) at the same time."

IV. Conclusion

For the foregoing reasons, the Court construes the disputed claim terms as set forth in the table above.

***47** IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2011 WL 98948, 2011 Markman 98948

Footnotes

[1] The parties have stipulated to the construction of several claim terms. (*See* Doc. # 209 at pp. 2–3.) The Court will refer to these stipulated constructions when appropriate in this Order.

[2] During the *Markman* hearing, Avago revised its proposed construction of the disputed claim term to remove the requirement that the electrode cannot be *physically* connected to any other component.

[3] After filing its initial brief, Avago appears to have changed its proposed construction to use the word "patterned" rather than "defining." This change does not affect the Court's analysis.

[4] During the *Markman* hearing, Avago revised its proposed construction to exclude the following final phrase: "... and where the first electrodes are on one surface of the piezoelectric layer, and the second electrodes are on an opposing surface."

[5] In its reply brief, TriQuint is willing to modify its proposed construction to state that "[m]utually inverse polarization requires a connection such that *when* the electric field applied to the first area of the piezoelectric layer is in the same direction as the polarization of the first area, the electric field applied to the second area is in the opposite direction of the polarization of the second area, and vice versa." TriQuint offers this modification to avoid confusion as to whether the electric fields applied to resonators must always be in the same direction and of the same magnitude. (Doc. # 208 at p. 14.)

[6] During the *Markman* hearing, TriQuint revised its proposed construction of the disputed claim term to remove the final sentence: "The electric dipole moments must be impressed (imposed) upon the piezoelectric material during manufacture."

[7] During the *Markman* hearing, TriQuint revised its proposed construction to provide that technological limitations *make it dificult,* but do not *prevent* the manufacture of the layer at the certain thickness. TriQuint argued that its use of "prevent" in the original proposed construction was misinterpreted by Avago, and revised its construction to clarify its intent.

[8] Avago revised its proposed construction of the disputed claim term in its reply brief from "the nearest ground pad" to "the ground pad." TriQuint argued, and the Court agrees, that Avago's prior focus on the nearest ground pad was improper, because it is unclear from Figure 9 of the #137 patent, which ground pad is in fact "nearest."

[9] Avago revised its proposed construction of the disputed claim term in its reply brief from "the nearest ground pad" to "the ground pad." TriQuint argued, and the Court agrees, that Avago's prior focus on the nearest ground pad was improper, because it is unclear from Figure 9 of the #137 patent, which ground pad is in fact "nearest."

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2017 WL 1169528
Only the Westlaw citation is currently available.
United States District Court,
D. Minnesota.

Boris A. MIKSIC, Plaintiff,
v.
BOECKERMANN GRAFSTROM MAYER, LLC, a Minnesota limited liability company f/k/a Johnson, West & Co. P.L.C., Boeckermann Grafstrom Mayer, P.A., and Johnson West & Co. P.L.C., Defendants.

Civil No. 15–539 (JRT/BRT)
|
Signed 03/28/2017

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER ON DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AND DEFENDANTS' MOTION TO EXCLUDE EXPERT TESTIMONY

JOHN R. TUNHEIM, Chief Judge United States District Court

***1** The Internal Revenue Service ("IRS") assessed substantial taxes, monetary penalties, and interest against Plaintiff Boris Miksic for his failure to file U.S. tax forms during tax years 2005 to 2010, and not disclosing his interests in and income from foreign trusts, businesses, and bank accounts. Miksic filed this accounting malpractice action alleging those errors were due to negligent tax preparation by Defendants Boeckermann Graftstrom Mayer LLC, formerly known as Johnson, West & Co. P.L.C., Boeckermann Graftstrom Mayer, P.A., and Johnson West & Co. P.L.C. (collectively "Defendants"). Miksic also contends that as a result of Defendants' negligence, he changed accountants and retained legal counsel to respond to the IRS audit and to bring this action.

Defendants move for summary judgment on Miksic's malpractice action and move to exclude testimony by Miksic's causation and liability expert, Arthur H. Cobb. Specifically, Defendants assert that: the six-year statute of limitations bars Miksic's malpractice action; Miksic failed to provide meaningful expert testimony as required by Minn. Stat. § 544.42; the doctrines of *in pari delicto* and laches bar Miksic's action; and Miksic cannot recover certain IRS penalties, all delinquent tax liabilities, and all attorneys' fees expended to bring the instant action.

The Court will deny in part and grant in part Defendants' motion for summary judgment. The Court will deny the motion as the Court finds that Miksic's claim is timely, Cobb's expert testimony provides a meaningful summary of his accounting malpractice opinion, and the *in pari delicto* and laches doctrines do not apply to the instant action. The Court, however, will grant Defendants' motion for summary judgment to preclude Miksic from recovering as damages abated Form 5471 penalties, payment for delinquent taxes, and attorneys' fees expended in the instant action. The Court finds Cobb is qualified to offer his expert opinion in this case and that his opinion will not confuse or mislead the jury, the Court will deny Defendants' motion to exclude Cobb's expert testimony.

BACKGROUND

I. MIKSIC'S RELATIONSHIP WITH DEFENDANTS

Miksic is a Croatian–American entrepreneur who lives in the United States. (Aff. of Michael M. Sawers ("Sawers Aff."), Ex. 1 ("Miksic Dep.") at 14:12–19, 18:22–19:25, Aug. 12, 2016, Docket No. 45.) English is not his first language. (*Id.* at 14:19–20.) Miksic owns several American and Croatian companies, including a Minnesota-based corporation named Cortec Corporation ("Cortec"), of which he is the sole shareholder, as well as a Croatian-based company named EcoCortec. (*Id.* at 18:24–20:21; 28:2–32:20.) Defendants provided accounting services for both Miksic and Cortec since 1988. (*Id.* at 49:9–50:18.) [1]

When Miksic first retained Defendants, his primary Certified Public Accountant ("CPA") was Cliff Lozinski. (Miksic Dep. at 76:20–77:20.) Once Lozinski retired in approximately 2006 (Pl.'s Mem. in Opp'n to Defs.' Mot. for Summ. J. at 3, Aug. 12, 2016, Docket No. 43), CPAs Cory Parnell and Corey Edmunds took on a substantial role in providing Miksic accounting advice and services, (Miksic Dep. at 76:20–77:20; Sawers Aff., Ex. 8 ("Edmunds Aff.") ¶¶ 3–4; Ex. 9 ("Parnell Aff.") ¶ 4).

II. THE DELINQUENT IRS FORMS

***2** In March 2010, the IRS notified Cortec that its federal return had been selected for examination. (Sawers Aff., Ex. 10.) As a result of that examination, the IRS notified Miksic that he failed to file various forms pertaining to his foreign interests, including (1) Form 5471 ("Information Return of a U.S. Person With Respect to Certain Foreign Corporations"), (*id.*, Ex. 11); (2) Form 3520 ("Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"), (*id.*, Ex. 12); (3) Form 3520–A ("Annual Information Return of Foreign Trust With a U.S. Owner"), (*id.*, Ex. 12); and (4) Form TD F 90–22.1 ("Report of Foreign Bank and Financial Accounts") (hereinafter "FBAR"), (*id.*, Ex. 13), (collectively the "Delinquent Forms"). Miksic alleges that the IRS assessed substantial monetary penalties, interest, and taxes as a result of Miksic's failure to file the Delinquent Forms between tax years 2005 to 2010.[2] Miksic asserts he may recover those amounts as damages, as well as costs, fees, and expenses to change accountants and retain legal counsel to respond to the IRS audit and to bring this action.

III. TAX YEARS AT ISSUE

The parties agree that during tax years 2005 to 2010, Defendants sent Miksic an engagement letter and a questionnaire. (*See* Defs.' Mem. in Supp. of Mot. for Summ. J. at 8, July 22, 2016, Docket No. 35; Pl.'s Mem. in Opp'n to Defs.' Mot. for Summ. J. at 9.) Miksic, however, signed Defendants' engagement letter only for tax year 2006. (Miksic Dep. at 57:5–58:5; Decl. of Michael T. Berger ("Berger Decl.), Ex. 4 at 2–3, Apr. 7, 2016, Docket No. 27.) That engagement letter states: "[y]ou have the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign them." (Berger Decl., Ex. 4 at 2.) The questionnaire attached to that letter asked, "[d]id you have any foreign income or pay any foreign taxes during the year?," and "[w]ere you a grantor or transferor for a foreign trust, have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country?" (*Id.* at 5–6.) Miksic asserts he did not return completed questionnaires for several of the tax years at issue. (*See* Sawers Aff., Ex. 4 at 67:4–10; 71:23–72:9.)

Instead, Miksic explained that he likely gave the questionnaire to Angie McGillivray, the Chief Financial Officer of Cortec. (Miksic Dep. at 46:20–24, 62:19–23, 63:16–65:6; *see also* Berger Aff., Ex. 5 at 33:10–34:9.) According to Miksic, McGillivray was "fully aware of all of the financial accounts in which [he] had an interest in the 2005 through 2010 timeframe," and he provided her with tax information to give to Defendants. (Miksic Dep. at 85:8–12; 48:7–49:8; 63:4–64:12.) Defendants counter that on three separate instances, one of Defendants' tax preparers (other than Parnell and Edmunds) inquired with McGillivray about Miksic's foreign financial accounts for tax years 2006, 2008, and 2010. (Berger Decl., Ex. 7, Ex. 10, Ex. 11; *see* Defs.' Mem. in Supp. of Mot. for Summ. J. at 13–14.) However, Defendants maintain, McGillivray and Miksic did not disclose Miksic's foreign accounts which should have been reported on his FBARs.

Miksic, on the contrary, asserts that Defendants did not follow up with him regarding his blank questionnaires (Sawers Aff., Ex. 4 at 67:4–10; 71:23–72:9), that Parnell and Edmunds never asked Miksic about foreign accounts (Parnell Aff. ¶ 9; Edmunds Aff. ¶ 12), that Defendants' tax return software defaulted to an inaccurate statement of Miksic's foreign interests (Edmunds Aff. ¶ 12), and —notwithstanding that Defendants filed an FBAR for Miksic in 2006 and indicated on Miksic's 2008 and 2009 tax returns that he had foreign accounts—Defendants failed to file FBARS in the tax years at issue succeeding 2006 (Sawers Aff., Ex. 4 at 83:10–84:20; Edmunds Aff. ¶ 7–8, 11). Miksic also contends that Defendants knew about Miksic's ownership interest in EcoCortec—which needed to be disclosed on Miksic's Form 5471—but that Defendants failed to file that form for tax years 2007 to 2009.[3] (Edmunds Aff. ¶ 8.) Lastly, Miksic argues Defendants never inquired whether he owned a foreign trust and that Miksic did not know his interest in and distributions from a Lichtenstein foundation required filing Forms 3520 and 3520A in tax years 2005 through 2008. (Miksic Dep. at 116:16–18; 152:3–154:5.)

IV. PROCEDURAL BACKGROUND

***3** On November 24, 2014, Miksic sued Defendants in Minnesota state court, and Defendants removed that action to federal court on December 22, 2014. (Case No.

14–5047 (DWF–TNL), Notice of Removal, Dec. 22, 2014, Docket No. 1.) The parties stipulated for dismissal of that action on February 17, 2015, and it was dismissed without prejudice on February 18, 2015. (Case No. 14–5047 (DWF–TNL), Joint Stipulation of Dismissal, Feb. 17, 2015, Docket No. 5; Dismissal Order, Feb. 18, 2015, Docket No. 6.) Miksic refiled this action on February 18, 2015, before the Court and asserted five claims against Defendants: accounting malpractice; breach of contract; unjust enrichment; negligent misrepresentation; and breach of fiduciary duty. Defendants moved for summary judgment and to exclude expert testimony on July 22, 2016.

DISCUSSION

I. MOTION FOR SUMMARY JUDGMENT

A. Standard of Review

Summary judgment is appropriate where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a). A fact is material if it might affect the outcome of the lawsuit, and a dispute is genuine if the evidence is such that it could lead a reasonable jury to return a verdict for either party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). A court considering a motion for summary judgment must view the facts in the light most favorable to the non-moving party and give that party the benefit of all reasonable inferences to be drawn from those facts. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). Summary judgment is appropriate if the nonmoving party "fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). "To defeat a motion for summary judgment, a party may not rest upon allegations, but must produce probative evidence sufficient to demonstrate a genuine issue [of material fact] for trial." *Davenport v. Univ. of Ark. Bd. of Trs.*, 553 F.3d 1110, 1113 (8th Cir. 2009). If the plaintiff's version of events "is blatantly contradicted by the record, so that no reasonable jury could believe it, a court should not adopt that version of the facts for purposes of ruling on a motion for summary judgment." *Scott v. Harris*, 550 U.S. 372, 380 (2007).

B. Statute of Limitations

The parties dispute whether the applicable statute of limitations bars Miksic's state-law cause of action for accounting malpractice against Defendants. Minn. Stat. § 541.05, subd. 1(5) provides a six year limitation period for a professional malpractice claim. *Bonhiver v. Graff*, 248 N.W.2d 291, 296 (Minn. 1976) (stating the statute of limitations for an accounting malpractice action is six years and citing to Minn. Stat. § 541.05, subd. 1(5)). Although the statute does not specifically state when that period begins, the Minnesota Supreme Court has "consistently held that the statute begins to run when the cause of action accrues, that is, when the plaintiff can allege sufficient facts to survive a motion to dismiss for failure to state a claim upon which relief can be granted." *Antone v. Mirviss*, 720 N.W.2d 331, 335 (Minn. 2006). The Minnesota Supreme Court also explained that a malpractice action accrues when the plaintiff sustained "some damage" as the result of the defendant's negligence. *Id.* at 335–36. [4]

***4** Miksic first sued Defendants on November 24, 2014, and thus any claim that accrued as early as six years from then—*i.e.*, November 24, 2008—is timely. Defendants assert that Miksic's claims accrued in April 2006 when he filed his tax forms for tax year 2005 and allegedly suffered "some damage," due to Defendants' tax preparation. Additionally, Defendants contend that the tax years at issue comprise a single course of representation such that all of Defendants' alleged negligence relates back to filing of Miksic's tax return in April 2006. Defendants rely upon *Ames & Fischer Co., II v. McDonald*, 798 N.W.2d 557, 563–64 (Minn. Ct. App. 2011) (finding that the applicable statute of limitations for an accounting malpractice claim accrued upon the filing of a tax return), *Reid Enterprises, Inc., v. Deloitte & Touche, LLP*, No. C8–99–1801, 2000 WL 665684, at *3 (Minn. Ct. App. May 23, 2000) (rejecting plaintiff's argument that there was separate negligence in each year the returns were prepared), and *Herrmann v. McMenomy & Severson*, 590 N.W.2d 641, 643–44 (Minn. 1999) (holding malpractice cause of action accrued when plaintiff took first prohibited tax action when such transactions spanned several years).

Miksic responds that his claims accrued no earlier than January 27, 2011, when the IRS issued its first penalty because prior to that date, not only would he have had no notice of the claim, but his damages would have been "[s]peculative, remote, or conjectural." *See Anderson v. Benson*, 394 N.W.2d 171, 175 (Minn. Ct. App. 1986) (rejecting buyer's alleged damages where buyer introduced no evidence that seller's failure to file a corporate tax return exposed the corporation to present or future tax liability to the IRS).

The Court finds that none of Defendants' proffered cases are controlling with regard to the statutes of limitations issue in the instant action. *Ames* is inapplicable because the certified question before the Minnesota Court of Appeals in that case was: "[d]oes a cause of action for professional malpractice arising out of a failure to make a [Internal Revenue Code] Section 754 election accrue when the tax return is filed without the election rather than when the automatic extension period expires?" *Ames*, 798 N.W.2d at 561–62. In deciding that narrow question, the *Ames* court held that the statute of limitations began to run "when the returns were filed without the Section 754 elections, which resulted in the immediate overpayment of taxes and the loss of the use of those funds." *Id.* at 564. In contrast to *Ames*, the failure to file the Delinquent Forms did not affect Miksic until January 27, 2011, the first date when the IRS levied penalties against him.

Furthermore, Defendants' attempt to fix the accrual date of Miksic's claims in April 2006 by characterizing the nature of Defendants' services as a continuous representation is misguided. Defendants assert *Herrmann* is apposite in that Miksic's opportunity to identify his interest in and income from foreign accounts and entities was identical in each of the relevant tax years and that this error related to damages Miksic allegedly suffered in April 2006. However, the tax professionals in *Herrmann* gave negligent advice once and the taxpayer acted on that advice for nearly a decade, 590 N.W.2d at 642–44; whereas in the instant action, Defendants were under a new obligation every year to conduct an investigation of the facts and prepare the appropriate tax documents for Miksic. Moreover, the *Reid* decision is factually distinguishable because in that case the IRS levied a single penalty "regardless of how many conformity violations Reid had during [a] six years [period]," 2000 WL 665684, at *2; whereas Defendants' supposed malpractice caused the IRS to assess substantial penalties for each tax year at issue.

According to Defendants, upon the failure to file the Delinquent Forms, Miksic should have sued Defendants, even though he was unaware of the failure, the IRS had not yet assessed penalties, and may never have assessed penalties. The Court is unpersuaded by Defendants' position. As the Supreme Court stated in *United States v. Boyle*, "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the [accountant or] attorney, to seek a 'second opinion,' or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place." 469 U.S. 241, 251 (1985). Accordingly, it would have been impossible for Miksic to discover the omission of his Delinquent Forms at any time earlier than receipt of his first IRS penalty notice.

***5** Only once the IRS first assessed penalties on January 27, 2011, Miksic incurred "some damage" to begin the statute of limitations period as the Minnesota Supreme Court described in *Antone*, 720 N.W.2d at 335. The *Antone* court explained that a malpractice cause of action accrues upon occurrence of "any compensable damage," not just the damage for which the precise relief is sought in the complaint. *Id.* at 336. "[T]he ability to ascertain the exact amount of damages is not dispositive with respect to the running of the statute of limitations." *Id.* at 338. Thus, at the time Miksic received his first assessed IRS penalty —although the extent of that and related penalties were unascertainable, and even if the IRS may later abate those penalties—Miksic incurred "some damage."[5] Thus, as Miksic's claim did not accrue until January 27, 2011, his instant action filed on November 24, 2014, is within the six year statute of limitations set forth in Minn. Stat. § 541.05, subd. 1(5).

C. Minnesota Statute § 544.42

Defendants also advocate for dismissal of Miksic's action on the grounds that Cobb's second affidavit fails to meet the Minnesota statutory requirements. Minnesota law requires a party asserting a claim for professional malpractice to serve a second affidavit of expert review, within 180 days after discovery begins, which sets forth the "substance of the facts and opinions to which the expert is expected to testify, and a summary of the grounds for each opinion." Minn. Stat. § 544.42, subds. 2, 4. Defendants rely upon *Guzick v. Kimball*, 869 N.W.2d 42, 51 (Minn. 2015), and *Brown–Wilbert, Inc. v. Copeland Buhl & Co.*, 732 N.W.2d 209, 219 (Minn. 2007), in which the Minnesota Supreme Court held that the expert affidavits failed to provide meaningful information beyond conclusory statements and summaries of the expert's opinions.[6]

However, Cobb's second affidavit belies Defendants' reliance on *Guzick* and *Brown–Wilbert*. In *Guzick*, the plaintiff did not provide a second affidavit of expert disclosure and instead referred back to the first affidavit in place of its second affidavit. 869 N.W.2d at 45–46.[7] Moreover, the first affidavit did not provide any information regarding the expert's causation theory but instead stated in a conclusory manner that the defendants' negligent acts "caused damages." *Id.* at 45, 51. Similarly, in *Brown–Wilbert*, the Minnesota Supreme Court held allegations in a complaint and answers to interrogatories did not satisfy the requirements for a second affidavit under Minn. Stat. § 544.42 when such information did "not identify or define any specific accounting standard of care, state how [the defendants] deviated from that standard of care, or allege how that deviation caused injury." 732 N.W.2d at 219.

***6** In contrast to those cases, Cobb's second affidavit lists several different accounting standards that form the applicable standard of care Defendants owed to Miksic, including specific provisions from the American Institute of Certified Public Accountants ("AICPA") Statements on Standards for Tax Service and the AICPA Code of Professional Conduct. (*See* Aff. of Arthur H. Cobb, Ex. 1 ¶¶ 8–10, Aug. 17, 2016, Docket No. 51.) The affidavit describes how Defendants breached that standard of care by not obtaining sufficient relevant data, not making a reasonable inquiry, not referring to Miksic's previous returns, allowing unanswered questions to default to "no," and not filing or advising Miksic to file various IRS forms. (*Id.* ¶¶ 11–17.) Furthermore, Cobb opines that Defendants' deviations from the applicable standards of care proximately and directly caused scrutiny by the IRS which caused Miksic to incur significant damages, including penalties and interest, as well as other costs, fees, and expenses. (*Id.* at ¶¶ 18–19.) Thus, Cobb's second affidavit goes well beyond conclusory statements that negligent acts "caused damages," as was the issue in *Guzick*, 869 N.W.2d at 51, and also meaningfully opines that Defendants' departure from the standard of care caused Miksic's injuries, as was the issue is *Brown–Wilbert*, 732 N.W.2d at 219.

D. In Pari Delicto

Defendants next seek to invoke the equitable defense of *in pari delicto*, a doctrine which bars a plaintiff's recovery due to his own wrongful conduct. *See Pinter v. Dahl*, 486 U.S. 622, 632 (1988). Defendants argue that Miksic is barred from recovering damages because not only did he fail to review and identify missing information from his tax returns, he also affirmatively withheld information about his foreign accounts and ownership in the Rust Foundation despite having received letters from a Swiss law firm about potential U.S. tax consequences associated with the foundation.

Defendants assert that *Christians v. Grant Thornton, LLP* is an instructive case. 733 N.W.2d 803 (Minn. Ct. App. 2007). In *Christians*, a company's Chief Executive Officer ("CEO") entered into a transaction contrary to his company's best interest, which he later concealed from the company's auditor, Grant Thornton, LLP. *Id.* at 806–07. Grant Thornton's audit resulted in an overstatement of the company's equity. *Id.* The company later went bankrupt and its trustee brought an auditor malpractice action against Grant Thornton. *Id.* at 807–08. The Minnesota Court of Appeals determined that *in pari delicto* barred such recovery because the CEO's inequitable conduct to deceive outsiders was imputed to the company, and thus the company bore "at least substantially equal responsibility for the injury it s[ought] to remedy [in the action]." *Id.* at 810, 814–15.

The Court finds *Christians* distinguishable from the instant action. In *Christians*, it was undisputed that the auditor was never presented with critical information about the company, despite the CEO's dishonest assertion that he had provided the auditor with all relevant financial records and related data. *Id.* at 814. In the instant action, however, the parties dispute whether Defendants inquired about Miksic's foreign financial accounts and entities during the tax years at issue. Although Defendants assert that they made such an inquiry for tax years in 2006, 2008, and 2010 regarding Miksic's foreign financial information (which primarily relates to FBARs), Defendants do not offer any argument regarding such an inquiry in tax years 2005, 2007, 2009. Furthermore, Miksic disputes Defendants' version of the facts and asserts that Defendants did not follow up with him—despite intimate and longstanding knowledge of his foreign affairs—to ensure the Delinquent Forms were timely filed. Miksic also asserts neither Parnell nor Edmunds ever asked Miksic if he had any foreign accounts, and that

Defendants' tax return software defaulted to an inaccurate statement of Miksic's foreign interests.

The other cases Defendants rely upon in support of the *in pari delicto* defense are also distinguishable. *Giordano v. UBS, AG*, involved a plaintiff who sought to hold a Swiss bank responsible for the consequences of the plaintiff's own filing of false tax returns when the Swiss bank was not involved in preparing those returns. 134 F. Supp. 3d 697, 701, 708–09 (S.D.N.Y. 2015). The *Giordano* court found that the plaintiff failed to "allege[ ] any facts that would relieve her of her own culpability for knowingly filing false tax returns." *Id.* at 710. *In re Hansel* is also distinguishable. No. 08–3177, 2012 WL 3113849, at *10 (Bankr. D. Minn. June 15, 2012) (holding debtor did not plead facts negating wrongdoing on her part).

***7** In contrast, Miksic asserts that Defendants—despite their intimate history of working with Miksic and general knowledge of his involvement with foreign entities—failed to inquire about Miksic's foreign financial accounts. Miksic specifically notes that notwithstanding that Defendants filed an FBAR for Miksic in 2006—and indicated on Miksic's 2008 and 2009 tax returns that he had foreign accounts – Defendants failed to file FBARS in the tax years at issue succeeding 2006. Miksic also contends that Defendants knew about Miksic's ownership interest in EcoCortec—which needed to be disclosed on Miksic's Form 5471—but that Defendants failed to file that form for tax years 2007 to 2009. Lastly, Miksic argues Defendants never inquired whether he owned a foreign trust and that Miksic did not know his interest in and distributions from a Lichtenstein foundation required filing Forms 3520 and 3520A in tax years 2005 through 2008. Based on this genuine material factual dispute of which party is at fault for the failure to file Miksic's Delinquent Forms, it is improper for the Court to apply the *in pari delicto* doctrine at this time.[8]

E. Damages

Defendants next contend that if this case proceeds, the Court must limit Miksic's claimed damages regarding FBAR penalties, Form 5471 penalties, delinquent taxes, and attorneys' fees. The Court will address each issue in turn.

1. FBAR Penalties

Defendants assert that because Miksic has appealed his FBAR penalties with the IRS, those damages should be considered too speculative and unrecoverable. In support of that argument, Defendants rely upon *Lewin v. Miller Wagner & Co.*, 725 P.2d 736 (Ariz. Ct. App. 1986), and *Olson, Clough & Straumann, CPA's v. Trayne Properties, Inc.*, 392 N.W.2d 2 (Minn. Ct. App. 1986). However, neither case is persuasive. In *Lewin*, the court held that the plaintiff's claimed accounting malpractice damages were speculative when the IRS agent had not levied any penalties and there was no evidence whether that agent's determination would be upheld at a higher IRS administrative level or in litigation. 725 P.2d at 740–41. In contrast, the IRS assessed substantial and fixed penalties based on Miksic's failure to file FBARs. Also unlike the instant action, in *Olson*, the court held reputation and loss of business damages which could not be reliably calculated were too speculative. 392 N.W.2d at 4.

Thus, the Court finds that Miksic's damages are not unduly speculative. *See, e.g., J & M Assocs., Inc. v. Callahan*, 753 F. Supp. 2d 1183, 1216 (S.D. Ala. 2010) (stating damages were "not speculative simply because [the taxpayer] ha [d] not paid the penalties, especially since the IRS ha[d] determined a specific amount owed"). Nevertheless, if this case proceeds to trial while Miksic's appeal with the IRS is still pending and if, as a result of trial, Miksic is entitled to recover from Defendants relating to his FBAR penalties, then the Court will order that amount of recovery be placed into escrow with the Court. The Court will require this because it recognizes that Miksic could doubly recover if the IRS abates Miksic's FBAR penalties. Furthermore, during the pendency of this case, Miksic's counsel is to provide a written report to the Court every six months providing any developments with Miksic's appeal with the IRS.

2. Form 5471 Penalties and Delinquent Taxes

***8** Defendants assert that after Miksic commenced this action, the IRS abated his Form 5471 penalties; thus that amount must be excluded to prevent double recovery. Defendants also contend that Miksic cannot recover the amount he paid to the IRS as tax deficiencies. Miksic does not offer any counter argument.

The Court finds Miksic is precluded from recovering any of these amounts. As the IRS abated Miksic's Form 5471 penalties, he may not seek that amount as damages in this action. *See e.g.*, *Vesta State Bank v. Indep. State Bank of Minn.*, 518 N.W.2d 850, 855 (Minn. 1994) ("[I]f inconsistent remedies are sought and it is doubtful which one will bring relief, a party may claim either or both alternatively until one remedy is pursued to a determinative conclusion."). Holding otherwise would improperly permit a double redress for a single claim. Furthermore, Miksic cannot recover as damages the amount he paid to the IRS as tax deficiencies because, "when a tax advisor's negligence leads to an underpayment of tax, the taxpayer cannot recover as damages the tax deficiency itself because the tax liability arose not from the negligent advice, but from the ongoing obligation to pay the tax." *O'Bryan v. Ashland*, 717 N.W. 2d 632, 633 (S.D. 2006). Thus, the Court finds that Miksic may not recover as damages his abated Form 5471 penalties or his payment of delinquent taxes.

3. Attorneys' Fees

Defendants finally assert Miksic cannot recover any attorneys' fees he paid to bring the instant accounting malpractice action and cite to *Whitney v. Buttrick*, 376 N.W.2d 274 (Minn. Ct. App. 1985). Defendants, however, do not address whether Miksic may claim damages for attorneys' fees paid to respond to the IRS audit. Miksic counters he is entitled to recover attorneys' fees he paid during his tax appeal with the IRS, citing to *Hill v. Okay Constr. Co.*, 252 N.W.2d 107, 121 (Minn. 1977), as well as attorneys' fees in the instant case to mitigate damages caused by Defendants' malpractice.

The Minnesota Supreme Court explained in *Hill* that, "[a]ttorneys fees and expenses are not generally included in the measure of recoverable damages for negligence. An exception is recognized, however, when the attorneys fees and expenses claimed are incurred in other litigation which is necessitated by the act of the party sought to be charged." 252 N.W.2d at 121 (citation omitted). Likewise, the Minnesota Court of Appeals in *Whitney* held that "appellant's claim that respondent is liable to him for attorney fees in suing respondent for legal malpractice fails in the absence of authorization by statute or case law. Attorney fees and expenses are not generally included in the measure of recoverable damages for negligence." 376 N.W.2d at 281 (citing *Hill*, 252 N.W.2d at 121).

Thus, although *Hill* appears to support Miksic's position that his attorneys' fees paid during his tax appeal with the IRS are recoverable—which Defendants do not contest—clearly under both *Hill* and *Whitney*, attorneys' fees expended in the instant accounting malpractice action are not recoverable. Miksic does not cite to any Minnesota case holding otherwise. The Court will therefore grant Defendant's motion for summary judgment that Miksic's request for attorneys' fees in connection with this action fails as a matter of law.

II. MOTION TO EXCLUDE EXPERT WITNESS TESTIMONY

***9** Defendants move to exclude testimony from Miksic's expert witness, Cobb. Defendants assert that Cobb is not qualified to offer an expert opinion on the specific tax preparation issues involved in this litigation, that Cobb employs the wrong professional standards in reaching his liability and causation theories, and that Cobb's testimony is legally deficient.

A. Standard of Review

Expert testimony is governed by Federal Rule of Evidence 702. Rule 702 provides the following:

> A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:
>
> (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
>
> (b) the testimony is based on sufficient facts or data;
>
> (c) the testimony is the product of reliable principles and methods; and
>
> (d) the expert has reliably applied the principles and methods to the facts of the case.

Fed. R. Evid. 702. The district court has a gate-keeping obligation to make certain that all testimony admitted under Rule 702 satisfies these prerequisites and that "any and all scientific testimony or evidence admitted is not only relevant, but reliable." *Daubert v. Merrell Dow*

Pharm., Inc., 509 U.S. 579, 589 (1993). The proponent of the expert testimony has the burden of establishing by a preponderance of the evidence that the expert is qualified, that his or her methodology is scientifically valid, and that "the reasoning or methodology in question is applied properly to the facts in issue." *Marmo v. Tyson Fresh Meats, Inc*., 457 F.3d 748, 757–58 (8th Cir. 2006). The reliability inquiry is "designed to 'make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field.' " *Id.* at 757 (quoting *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 152 (1999)).

The Eighth Circuit has held that "[c]ourts should resolve doubts regarding the usefulness of an expert's testimony in favor of admissibility." *Id.* at 758; *see also Kumho Tire*, 526 U.S. at 152 ("[T]he trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable."). "Only if the expert's opinion is so fundamentally unsupported that it can offer no assistance to the jury must such testimony be excluded." *Bonner v. ISP Techs., Inc.*, 259 F.3d 924, 929–30 (8th Cir. 2001) (quoting *Hose v. Chi. Nw. Transp. Co.*, 70 F.3d 968, 974 (8th Cir. 1996)).

B. Cobb's Qualifications

The parties do not dispute that Cobb is not a tax preparer. Defendants assert Cobb is not qualified to offer an expert opinion because he has no education, training, or experience in tax preparation of the specific forms at issue and, as a result, has no experience in complying with the specific professional standards governing tax preparation services. Defendants principally rely on *Khoday v. Symantec Corp.*, 93 F. Supp. 3d 1067, 1081 (D. Minn. 2015) (holding "general background" and "common sense" were "not adequate methods or techniques for formulating specific opinions," especially where the expert had not personally preformed any software downloads or used the websites at issue), and *Noske v. Friedberg*, 713 N.W.2d 866, 872 (Minn. Ct. App. 2006) (affirming the trial court's decision to preclude a law professor who taught torts and professional responsibility from testifying in a legal malpractice case because "lack of practical or academic experience in the criminal-law area" rendered his testimony about the duty of a criminal defense attorney inadmissible).

***10** However, Defendants argument is refuted by Cobb's deposition testimony. Cobb indicated that some of his continuing education credits related to the preparation of individual tax returns and that he took a course within the last year specifically on tax preparation for individuals with foreign accounts or foreign investments. (Sawers Aff., Ex. 6 ("Cobb Dep.") at 40:11–41:5.) Cobb also testified that he has advised and analyzed FBAR and Form 5471 filings, analyzed tax returns, and served on the professional ethics committee of the Minnesota Society of Certified Public Accountants where he analyzed accountants in practice. (*Id.* at 34:7–36:18, 43:8–45:4.) Furthermore, Cobb explained that he applied various AICPA professional standards for tax services—including preparation of individual tax forms—and that he has had many instances throughout his career to analyze tax preparation and tax returns. (*Id.* at 43:8–48:25, 59:13–24.)

Thus, unlike *Khoday*, 93 F. Supp. 3d at 1081, and *Noske*, 713 N.W.2d at 872, the Court finds that Cobb has sufficient educational and practical experience relating to tax accounting and the applicable professional standards to testify regarding the professional duties applicable to the tax accountants in this dispute.

C. Cobb's Opinion Regarding AICPA AR § 100

Defendants also assert that Cobb's liability and causation views, which are based in part upon AICPA AR § 100, should be excluded because that standard was erroneously applied and will confuse the jury. (*See* Sawers Aff., Ex. 29 ("Cobb Report.") at 12; Cobb Dep. at 106:1–5.) Defendants specifically note that AICPA AR § 100 applies to audit and financial review services, whereas the instant malpractice action involves Defendants' performance of tax services. (*See* Cobb Dep. at 105:4–22.) Thus, Defendants assert, Cobb's liability or causation views are not derived from any reliable or accepted application of AICPA AR § 100 to this case.

However, Defendants' argument misunderstands Cobb's application of AICPA AR § 100 in this action. Cobb does not opine that AICPA AR § 100 applied to Defendants' tax preparation services specifically. (*See* Cobb Report. at 12.) Instead, Cobb explained during his deposition that, pursuant to its audit and financial review services of Cortec, Defendants had an independent duty to investigate and obtain a general understanding of Cortec's organization and financial dealings. (Cobb

Dep. at 106:6–17.) That knowledge, Cobb asserts, should have informed Defendants' tax preparation services for Miksic and would have prevented many of the tax filings errors at issue. (*Id.* at 106:6–109:8.) As the Court does not find that this distinction would confuse a jury or would render Cobb's opinion unreliable, the Court will deny Defendants' motion to exclude Cobb's expert testimony.

This case will be placed on the Court's next available trial calendar.

ORDER

Based on the foregoing, and all the files, records, and proceedings herein, **IT IS HEREBY ORDERED** that:

1. Defendants' Motion for Summary Judgment [Docket No. 33] is **GRANTED in part** and **DENIED in part** as follows:

a. To the extent the motion seeks to preclude Miksic from recovering as damages abated Form 5471 penalties, payment for delinquent taxes, and attorneys' fees expended to bring the instant action, the motion is **GRANTED.**

b. In all other respects, the motion is **DENIED.**

2. Defendants' Motion to Exclude Expert Witness Testimony [Docket No. 37] is **DENIED**.

All Citations

Slip Copy, 2017 WL 1169528

Footnotes

[1] In 1988, Miksic retained Johnson, West & Co. P.L.C., which later merged with Boeckermann Graftstrom Mayer, LLC, in 2012. (*Id.* at 50:2–18; Sawers Aff., Ex. 7.)

[2] The Court was unable to determine, based on the parties' briefings and a thorough review of the record, the exact amount of IRS penalties, interest, and delinquent taxes assessed during the 2005 to 2010 tax years relating to the Delinquent Forms. The parties themselves offered different amounts, (*compare* Compl. ¶¶ 44–50, Feb. 18, 2015, Docket No. 1, *with* Defs.' Mem. in Supp. of Mot. for Summ. J. at 17–19, July 22, 2016, Docket No. 35, *and* Pl.'s Mem. in Opp'n to Defs.' Mot. for Summ. J. at 5–6, Aug. 12, 2016, Docket No. 43), and the Court was unable to resolve the discrepancies based on the parties' citations to the record.

[3] The IRS, however, ultimately abated the $60,000 it initially assessed in penalties for Miksic's late Form 5471 filing. (Berger Decl., Ex.14.)

[4] Although *Antone* was a legal malpractice case and the instant action is an accounting malpractice case, the parties agree that the statute of limitations – Minn. Stat. § 541.05, subd. 1(5)—applies to both kinds of professional negligence cases. (*See* Defs.' Mem. in Supp. of Mot. for Summ. J. at 21; Pl.'s Mem. in Opp'n to Defs.' Mot. for Summ. J. at 19.)

[5] Defendants also contend that Miksic's claims are barred by the doctrine of laches because Miksic waited many years before filing this case and significant information was lost through the death of Cliff Lozinski, a critical witness in this malpractice action. However, because Miksic's accounting malpractice action is a legal action governed by an applicable statute of limitations, the equitable doctrine of laches has no application. *See Aronovitch v. Levy*, 56 N.W.2d 570, 573–574 (Minn. 1953) ("Where a party is seeking a legal remedy upon a legal right, we have held that the doctrine of laches has no application and that the remedy will be barred only by the statute of limitations.") (collecting cases).

[6] Defendants also assert that Cobb's second affidavit is speculative and did not include the substance of his opinions because he testified during his deposition that he reached those opinions after serving his second affidavit. (*See* Decl. of Michael T. Berger, Ex. 5 at 9:5–20, July 22, 2016, Docket No. 40; *see also* Aff. of Arthur H. Cobb, Ex. 1, Aug. 17, 2016, Docket No. 51.) However, there is no reason to doubt that Cobb's second affidavit reflected his analysis at the time it was submitted and that his expert opinions had not been cemented at that time because discovery was ongoing. This is consistent with the statutory requirement that a second affidavit of expert review be served within 180 days after discovery begins. Minn. Stat. § 544.42, subd. 2.

[7] In *Guzick*, the Minnesota Supreme Court refers to the first affidavit required by Minn. Stat. § 544.42 as the "affidavit of expert review" and the second affidavit as the "affidavit of expert disclosure." 869 N.W.2d at 46–47.

[8] Defendants also contend that Miksic's signature on his tax return serves as his constructive notice of the contents and is *prima facie* evidence that he understood questions on his tax return regarding FBAR and Form 3520 filing requirements. Defendants cite to *United States v. Williams*, 489 Fed.Appx. 655, 659 (4th Cir. 2012) (finding that a signature was *prima*

facie evidence the taxpayer reviewed the return and that line 7a put the taxpayer on inquiry notice of FBAR requirements); *United States v. McBride*, 908 F. Supp. 2d 1186, 1208 (D. Utah 2012) (finding as a matter of law that a taxpayer who signs his return is charged with having reviewed that return and with having knowledge of his foreign account disclosure requirement); *Thomas v. UBS AG*, No. 11–4798, 2012 WL 2396866, at *5 n. 2 (N.D. Ill. June 21, 2012) (finding that "[t]he simple yes-or-no question of Schedule B makes it inconceivable that [a taxpayer] could have misinterpreted this question"). However, none of these cases were accounting malpractice cases or discussed the *in pari delicto* defense, and thus, they do not assist the Court in making such a determination. These cases instead generally involved whether the IRS could assess penalties against taxpayers for willfully violating the Internal Revenue Code section requiring an annual report of foreign financial interests.

End of Document

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United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
Michael QUIEL, Defendant/Movant.

CV 16-1535-PHX-JAT (MHB)
|
CR 11-2385-PHX-JAT
|
Signed 06/06/2017

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REPORT AND RECOMMENDATION

Michelle H. Burns, United States Magistrate Judge

***1** TO THE HONORABLE JAMES A. TEILBORG, UNITED STATES DISTRICT JUDGE:
Defendant/Movant Michael Quiel, who is represented by counsel, filed an amended Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody. (CV 16-1535 ("CV") Doc. 7.)[1] Plaintiff United States of America (the "government") filed a Response to the amended Motion, and Movant has filed a Reply. (CV Docs. 11, 14.)

BACKGROUND[2]

On December 8, 2011, a grand jury indicted Movant Michael Quiel with one count of Conspiracy to Defraud the United States, two counts of Willful Subscription to False Individual Income Tax Returns, and two counts of Willful Failure to File Reports of Foreign Bank and Financial Accounts ("FBAR").[3] (CR Docs. 3, 463.)

On September 24, 2013, Movant was convicted on two counts of Willful Subscription to False Individual Income Tax Returns, in violation of 26 U.S.C. § 7206(1).[4] He was sentenced to a 10-month term of imprisonment, to be followed by a one-year term of supervised release. Movant appealed his convictions to the Ninth Circuit Court of Appeals arguing, the following:

- "[Movant] was denied his constitutional right to cross-examine Rusch on three exhibits entered on redirect"
- "The Government's repeated reference to [Movant's] complicated securities transactions as fraud was prejudicial and the court's allowing such references over objection was error"
- "[Movant] was denied his constitutional right to counsel by the trial court's allowing Rusch to testify in violation of [Movant's] attorney-client privilege"
- "The trial court erroneously refused to require production of the special agent's report, [Movant's] individual master file, and the notes of the Government's chief investigator, and refused to review the documents in camera or even preserve them for review by this court"

(United States v. Quiel, No. 13-10503, Doc. 20.)

***2** The Ninth Circuit affirmed Movant's convictions on December 19, 2014, and the mandate issued on February 6, 2015. United States v. Quiel, 595 Fed.Appx. 692 (9th Cir. 2014), cert. denied, 135 S.Ct. 2336 (2015). The Ninth Circuit held, in pertinent part:

> The question of whether Defendants willfully failed to report income ... is one of fact for the jury. *See Rykoff v. United States*, 40 F.3d 305, 307-08 (9th Cir. 1994). The jury could have concluded that Kerr and Quiel knew they had a duty to report the income from their foreign accounts, because Christopher Rusch, their attorney and business partner, testified that the accounts were set up using nominees under Kerr's and Quiel's control in order to evade reporting requirements. Even without Rusch's testimony, the jury could have inferred control because (a) the

> accounts were traded in Kerr's and Quiel's stock for their benefit; (b) the foreign firms never served their stated purpose of finding investors; and (c) these firms were not actual, functioning businesses. Additionally, even without Rusch's testimony, the jury could infer motive from Kerr's having recently paid high tax rates and Quiel's recent payment of a large tax penalty before either engaged in these transactions.

On March 13, 2015, Movant and Kerr filed a Joint Motion for New Trial pursuant to Rule 33 of the Federal Rules of Criminal Procedure alleging newly discovered evidence. (CR Doc. 454.) Specifically, Defendants' argued: (1) "evidence has emerged showing that Rusch engaged in fraudulent activities"; (2) "the Government has agreed 'to look the other way while its witness commits additional crimes' "; and (3) "Pierre Gabris, a Swiss-national and alleged participant in the structuring of the Swiss accounts, would testify that 'he did not prepare or send trial exhibits 51 and 52,' which were offered into evidence on Rusch's re-direct" and "contain emails originally sent from Gabris to Rusch, who forwarded them to Defendants, regarding accounting statements from Defendants' Swiss corporations." (CR Docs. 454, 463.) The Court denied the Joint Motion for New Trial on July 15, 2015, (CR Doc. 463), and on July 28, 2015, Movant and Kerr filed a Notice of Appeal from the July 15, 2015 Order (CR Doc. 467).

On December 28, 2015, in the appellate court case, Movant and Kerr filed a Joint Motion for Remand to the District Court & Motion to Stay Briefing Schedule, arguing that the Court of Appeals should remand the action to the district court so it can: (1) "consider evidence that was before it but which that [the district] Court did not consider," and (2) consider new evidence and argument that either came to light after the Joint Motion for New Trial was filed or "was [not] otherwise ... presented." (United States v. Kerr, et al., No. 15-10393, Doc. 17.)

The Ninth Circuit denied the Motion for Remand without prejudice to the filing of "a renewed motion accompanied by an indication that the district court is willing to entertain the limited remand motion." (United States v. Kerr, et al., No. 15-10393, Doc. 19.) On March 7, 2016, Movant and Kerr filed a Joint Motion to Accept Remand to Consider New Evidence for a New Trial in the district court. (CR Doc. 471.) Defendants argued: (1) "This Court should accept a remand so as to consider new evidence and argument that were not before this Court but which came to light while the motion was pending, after it was appealed, or that was otherwise not presented"; and (2) "This Court should accept remand so as to consider evidence that was presented to this Court" but "which this Court did not consider." (CR Doc. 471.) Defendants' newly discovered evidence consisted of four declarations, one of which came from Jerome Perucchi that was signed on June 4, 2015, and was used as part of civil lawsuit in a state court matter. (CR Doc. 471.)

***3** While the Joint Motion was pending before the district court, on May 17, 2016, Movant filed a Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody. (CV Doc. 1; CR Doc. 474.) Thereafter, the district court directed the parties to show cause why the § 2255 proceeding should not be stayed pending the Court's determination on the Joint Motion to Accept Remand. (CV Doc. 3.)

Then, on July 22, 2016, the Court denied the Joint Motion to Accept Remand (CR Doc. 475),[5] and on August 2, 2016, the Court discharged the Order to Show Cause after concluding that it had been mooted by the Court's ruling on the Joint Motion (CV Doc. 6). In the same August 2, 2016 Order, the Court also denied Movant's § 2255 Motion with leave to amend and gave Movant 30 days to file an amended motion using the court-approved form. (CV Doc. 6.)

On September 1, 2016, Movant filed an amended Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody (CV Doc. 7). In the amended § 2255 Motion, Movant alleges four grounds for relief. In Ground One, he claims that he received ineffective assistance of counsel because his trial attorney refused to call any witnesses or submit any evidence after the government rested its case in chief. In Ground Two, Movant appears to argue that his due process rights were violated by the introduction at trial of perjured testimony that the government knew or should have known was false. Movant further alleges that the government failed or refused to produce evidence that would confirm that perjured testimony was introduced at trial. In Ground Three, Movant claims that the government has not produced evidence that it properly appointed the attorneys who prosecuted him, and the government has not demonstrated that it followed "proper procedure when it began prosecution." In Ground Four, Movant argues that he received ineffective assistance of counsel in connection with "matters that occurred pre and post trial." (CV Docs. 7, 10.)

DISCUSSION

In its Response, the government argues that: (1) both of Movant's ineffective assistance of counsel claims are meritless; (2) Movant's false testimony claim is either procedurally defaulted for failing to raise it on direct appeal, or that Movant cannot re-litigate a claim that was previously decided by the district court in its order denying the Joint Motion for New Trial and order denying the Joint Motion to Accept Remand; and (3) Movant's claim that the Court lacked jurisdiction because the attorneys who appeared on the government's behalf were not properly appointed public officers is procedurally defaulted. Thus, the government contends that Movant's amended Motion to Vacate, Set Aside, or Correct Sentence be denied and dismissed with prejudice.

A. Grounds One and Four

***4** The two-prong test for establishing ineffective assistance of counsel was set forth by the Supreme Court in Strickland v. Washington, 466 U.S. 668 (1984). To prevail on an ineffective assistance claim, a convicted defendant must show (1) that counsel's representation fell below an objective standard of reasonableness, and (2) that there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different. See id. at 687-88.

There is a strong presumption that counsel's conduct falls within the wide range of reasonable assistance. See id. at 689-90. "A fair assessment of attorney performance requires that every effort be made to eliminate the distorting effects of hindsight, to reconstruct the circumstances of counsel's challenged conduct, and to evaluate the conduct from counsel's perspective at the time." Id. at 689. Review of counsel's performance is extremely limited. Acts or omissions that "might be considered sound trial strategy" do not constitute ineffective assistance of counsel. Id. The prejudice component "focuses on the question whether counsel's deficient performance renders the result of the trial unreliable or the proceeding fundamentally unfair." Lockhart v. Fretwell, 506 U.S. 364, 372 (1993).

In the context of an uncalled witness, a petitioner must identify the witness, see United States v. Murray, 751 F.2d 1528, 1535 (9th Cir. 1985), show that the particular witness was willing to testify, see United States v. Harden, 846 F.2d 1229, 1231-32 (9th Cir. 1988), what the witness's testimony would have been, see United States v. Berry, 814 F.2d 1406, 1409 (9th Cir. 1987), and that the testimony would have been sufficient to create a reasonable doubt as to guilt, see Tinsley v. Borg, 895 F.2d 520, 532 (9th Cir. 1990). See also Dows v. Wood, 211 F.3d 480, 486-87 (9th Cir. 2000) (finding the defendant did not establish IAC where there was no evidence, other than "[Defendant's] self-serving affidavit," that alibi witness "would have provided helpful testimony for the defense").

The court need not address both Strickland requirements if the movant makes an insufficient showing on one. See Strickland, 466 U.S. at 697 (explaining that "[i]f it is easier to dispose of an ineffectiveness claim on the ground of lack of sufficient prejudice, ... that course should be followed."); Rios v. Rocha, 299 F.3d 796, 805 (9th Cir. 2002) (stating that "[f]ailure to satisfy either prong of the Strickland test obviates the need to consider the other").

1. Ground One

In Ground One, Movant alleges that his trial counsel, Michael Minns, "provided Ineffective Assistance of Counsel by refusing to call any witnesses, including expert witnesses ...." Movant states:

> Gail Prather would have testified to the correctness of the 2007 and 2008 Forms 1040 filed by Mr. Quiel and that no tax was owed (Counts 4 and 5). Ms. Prather's report stated, "Michael Quiel ... owe[d] zero net tax." (Doc. 198-2 at 3) "If the unidentified deposits and resulting expenditures and losses were included substantial refunds would be generated." (Doc. 198-2 at 4). ...

Movant also states:

> Matthew Kadish was a defense expert who would have testified that Mr. Quiel was not required to file an FBAR form. His testimony contradicted Cheryl Bradley and Rusch that with only a credit card and no account in Belize, Mr. Quiel would not be required to file an FBAR. He also opinioned that because Mr. Quiel "would own less than 10%," "did not form the entity," "did not have signatory" authority over the accounts, nor entitlement to more than [his] proportionate ownership," then Mr. Quiel would not have known if the reporting requirement was triggered. (Doc. 350-1, pg 13-14) Because there was no tax owed for 2007 and 2008, there would be no civil penalties, no concealment of taxable income, and that the only problem was that Mr. Quiel was following "very bad professional advice, rather than willfully misreporting or failing to file [an FBAR form]." (Doc. 350-1 at 16).

***5** Lastly, Movant states:

> Cynthia King was a defense securities expert who would have testified that there was no business wrongdoing by Mr. Quiel in: 1. Transacting in reverse mergers; 2. Investing in private start-up companies; 3. Receiving payment in the form of securities; 4. Signing a blank stock power; 5. Making stock purchase agreements; 6. Participating in forward and reverse stock splits; 7. Structuring investments so as to not own more than 4% of a company; 8. Lacking evidence that Mr. Quiel violated SEC rules, that he never fraudulently acquired stock nor filed false or misleading information with the SEC. (Doc. 398-3, pg 3-5).

Movant claims that he "was familiar with the witnesses, their reports, and the testimony they were prepared to give. Thus, contrary to the government's unsubstantiated allegations ... Mr. Quiel knew that the experts would have testified 'that [he] owed no tax for 2007 and 2008, that the Forms 1040 [he] filed for those years were accurate, that [he] did not ... do anything wrong'; in other words, there was no fraud or deceit, no willfulness, and the 2007 and 2008 returns were NOT incorrect as to a material matter. Thus, three elements under Section 7206(1) would have been negated." [6]

According to Defendant's Joint Submission of Expert Reports (CR Doc. 198), Matthew Kadish submitted an expert report stating that his "opinion in this matter is limited to foreign bank account reporting under Title 31 of the U.S. Code." (CR Doc. 198-1 at 2.) According to the report, Mr. Kadish's proposed testimony included a history of the FBAR reporting requirements and his opinion regarding its perceived complexity followed by two primary opinions: (1) that Defendants may not have had a filing obligation, and (2) that Defendants' did not act willfully in failing to file their FBARs disclosing their Swiss accounts. (CR Doc. 198-1 at 11.) At the end of his report, Mr. Kadish states, "if as Gail Prather opines, neither Quiel nor Kerr owes taxes for the years in question, that would appear to undermine the Government's assertion of a coordinated effort to conceal taxable income, and would seem to further support Quiel's and Kerr's assertion that they were following very bad professional advice, rather than willfully misreporting or failing to file the Form 90-22.1 as charged by the Government."

In the same Submission, Gail Prather provided an expert report stating, "[b]ased on the results of our calculations, we find that there is sufficient evidence to support the conclusion that

> ***6** — Michael Quiel ("Quiel") and Stephen Kerr ("Kerr") owe zero net tax.
>
> — If the unidentified deposits and resulting expenditures and losses were included substantial refunds would be generated." (CR Doc. 198-2 at 2-3.)

Ms. Prather summarizes the findings in her report, stating:

> Quiel calculations include the deposits and sales of shares with interest, dividends, and foreign exchange transactions less the expenditures from the accounts and resulting capital losses.
>
> 2007—increase in tax of $516,303 less tax due to carry back of $762,997 for a refund of $246,694.
>
> 2008—increase in tax of $197,805
>
> Net operating loss of $2,304,770 available for carry back.

> Net due taxpayer as a result of recording additional income and resulting expenditures and losses $48,889.

Additionally, in their Response to Government's Motion to Preclude and/or Limit Testimony of Defendants' Proposed Expert Witnesses, Defendants' state, "Ms. Prather has two consistent opinions. The first is that no taxes are due because there is no duty to report the Swiss funds. The second is that even if there were such a duty, no taxes would be due and owing because of losses. For Mr. Quiel, a refund has been sent to him. Mr. Kerr and Mr. Quiel both have large loss carry-backs eliminating any tax due, if applicable." (CR Doc. 206 at 22.)

Lastly, the Joint Submission of Expert Reports contains the expert report submitted by Cynthia King. Defendants state that "[t]he purpose of Ms. King's testimony is to refute the 404(b) information." (CR Doc. 206 at 25.) According to her report, Ms. King stated, "I have been asked to analyze the facts discussed in this report by counsel for Stephen Kerr ("Kerr") and Michael Quiel ("Quiel"). I have done so. ... [M]y opinion is that none of the allegations in the Government's 404B notice substantiate any wrongdoing." (CR Doc. 198-3 at 1.)

The Court finds that Movant has failed to demonstrate a reasonable probability that, but for counsel's errors, the result of the proceeding would have been different. The counts of conviction required the government to prove that defendants "[w]illfully ma[de] and subscribe[d]" tax returns that they did "not believe to be true and correct as to every material matter," 26 U.S.C. § 7206(1).[7] None of these three experts opine that the 2007 and 2008 tax returns Movant filed with the IRS were true and accurate as to every material matter. (CR Docs. 198-1, 198-2, 198-3.)

***7** According to his expert report, Mr. Kadish's opinion was "limited to foreign bank account reporting under Title 31 of the U.S. Code." (CR Doc. 198-1.) He would have testified that Movant may not have had a filing obligation, and that Movant did not act willfully in failing to file the FBARs. However, Movant was never convicted of the FBAR counts. The Court dismissed the FBAR counts with prejudice. (CR Doc. 308.) Thus, Movant cannot establish prejudice from counsel's failure to call Mr. Kadish at trial.

Second, according to her report, Ms. Prather would have testified that Movant "owe[s] zero net tax" and that "[i]f the unidentified deposits and resulting expenditures and losses were included substantial refunds would be generated." (CR Doc. 198-2.) However, Movant was convicted of violating 26 U.S.C. § 7206(1)—which does not require the government to prove a tax loss. Thus, since a tax due and owing is not an element of Section 7206(1), the Court fails to find a reasonable probability that the result of the proceeding would have been different because of Ms. Prather's testimony.

Movant claims, however, that Ms. Prather "would have testified to the 'validity' of the Forms 1040 filed by Defendant for 2007 and 2008." The Court's review of her expert report reveals that nowhere in her report does she opine that Movant's 2007 and 2008 returns were true and accurate as to every material matter. Instead, Ms. Prather's report concludes stating that in 2007, Movant had an increase in tax of $516,303, and in 2008, Movant had an increase in tax of $197,805, and that loss carry-backs eliminated any tax due. Based on this proposed testimony, the Court cannot say that there is a reasonable probability that the result of the proceeding would have been different.

Lastly, according to Movant's pleadings and Ms. King's expert report, she would have testified "to refute the 404(b) information." She would have opined that "none of the allegations in the Government's 404B notice substantiate any wrongdoing." Ms. King would have specifically testified to the legitimacy of Movant transacting in reverse mergers; investing in private start-up companies; receiving payment in the form of securities; signing a blank stock power; receiving stock purchase agreements; participating in forward and reverse stock splits; structuring investments so as to not own more than 4% of a company; and that she saw no evidence that Movant "fraudulently acquired stock in violation of SEC rules," or "caused forms to be filed with the SEC that contained false or misleading information." Again, however, none of specifics set forth in her testimony state that the 2007 and 2008 tax returns Movant filed with the IRS were true and accurate as to every material matter. Thus, the Court fails to find a reasonable probability that the result of the proceeding would have been different because of Ms. King's testimony.

Movant, however, alleges that he "was familiar with the witnesses, their reports, and the testimony they were prepared to give," and that he "knew that the experts would have testified 'that [he] owed no tax for 2007 and 2008, that the Forms 1040 [he] filed for those years were accurate, that [he] did not ... do anything wrong'; in other words, there was no fraud or deceit, no willfulness, and the 2007 and 2008 returns were NOT incorrect as to a material matter." Other than the fact that Movant "owed to no tax," Movant's allegations are speculative and unsupported by the expert reports. Such conclusory allegations are insufficient to support a claim for ineffective assistance of counsel. See, e.g., Shah v. United States, 878 F.2d 1156, 1161 (9th Cir. 1989) ("Mere conclusory allegations are insufficient to state a claim of ineffective assistance of counsel."); Jones v. Gomez, 66 F.3d 199, 204-05 (9th Cir. 1995) (stating that conclusory allegations with no reference to the record or other evidence do not warrant habeas relief).

2. Ground Four

***8** In Ground Four, Movant argues that he received ineffective assistance of counsel in connection with "matters that occurred pre and post trial." Specifically, Movant states that his counsel "in the Maricopa County case and in the bond hearing," Joy Bertrand, had "ample access and knowledge to provide the dismissal in the Maricopa County case to this Court." Movant states that Ms. Bertrand's "failure to provide that information caused Mr. Quiel's custody level to rise and resulted in his incarceration at a 'low facility' rather than at a 'minimum' facility commonly referred to as a camp. As such, Mr. Quiel was held in El Paso, Texas, more than 500 miles from his family, as opposed to a camp in Tucson, Arizona, less than two hours from his family." Movant states that Ms. Bertrand "failed to obtain and file Mr. Perucchi's affidavit with this Court," would not communicate with him regarding the Rule 33 motion, and refused to file documents he sent to her, thus denying him access to the court.

The argument alleged in Ground Four is not entirely clear. The Court assumes that Ms. Bertrand was Movant's counsel in a Maricopa County case, during the federal bond hearing in this matter, and during various stages of the Rule 33 litigation. Initially, the Court notes that any allegation of ineffective assistance regarding Movant's "Maricopa County case" is not relevant and has nothing to do with the instant matter. Further, Movant has failed to provide any information on how his bond hearing proceedings, wherein Movant was ordered released, affected his trial. Lastly, to the extent Movant alleges that Ms. Bertrand failed to properly advise, represent, and discuss matters with him during the Rule 33 proceedings, the Court is not persuaded. Movant's cursory allegations, which are devoid of any factual support and are purely speculative in nature, cannot support a claim of ineffective assistance of counsel. See, e.g., Shah, 878 F.2d at 1161 ("Mere conclusory allegations are insufficient to state a claim of ineffective assistance of counsel."); Jones, 66 F.3d at 204-05 (stating that conclusory allegations with no reference to the record or other evidence do not warrant habeas relief). Thus, the Court finds that Movant has failed to demonstrate ineffective assistance of counsel. Movant is not entitled to any relief.

B. Ground Two

In Ground Two, Movant appears to argue that his due process rights were violated by the introduction at trial of perjured testimony that the government knew or should have known was false. Movant further alleges that the government "failed or refused to produce the evidence that would verify the perjury."

In support of his claim, Movant states "[a]t trial, Christopher Rusch testified that he prepared TD F 90.22-1 (FBAR) forms for Mr. Quiel. Rusch testified that he prepared amended returns for Mr. Quiel that had FBARs attached. (Tr. March 19, 2013, pg 1614, 1619, 1622-24)." Movant states that "Cheryl Bradley testified that she sent Mr. and Mrs. Quiel a letter requesting various things," including the "FBAR forms for tax years ending after [2001] (Tr. March 7, 2013, pg 591). When asked, 'Did you receive the information that was listed in this letter, Items 1 through 9?' Ms. Bradley answered, 'Yes,' and that it came 'through Christopher Rusch.' (Tr. March 7, 2013, pg 592)." Movant states that he has the amended returns, but no FBARs are with the returns. Movant states that the IRS claims that it "needs additional time to respond," and argues that "[i]f those documents do not exist, then the evidence (or lack thereof) demonstrates that both Cheryl Bradley and Christopher Rusch offered perjured testimony during the trial. That testimony, if shown false, could be sufficient for the jury to have acquitted Mr. Quiel."

Movant also states, "Rusch testified on Day 12, 'Perucchi agreed to stand in as the nominee beneficial owner.' (Tr.

March 27, 2013 pg 2530, ln 12-13). Rusch further testified that he opened 'a new Swissquote account ... in the name of Jerome Perucchi.' (Tr. March 27, 2013, pg 2536, ln 9-10). And, Rusch testified that he was 'the notary for Mr. Perucchi, who [Rusch] said was not actually in front of [him] when [Rusch] notarized that [Perucchi] was.' (Tr. March 27, 2013, pg 2584 ln 20-22). The purpose of the document falsely notarized was 'to open an account at Sterne Agee ... [t]o sell stock, the ITLI or Intelligentias stock ... [which was] Mr. Perucchi authorizing to sell, assign or transfer these stocks.' (Tr. March 27, 2013, pg 2585 ln 12-19.) When questioned why he didn't have Mr. Perucchi in front of him, Rusch testified, 'He was in Switzerland and I needed to get it notarized ... so I just printed the notary on there and stamped it.' (Tr. March 27, 2013, pg 2585, ln 22-25). Rusch was asked, 'And why didn't you fly to Switzerland and have Mr. Perucchi sign this in front of you? A. It would have taken too long and been too costly.' (Tr. March 27, 2013, pg 2586, ln 1-3)."

***9** Movant then quotes the affidavit of Jerome Perucchi stating, "[m]y involvement with the Fund was extremely limited. ... My business associate asked if I would serve as the director of the Fund for the first year of its existence. I agreed to do so. Perucchi Decl. ¶ 18. He declared, 'To the best of my recollection, the only documents that I signed regarding the Fund were [ ] to create the fund and nam[e] me as the director.' Perucchi Decl. ¶ 19. Most importantly, Perucchi verified, "I had no knowledge the Fund was ever incorporated and brought into existence. I never performed any functions as the director of the Fund, invested any money in the Fund, managed the Fund, or received any compensation of any kind from the Fund or Mr. Quiel.' Perucchi Decl. ¶ 20-21." Thus, Movant contends that Rusch "not only falsely notarized Mr. Perucchi's signature, he forged that signature multiple times to perpetuate his scheme and hide his lies, which he hid from Mr. Quiel and from this Court during trial."

Lastly, Movant addresses "additional false testimony," including, testimony regarding Exhibits 51 and 52 that Rusch testified that he "printed" and "faxed" to Movant —but that Movant never received; the use of Movant's passport and personal information without Movant's knowledge or permission; evidence at trial showing that Rusch arranged for and/or oversaw setting up Swiss entities and funds that Mr. Quiel had no control over; and "things Rusch testified to at trial, which included his criminal behavior, did not cease[,] rather they continued on under the pseudonym of Reeves."

Movant's claim alleged in Ground Two is vague, at times, and difficult to pin down. In addition to the litany of speculative and non-specific "supporting facts," Movant fails to specify whether he is alleging a claim pursuant to Brady v. Maryland, 373 U.S. 83 (1963) or Napue v. Illinois, 360 U.S. 264 (1959). Although the Court recognizes that both Brady and Napue violations can overlap, the crux of Movant's claim relates to the alleged "introduction at trial of perjured testimony," in violation of Napue—rather than the suppression of evidence. [8]

"The knowing use of false evidence by the state, or the failure to correct false evidence, may violate due process." Towery v. Schriro, 641 F.3d 300, 308 (9th Cir. 2010). In order to establish a Napue claim, a movant must demonstrate "(1) the testimony (or evidence) was actually false, (2) the prosecution knew or should have known that the testimony was actually false, and (3) that the false testimony was material." United States v. Zuno-Arce, 339 F.3d 886, 889 (9th Cir. 2003) (citing Napue, 360 U.S. at 269-71).

1. Movant's allegation regarding the "amended returns"

Movant alleges that Rusch and Cheryl Bradley "testified that FBAR forms were prepared on behalf of Mr. Quiel accompanying amended returns filed for him." He states that he has the amended returns, "but there are no FBAR forms that he is aware of." Movant contends that if the FBAR forms do not exist "then the evidence (or lack thereof) demonstrates that both Cheryl Bradley and Christopher Rusch offered perjured testimony." At the outset, Movant must first demonstrate that the Rusch and Ms. Bradley's testimony was actually false on this point. Movant appears to assume that because the IRS "needs additional time to respond" to his "FOIA request," that no FBARs exist and therefore the testimony was false. Having reviewed the trial testimony cited by Movant and argument alleged in his briefing, the Court fails to draw the inference and finds that Movant has not demonstrated that either Rusch or Ms. Bradley's testimony was false. Movant's mere suggestions do not support his contention that Rusch or Ms. Bradley provided false testimony. If an assertion that testimony was perjured rests on "mere speculation," it is insufficient to establish a claim under

Napue. See United States v. Aichele, 941 F.2d 761, 766 (9th Cir. 1991).

2. Movant's allegation regarding the Perucchi affidavit

***10** Movant states that Rusch testified he opened "a new Swissquote account in the name of Jerome Perucchi," and that "he was 'the notary for Mr. Perucchi, who [Rusch] said was not actually in front of [him] when [Rusch] notarized that [Perucchi] was.' " The "purpose of the document falsely notarized was 'to open an account at Sterne Agee ... [t]o sell stock, the ITLI or Intelligentias stock ... [which was] Mr. Perucchi authorizing to sell, assign or transfer these stocks.' " Movant then compares Rusch's testimony on this point to the affidavit of Jerome Perucchi stating, "[m]y involvement with the Fund was extremely limited. ... My business associate asked if I would serve as the director of the Fund for the first year of its existence. I agreed to do so. Perucchi Decl. ¶ 18. He declared, 'To the best of my recollection, the only documents that I signed regarding the Fund were [ ] to create the fund and nam[e] me as the director.' Perucchi Decl. ¶ 19. Most importantly, Perucchi verified, 'I had no knowledge the Fund was ever incorporated and brought into existence. I never performed any functions as the director of the Fund, invested any money in the Fund, managed the Fund, or received any compensation of any kind from the Fund or Mr. Quiel.' Perucchi Decl. ¶ 20-21." Movant, therefore, alleges that Rusch forged Perucchi's signature multiple times.

Having reviewed Rusch's testimony, the Perucchi affidavit, and Movant's argument on this point, the Court finds that Movant has failed to demonstrate that Rusch testified falsely. Movant's presumed attempt to illustrate an inconsistency between certain portions of Rusch's trial testimony and the Perucchi affidavit fails as the Court finds no inconsistency. In any event, the mere fact that there may exist contradictions in testimony does not rise to the level of a due process violation. See, e.g., United States v. Croft, 124 F.3d 1109, 1119 (9th Cir. 1997) (fact that a witness makes inconsistent statements, or that other evidence conflicts with a witness's testimony, does not alone establish that the witness offered false evidence); Zuno-Arce, 339 F.3d at 889 (9th Cir. 2003) (rejecting Napue claim where petitioner failed to demonstrate testimony at trial was "actually false"); Lambert v. Blackwell, 387 F.3d 210, 249, 252 (3rd Cir. 2004) (discrepancies in testimony do not mean testimony is perjured). And, furthermore, although Rusch testified that he notarized account documents without Mr. Perucchi "in front of [him]," nothing in the Perucchi affidavit supports Movant's allegation that Rusch "forged" Mr. Perucchi's signature multiple times. Lastly, Movant has also failed to show that the government knew or should have known that any of the alleged testimony was actually false.

3. Movant's allegations regarding "additional false testimony"

Movant states that Rusch testified regarding Exhibits 51 and 52 that he "printed" the documents and "faxed" them to Movant. Citing to his own declaration, Movant claims that he never received the documents and, therefore, Rusch's testimony is false.[9] According to the record, specifically, Defendants' Joint Motion for New Trial and the District Court's Order on Defendants' Joint Motion for New Trial, Exhibits 51 and 52 contain emails originally sent from Pierre Gabris to Rusch, who forwarded them to Movant and Kerr, regarding accounting statements from Defendants' Swiss corporations. (CR Docs. 454, 463.)

At trial, Rusch testified as follows:

> BY MR. STOCKWELL:
>
> Q. There was a discussion on cross-examination about providing account statements and accountings of what's going on in these bank accounts to the defendants. Do you recall that?
>
> A. Yes.
>
> Q. Did you provide any information about what was transpiring in these accounts to the defendants?
>
> A. Yes, I did.
>
> Q. And what did you provide to—we'll start with Mr. Kerr. What did you provide to Mr. Kerr?
>
> A. I received accounting statements in Excel format that had been typed up by Mr. Gabris or his office, and I forwarded them on by fax to Mr. Kerr.
>
> Q. And how about Mr. Quiel?
>
> A. The same. I received information, accounting statementsfrom Mr. Gabris and his office, and printed them out and faxed them to Mr. Quiel.

***11** Q. And what time frame would you have provided this information to Mr. Kerr or Mr. Quiel?

A. Over a number of years, 2008, '9 and '10, possibly there was—there were accounting statements. There was not—it wasn't done on a regular basis. For example, it wasn't every two weeks or month, but from time to time they would request and I would send.

Q. And if you can take a look at what's been marked as Government Exhibit 51, 52 and 53, please. Just 51 and 52.

A. I see 51 but not 52.

Q. I believe you'll have it shortly. Do you recognize what's in Government Exhibits 51 and 52?

A. 51, yes. 52, yes.

Q. And how do you recognize these documents?

A. These are e-mails that I received from Mr. Gabris that are accounting statements that I forwarded on to Messrs. Kerr and Mr. Quiel.

Q. Did you keep these in your files?

A. Yes, I did.

Q. Did you produce them to the Government?

A. Yes, I did.

MR. STOCKWELL: Your Honor, at this time the Government moves to admit Government Exhibits 51 and 52.

MR. MINNS: They're beyond the scope. And they're the hearsay statements of Mr. Pierre Gabris, who I will not have an opportunity to cross-examine.

MR. STOCKWELL: May I be heard, Your Honor?

THE COURT: You may.

MR. STOCKWELL: The witness, again, was questioned on cross-examination about providing information to the defendants. The implication was he did not actually provide anything to the defendants. These are being offered to rebut that. And they're not being offered for the truth of anything in the document, but just to their existence.

THE COURT: The objection is overruled. 51, 52 are received.

MR. STOCKWELL: Permission to publish, Your Honor?

THE COURT: You may.

BY MR. STOCKWELL:

Q. Mr. Rusch, if you can take a look at Government Exhibit 51. MR. STOCKWELL: If we can publish this on the Government's computer, which we already have. Thank you.

BY MR. STOCKWELL:

Q. What is Government Exhibit 51?

A. It's an accounting statement provided by Pierre of the accounts at Red Rock, Legacy, and then Swissquote.

Q. And why did he provide this to you?

A. Mr. Quiel phoned me and asked me to get an accounting. I telephoned Mr. Gabris, obtained that accounting.

Q. And what did you do once you received this e-mail?

A. I printed it out and faxed it to Mr. Quiel and to Mr. Kerr, and then placed it in my file.

(CR Doc. 335 at 2532-2534.)

The Court finds that Movant's unsupported assertions set forth in his self-serving affidavit that Rusch "never faxed, emailed, or in any other way provided copies of Exhibits 51 and 52" to him, in contrary to Rusch's testimony, insufficient to make out a Napue claim. Other than the conclusory statement, Movant fails to demonstrate that Rusch's testimony was false, or that the government knew or should have known that his testimony was false when presented. See, e.g., Henry v. Ryan, 720 F.3d 1073, 1084 (9th Cir. 2013) (finding that petitioner's conclusory assertion that any testimony inconsistent with the truth must be not only inaccurate but also perjured, does not constitute evidence sufficient to make out a Napue claim); Aichele, 941 F.2d at 766 (Napue claim is not shown where defendant's contention that witness' statements during testimony "were perjured is mere speculation");

see also Abrante v. St. Amand, 595 F.3d 11, 18 (1st Cir. 2010) (rejecting Napue claim where defendant "engage[d] in a series of speculations in support of his view that [two witnesses] gave false testimony, but he offer[ed] no evidence that would lead to the conclusion that the government knew that the testimony was allegedly false").

***12** Additionally, it appears that Movant's Napue claim related to Exhibits 51 and 52 is procedurally defaulted. "Habeas review is an extraordinary remedy and will not be allowed to do service for an appeal," Bousley v. United States, 523 U.S. 614, 621 (1998), absent a showing of cause and prejudice, a section 2255 movant procedurally defaults all claims which were not raised in a direct appeal, other than claims asserting that the movant was deprived of the right to the effective assistance of counsel. See United States v. Frady, 456 U.S. 152, 167-68 (1982); United States v. Ratigan, 351 F.3d 957, 964 (9th Cir. 2003); United States v. Johnson, 988 F.2d 941, 945 (9th Cir. 1993). "[T] o obtain collateral relief based on trial errors to which no contemporaneous objection was made, a convicted defendant must show both (1) 'cause' excusing his double procedural default, and (2) 'actual prejudice' resulting from the errors of which he complains." Frady, 456 U.S. at 167-68. A section 2255 movant who fails to show cause and prejudice can still obtain review of a claim on collateral attack by demonstrating the likelihood of his "actual," i.e., factual, innocence. See Bousley, 523 U.S. at 623; United States v. Braswell, 501 F.3d 1147, 1150 (9th Cir. 2007). To establish actual innocence the movant must demonstrate that, in light of all the evidence, including new evidence that might be introduced by both sides, it is more likely than not that no reasonable juror would have convicted him. See Ratigan, 351 F.3d at 964, quoting Bousley, 523 U.S. at 623.

Movant failed to allege his Napue claim related to Exhibits 51 and 52 on direct appeal, and he has not shown cause, prejudice, or any likelihood of his factual innocence. Accordingly, this claim is procedurally defaulted.

Lastly, as to Movant's "additional false testimony" set forth in his "supporting facts" and declaration regarding —the use of his passport and personal information without his knowledge or permission; evidence at trial showing that Rusch arranged for and/or oversaw setting up Swiss entities and funds that Mr. Quiel had no control over; and "things Rusch testified to at trial, which included his criminal behavior, did not cease[,] rather they continued on under the pseudonym of Reeves," Movant fails to demonstrate, much less allege, testimony (or evidence) that was actually false, or that the prosecution knew or should have known that any of this testimony (or evidence) was actually false. Moreover, any Napue claim raised pursuant to these "supporting facts" appears procedurally defaulted, and Movant has not shown cause, prejudice, or any likelihood of his factual innocence.

C. Ground Three

In Ground Three, Movant appears to allege defects in the prosecution of this matter because "U.S. has not been able to produce documents to show that the attorneys who appeared on the U.S.' behalf were properly appointed. Also, the U.S. refuses to produce the evidence that it followed proper procedure when it began prosecution against Mr. Quiel." Movant contends that the "assistant U.S. attorneys who prosecuted Mr. Quiel must be properly appointed public officers. Mr. Quiel sought through the FOIA process the proof of appointments of Ann B. Scheel, Monica Edelstein, Timothy Stockwell, Frank P. Cihlar, Alexander Robbins, Jeffrey A. Neiman, R. Alexander Acosta, Michael P. Ben'ary, Keven M. Downing, and John A. Dicicco." Movant alleges that "Edelstein and Scheel have nothing so far; Ben'ary, Downing and Neiman are no longer employees of the U.S., Acosta never worked for DOJ; Cihlar and Stockwell have outdated oaths; and Robbins and Dicicco may not be in compliance." Movant has also "sought a copy of the referral document for his prosecution through FOIA."

Initially, the Court notes that pursuant to Federal Rule of Criminal Procedure 12, certain motions must be made before trial, including "a motion alleging a defect in instituting the prosecution" and "a motion alleging a defect in the indictment or information." See Fed.R.Crim.P. 12(b)(3)(A), (B); United States v. Kahlon, 38 F.3d 467, 469 (9th Cir. 1994). Subsection (c) provides, "[i]f a party does not meet the deadline for making a Rule 12(b)(3) motion, the motion is untimely." The court must rule on pretrial motions before trial unless it finds good cause to defer a ruling. See Fed.R.Crim.P. 12(d).

***13** In United States v. Suescun, 237 F.3d 1284 (11th Cir. 2001), the Eleventh Circuit Court of Appeals considered whether claims similar to those raised by Plaintiff in Ground Three warranted reversal of the appellant's conviction. In that case, the appellant argued on direct appeal from his criminal conviction, that: (1) the indictment was a nullity because it was obtained by a U.S. Attorney who had not been properly appointed under U.S. Const. art. II, § 2, cl. 2; and (2) his convictions were a nullity because the Appointments Clause and the Separation of Powers principle prevented the district court from appointing the interim U.S. Attorney. See Suescun, 237 F.3d at 1286. The Eleventh Circuit found that the appellant alleged a defect in the proceedings, and that, as a result, he was required to present his objections prior to trial or at the time set by the court, pursuant to Fed.R.Crim.P. 12(f), and noted that he failed to do so. See id. at 1286-87. The court concluded that appellant waived his challenges and that he had not sought relief from the waiver. See id. at 1287. In analyzing whether a jurisdictional exception to the waiver applied, the court further concluded that "[a]n appointment of a United States Attorney that is not made as provided by the Appointments Clause does not affect the Government's power to prosecute," so that, even if the appointment of the temporary U.S. Attorney was invalid, the district court had jurisdiction to entertain the case and adjudicate the appellant guilty of the offenses. See id. at 1287-88.

Here, Movant, in effect, challenges his criminal convictions on the basis that the United States Attorney for the District of Arizona, as well as, other members of the U.S. Attorney's Office were not properly appointed and that, as a result, Movant's prosecution was defective. However, as in Suescun, Movant should have raised these alleged defects in his criminal proceeding in a pre-trial motion made under Fed.R.Crim.P. 12(b)(3). More importantly, for purposes of this § 2255 Motion and as stated in Suescun, the Court still retained jurisdiction to entertain the case regardless of any alleged defects in the proceedings. See id.; see also United States v. Fitch, 2013 WL 1187422 (D. Nevada March 19, 2013). Accordingly, the Court will recommend that Movant's claim as alleged in Ground Three be denied.

CONCLUSION

Having determined that Movant's claims are meritless and/or procedurally defaulted, the Court will recommend that Movant's amended Motion to Vacate, Set Aside, or Correct Sentence be denied and dismissed with prejudice.

IT IS THEREFORE RECOMMENDED that Movant's amended Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody (CV Doc. 7 and CR Doc. 474) be **DENIED and DISMISSED WITH PREJUDICE**;

IT IS FURTHER RECOMMENDED that a Certificate of Appealability and leave to proceed *in forma pauperis* on appeal be **DENIED** because Petitioner has not made a substantial showing of the denial of a constitutional right.

This recommendation is not an order that is immediately appealable to the Ninth Circuit Court of Appeals. Any notice of appeal pursuant to Rule 4(a)(1), Federal Rules of Appellate Procedure, should not be filed until entry of the district court's judgment. The parties shall have fourteen days from the date of service of a copy of this recommendation within which to file specific written objections with the Court. See 28 U.S.C. § 636(b)(1); Rules 72, 6(a), 6(b), Federal Rules of Civil Procedure. Thereafter, the parties have fourteen days within which to file a response to the objections. Pursuant to Rule 7.2, Local Rules of Civil Procedure for the United States District Court for the District of Arizona, objections to the Report and Recommendation may not exceed seventeen (17) pages in length. Failure timely to file objections to the Magistrate Judge's Report and Recommendation may result in the acceptance of the Report and Recommendation by the district court without further review. See United States v. Reyna-Tapia, 328 F.3d 1114, 1121 (9th Cir. 2003). Failure timely to file objections to any factual determinations of the Magistrate Judge will be considered a waiver of a party's right to appellate review of the findings of fact in an order or judgment entered pursuant to the Magistrate Judge's recommendation. See Rule 72, Federal Rules of Civil Procedure.

All Citations

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Footnotes

1 The original Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody is pending in the criminal matter—CR 11-2385 ("CR") Doc. 474.

2 The facts and background of this matter have been repeated multiple times in both the civil and criminal cases, as well as, the parties' briefing in both appellate court matters—United States v. Quiel, No. 13-10503 and United States v. Kerr, et al., No. 15-10393.

3 Co-defendant Stephen Kerr ("Kerr") was charged with these same counts, (CR Docs. 3, 463), and Christopher Rusch ("Rusch"), Movant and Kerr's former attorney, was also charged with one count of Conspiracy to Defraud the United States and an additional count of failure to file an FBAR, which was added later (CR Docs. 3, 463, 331 at 1607). Rusch subsequently entered into a plea agreement compelling him to testify at the request of the United States. (CR Docs. 463, 415.)

4 The record reflects that shortly after the jury returned its verdict, Movant filed a Motion for a Judgment of Acquittal or for a New Trial. (CR Docs. 301, 302, 304.) The Court denied the Motion on August 16, 2013. (CR Doc. 346.)

5 On July 27, 2016, Movant and Kerr filed a Joint Amended Notice of Appeal seeking to appeal both the district court's denial of the Joint Motion for New Trial (CR Doc. 463) and the denial of the Joint Motion to Accept Remand (CR Doc. 475). In their Joint Brief filed on December 12, 2016, Defendants argued:

> I. When A District Court Does Not Even Consider Evidence And Then Analyzes Other Allegations But Not The Evidence Itself, Is It An Abuse Of Discretion?
>
> II. When A District Court Fails To Properly Analyze The Evidence With The Appropriate Legal Standards, Is It An Abuse Of Discretion?
>
> III. When A District Court Fails To Properly Apply The Law To Newly Discovered Evidence, As Well As Analyze The Evidence, Is It An Abuse Of Discretion?

(United States v. Kerr, et al., No. 15-10393, Doc. 32.) The matter is fully briefed and pending before the Ninth Circuit.

6 Although Movant attempts to enlarge his claim by stating that trial counsel failed to call "any witnesses," Movant only lists the three experts in support of his ineffective assistance argument. The Court finds that Movant's attempt to enlarge his claim beyond counsel's failure to call the three experts specifically named in his Motion unpersuasive. Without identifying the witnesses, establishing that any of his unnamed witnesses were willing to testify, or what the unnamed witness' testimony would have been, any ineffective assistance of counsel claim alleged by counsel's failure to call "any witnesses" is entirely speculative and conclusory.

7 The Jury Instructions stated the following:

> In order for the defendants to be found guilty ..., the government must prove each of the following elements beyond a reasonable doubt (you must apply all three elements to each defendant individually):
>
> First, the defendant made and signed a tax return for the respective years that he knew contained false information as to a material matter;
>
> Second, the returns contained a written declaration that they were being signed subject to the penalties of perjury; and
>
> Third, in filing the false tax returns, the defendant acted willfully.
>
> A matter is material if it had a natural tendency to influence, or was capable of influencing, the decisions or activities of the Internal Revenue Service.

8 In order to establish a Brady violation (1) " '[t]he evidence at issue must be favorable to the accused, either because it is exculpatory, or because it is impeaching'; (2) '*that evidence must have been suppressed by the State, either willfully or inadvertently*'; and (3) 'prejudice must have ensued.' " United States v. Williams, 547 F.3d 1187, 1202 (9th Cir. 2008) (emphasis added) (quoting Strickler v. Greene, 527 U.S. 263, 281-82 (1999)).

9 Contrary to Movant's Napue allegation in the instant Motion, the Court determined in its Order on Defendants' Joint Motion for New Trial, that Movant and Kerr were not contending that they were never forwarded the emails, but rather, that the exhibits themselves were falsified. (CR Docs. 454, 463.)

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792 F.3d 847
United States Court of Appeals,
Seventh Circuit.

UNITED STATES of America, Plaintiff–Appellant,
v.
H. TY WARNER, Defendant–Appellee.

No. 14–1330.
|
Argued Sept. 17, 2014.
|
Decided July 10, 2015.

Synopsis
Background: Defendant was convicted, upon plea of guilty, in the United States District Court for the Northern District of Illinois, Charles P. Kocoras, J., of willful tax evasion, and was sentenced to two years' probation with community service, plus $100,000 fine and costs. Government appealed.

Holdings: The Court of Appeals, Kanne, Circuit Judge, held that:

[1] sentence was procedurally reasonable, and

[2] sentence was substantively reasonable.

Affirmed.

Flaum, Circuit Judge, concurred in judgment and filed opinion.

Attorneys and Law Firms

***850** Stuart D. Fullerton, Attorney, Michelle Marie Petersen, Attorney, Office Of The United States Attorney, Chicago, IL, for Plaintiff–Appellant.

Paul D. Clement, Attorney, Erin Murphy, Attorney, Bancroft PLLC, Mark E. Matthews, Attorney, Caplin & Drysdale, Washington, DC, Michael Samuel Shapiro, Attorney, Scandaglia & Ryan, Chicago, IL, for Defendant–Appellee.

Before FLAUM, KANNE, and ROVNER, Circuit Judges.

Opinion

KANNE, Circuit Judge.

Defendant H. Ty Warner, the billionaire creator of Beanie Babies, evaded $5.6 million in U.S. taxes by hiding assets in a Swiss bank account. He pled guilty to one count of tax evasion, made full restitution, and paid a $53.6 million civil penalty. The Sentencing Guidelines provided a recommended 46- to 57–month term of imprisonment, but the district judge gave Warner a more lenient sentence: two years' probation with community service, plus a $100,000 fine and costs. The government claims his sentence is unreasonable because it does not include a term of incarceration.

[1] In a typical case, we might agree. But this is not a typical case. The district judge found Warner's record of charity and benevolence "overwhelming." Indeed, the judge remarked that Warner's conduct was unprecedented when viewed through the judge's more-than-three decades on the bench. In the district court's opinion, this and other mitigating factors—including the uncharacteristic nature of Warner's crime, his attempt to disclose his account, his payment of a penalty ten times the size of the tax loss, and the government's own request for a sentence well below the guidelines range—justified leniency. District courts enjoy broad discretion to fashion an appropriate, individualized sentence in light of the factors in 18 U.S.C. § 3553(a). The court here did not abuse its discretion. Rather, it fully explained and supported its decision and reached an outcome that is reasonable under the unique circumstances of this case. We therefore affirm Warner's sentence.

I. BACKGROUND

Warner was born in Chicago in 1944 and grew up in a troubled family. He attended a military high school in Wisconsin and spent a year at Kalamazoo College, but ultimately dropped out because he could no longer afford tuition. To make ends meet, he worked a series of odd jobs, including stints as a busboy, a bellman, and a door-to-door salesman. Eventually, he found his feet selling children's plush toys for the Dakin Toy Company. Within a few years, he was Dakin's top salesman.

In 1985, Warner formed his own plush toy company, Ty Inc., which he initially ran by himself out of his condominium. His big break came in the early 1990s with the introduction of a new toy to the market: the Beanie Baby. A huge success, the Beanie Baby propelled Ty Inc. into a multi-billion-dollar company and made Warner rich. His net worth at the time of sentencing was roughly $1.7 billion.

A. Warner's Tax Evasion and Attempted Disclosure

In 1996, during the early period of Beanie Babies' success, Warner traveled to Zurich, Switzerland, and opened an offshore bank account at UBS AG ("UBS"). The record does not disclose how much money Warner originally deposited or where the funds came from, but within several years the account contained $93 million. Consistent with their advice, Warner instructed his bankers not to send him any correspondence and to destroy all account documents after five years. He did ***851** not report the account to the Internal Revenue Service ("IRS").

Warner was not the only American taxpayer hiding assets at UBS. With the help of bankers in UBS's cross-border division, many others opened offshore accounts to avoid U.S. taxes. One of the bankers involved in this fraudulent scheme was Hansreudi Schumacher, who serviced Warner's account. After UBS entered into a Qualified Intermediary Agreement with the IRS in 2001 (which created certain tax reporting obligations), Schumacher left to join another Swiss bank.

Warner followed him. In late 2002, Warner traveled to Switzerland and, with Schumacher's help, transferred his funds from UBS to Zuercher Kantonalbank ("ZKB"), a smaller Swiss bank without a significant U.S. presence. He placed the funds at ZKB in the name of a Liechtenstein shell entity, the "Molani Foundation." And he instructed UBS "not to engage in any sort of communication with me re transfer," but instead to send all correspondence to Schumacher. At ZKB, Warner's account grew to over $107 million.

Warner did not disclose his offshore account to the IRS. On the contrary, he reported on his annual tax returns that he had no foreign financial account. And he did not report or pay taxes on the interest income generated by his offshore assets, which amounted to over $24.4 million through 2007. As a result, the government lost $5,594,877 in tax revenue—the second-highest loss among the former UBS clients who have been prosecuted to date.

In 2008 the Department of Justice launched a program to aggressively combat offshore tax evasion.[1] The program began with an investigation of UBS. In April the government indicted former UBS banker Bradley Birkenfeld. In February 2009 it filed a one-count information against UBS and quickly executed a deferred prosecution agreement, under which UBS admitted wrongdoing and agreed to hand over information on certain U.S. offshore clients. Several months later, the government brought charges against former UBS and Schumacher client Jeffrey Chernick. In August 2009 Schumacher himself was indicted.

At the same time, the government encouraged tax-evaders to come forward on their own by announcing an IRS offshore voluntary disclosure program in March 2009 (the "OVDP"). Under the program, taxpayers who voluntarily disclosed their offshore accounts could avoid criminal prosecution by paying back taxes, interest, and penalties, including 20% of the account's peak value. On the other hand, those who continued to hide their assets would face heightened enforcement and severe penalties. Taxpayers had a six-month window—until September 23, 2009 (later extended)—to take advantage of the OVDP. Thousands of taxpayers were admitted into the program.[2]

Warner was aware of the government's investigation of UBS, which was widely publicized, and of Schumacher's indictment. Warner says that he regretted his decision to open the offshore account from the beginning but felt stuck; and that he never withdrew or otherwise used the funds in the account. In 2009 he contacted his lawyer to discuss his options, and his lawyer told him about the OVDP. On September 18, 2009—just before the original ***852** deadline—Warner applied to enter the program. Unbeknownst to him, however, he was already under investigation; the government had obtained his account information in 2008 or 2009, possibly from UBS. The pending investigation made Warner ineligible for the OVDP, *see* IRM § 9.5.11.9(4)(a), (b) (Sept. 9, 2004), so the government rejected his application.

Two years later, in 2011, a grand jury subpoenaed Warner's offshore banking records. He resisted the subpoena, but we ultimately required him to comply. *In re Special Feb. 2011—1 Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d 903, 909 (7th Cir.2012), *cert. denied,* ––– U.S. ––––, 133 S.Ct. 2338, 185 L.Ed.2d 1064 (2013).

B. Warner's Information and Guilty Plea

In September 2013 the government filed a one-count information charging Warner with willful tax evasion in violation of 26 U.S.C. § 7201. The information alleged that Warner evaded $885,300 in taxes for 2002 by: (1) excluding from his reported income the interest from his offshore assets; (2) fraudulently stating on his tax return that he had no foreign account; and (3) failing to file a Report of Foreign Bank and Financial Account (an “FBAR” form), as required by the Bank Secrecy Act and implementing regulations, *see* 31 U.S.C. § 5314.

In October 2013 Warner pled guilty to the one-count information. As part of his plea agreement, he also admitted to similar misconduct from 1996 to 2007, which he agreed constituted “relevant conduct” under U.S. Sentencing Guidelines Manual § 1B1.3 (Nov. 2012) (“USSG”). He promised to pay full restitution and a civil FBAR penalty of $53,552,248—equal to 50% of the maximum balance in his offshore account in 2008 (which is 30% higher than the penalty he would have owed had he been admitted to the OVDP). As far as we are aware, Warner's $53.6 million payment is the largest FBAR penalty the government has collected to date. Warner paid both the penalty and restitution before his sentencing hearing.

Warner's plea deal included an agreed-upon guidelines calculation. The base offense level for a tax loss of $5.6 million was 24 under USSG §§ 2T1.1 and 2T4.1(J). The parties agreed to add 2 levels under USSG § 2T1.1(b)(2) because the offense involved sophisticated means, subtract 2 levels for acceptance of responsibility under USSG § 3E1.1(a), and subtract 1 more under USSG § 3E1.1(b) because Warner's guilty plea obviated the need to prepare for trial—resulting in a final offense level of 23. Because Warner had no prior convictions, his criminal history category was I. This yielded an advisory guidelines range of 46 to 57 months' imprisonment. *See* USSG ch. 5, pt. A (sentencing table).

Beyond stipulating to the guidelines calculation, the plea agreement left each side free to argue for whatever sentence it deemed appropriate.

C. Sentencing

In their pre-sentencing submissions, neither side proposed a sentence within the guidelines range. The government requested incarceration “in excess of a year and a day,” a sentence well below the recommended minimum. The probation officer recommended a prison term of 15 months. Warner argued that a sentence of probation with community service would suffice, and that it would provide greater benefit to society. He offered to mentor students in business and product development at three urban high schools on Chicago's South Side. The president of one of the schools submitted a letter detailing specific ways that Warner could help. In addition, approximately seventy people— ***853** business associates, employees, neighbors, charitable foundations, and others who knew Warner—submitted character-reference letters in his behalf.

The sentencing hearing took place on January 14, 2014, before District Judge Kocoras. After argument from both sides, the court pronounced Warner's sentence and explained its decision. The court also issued a short written statement of reasons to supplement its oral explanation. The hearing transcript runs fifty-five pages.

The district court adopted the findings in the presentence report and agreed with the calculation of the guidelines range. But the court decided to impose a below-guidelines sentence based on “the nature and circumstances of the offense and the history and characteristics of the defendant.” 18 U.S.C. § 3553(a)(1). The court was moved by the letters submitted in Warner's behalf, which were “quite different” from the letters it typically received in other cases: they were voluminous, detailed, and revealed Warner's “personal qualities, which differ from those he manifested in committing the crimes he has admitted.” The court read several letters into the record. For brevity's sake, we give only a partial summary.

One letter related that in 2012 Warner stopped to ask a stranger for directions in Santa Barbara, California. Her name was Jennifer Vasilakos, and she was holding a fundraiser called “Parking for Jenny.” In addition to directions, she gave him a flyer explaining that she suffered from kidney failure and needed money to pay for an expensive adult stem cell treatment. An hour later, after reading the flyer, Warner returned and promised to pay the full amount she needed ($20,000). He followed through, but "[his] generosity went further than simply donating." He helped her "raise awareness" and connected her with others interested in the potential of adult stem cells for treating kidney failure. As a result, she has met with leaders in the field, toured laboratories, and "altered the path of research."

Another letter came from the president of the Children's Hunger Fund, an organization serving needy children in orphanages, disaster-stricken areas, and elsewhere. Over thirteen years, Warner donated millions of plush toys valued at $70 million and enabled numerous charitable projects. The president called Warner's generosity "nothing short of amazing" and "unprecedented" in his thirty-plus years in the non-profit sector. What is more, "in every instance," he noted, Warner "ha[d] humbly requested that no special efforts be made to publicly acknowledge his philanthropy."

In a third letter, the director of financial reporting for Warner's company called him "the most benevolent person I have ever met." He explained, for example, that when Ty Inc. broke $1 million in annual sales, Warner surprised his employees with an annual bonus equal to one year's salary; he also maintained his sales team's high commission rates, making many of them millionaires.

The other letters that the district court read at the hearing told similar stories. For example, in honor of Princess Diana, Warner designed a plush toy and donated $20 million in profits to her memorial fund. To commemorate a friend's 18–year–old son who had succumbed to cancer, Warner created an Issy Bear and donated $2 million in profits for cancer research. He gave $6.3 million to a charter school in Las Vegas; donated $13 million to enable the acquisition and development of a park in Westmont, Illinois; and gave $2 million for disaster relief in Japan. In addition to these letters, the court noted that dozens more "describe[d] a host of other actions, large and small, which reflect on Mr. Warner ***854** and are entitled to consideration in determining a just sentence for him."

The district court found that "Mr. Warner's private acts of kindness, generosity and benevolence are overwhelming." Moreover, many of them took place long before Warner knew he was under investigation; the court found they were "motivated by the purest of intentions" and "without a view toward using [them] at sentencing." Most were "done quietly and privately." The district judge, who has been on the bench for more than thirty years, then remarked: "Never have I had a defendant in any case—white collar crime or otherwise—demonstrate the level of humanity and concern for the welfare of others as has Mr. Warner."

The court also discussed the other § 3553(a) factors, which it acknowledged "run in different directions." On the one hand, the court emphasized the need to maintain the "dignity of the law," to treat "the rich and the poor similarly," and to deter other tax-evaders. It recognized that Warner "hid a substantial amount of money" for many years, and that his crime was "a serious one [which] goes to the essence of how we govern ourselves." The court also acknowledged the government's comparisons to other tax evaders who had received prison sentences despite having lower tax losses than Warner, though it found the comparisons unhelpful because Warner was "very unique."

On the other hand, the court found that Warner concealed only a "small fraction" of his total income and tried to come clean through the OVDP "prior to him knowing his name had been submitted to the [IRS]." Moreover, in one sense, Warner had already been "punished ... severely" by paying a penalty of over $53 million—possibly "the largest fine in history" and "more than he ever would have paid had he filed the returns and included all of the income," though it was admittedly only "a small percentage" of Warner's total wealth. He also suffered the "humiliation" of a "highly publicized prosecution." Warner was 69 years old, had no prior criminal history and, in the district court's view, was extremely unlikely to commit any further crimes. The district court also noted Warner's prompt payment of his civil liabilities and his compliance with the plea agreement.

Having examined the relevant factors, the district judge said it was now "left to me to weigh them all and balance them, as best ... I am humanly able." He candidly admitted that it was a "hard question" whether to incarcerate Warner, and that he "struggled over it." But in the end he found that Warner's good works "trump[ed]" his misconduct and that "society will be best served by allowing him to continue his good works" outside of prison. A sentence below the guidelines range was fitting, the court explained, because "the Guidelines do not describe similarly situated defendants"; Warner was "very unique." The government itself had recommended a well-below-guidelines sentence—an approach the court commended as "quite reasonable."

The district court sentenced Warner to two years' probation, subject to standard conditions and a special condition requiring at least 500 hours of community service at the three South Side high schools he had identified. The court also fined Warner $100,000—the maximum amount authorized by 26 U.S.C. § 7201—and ordered him to pay costs.

The government timely appealed. The district court had jurisdiction under 18 U.S.C. § 3231, and we have appellate jurisdiction under 28 U.S.C. § 1291 and 18 U.S.C. § 3742(b).

II. ANALYSIS

The government contends that Warner's sentence is unreasonable because it does ***855** not include a prison term. For the reasons that follow, we disagree.

For starters, no statute expressly required the district court to send Warner to prison. The law that Warner violated, 26 U.S.C. § 7201, permits the court to impose a fine instead, which it did here. And Warner was eligible for probation under 18 U.S.C. § 3561.

[2] **[3]** It was therefore up to the district court to select an appropriate sentence in accordance with the factors in 18 U.S.C. § 3553(a). One of those factors is the type and range of sentence established by the guidelines. 18 U.S.C. § 3553(a)(4). After *United States v. Booker,* however, the guidelines are merely advisory. 543 U.S. 220, 245, 125 S.Ct. 738, 160 L.Ed.2d 621 (2005). While the § 3553(a) analysis still begins with a consideration of the guidelines, it does not end there. *Rita v. United States,* 551 U.S. 338, 351, 127 S.Ct. 2456, 168 L.Ed.2d 203 (2007). The sentencing judge may not perfunctorily impose a guidelines sentence or even presume that such a sentence is appropriate in a given case. *See Gall v. United States,* 552 U.S. 38, 50, 128 S.Ct. 586, 169 L.Ed.2d 445 (2007). The guidelines range is only "a rough approximation of sentences that might achieve § 3553(a)'s objectives" in the "mine run of cases." *Rita,* 551 U.S. at 350–51, 127 S.Ct. 2456. It supplies "the starting point and the initial benchmark," but nothing more. *Gall,* 552 U.S. at 49, 128 S.Ct. 586.

The district court must next consider the other § 3553(a) factors. *Id.* at 49–50, 128 S.Ct. 586. The first factor encompasses both "the nature and circumstances of the offense" and "the history and characteristics of the defendant." 18 U.S.C. § 3553(a)(1). The second demands a sentence that is "sufficient, but not greater than necessary" to accomplish the basic purposes of sentencing: just punishment, deterrence, incapacitation, and rehabilitation. *Id.* § 3553(a)(2). The sixth factor is "the need to avoid unwarranted sentence disparities" among similarly situated defendants. *Id.* § 3553(a)(6). The others are: the types of sentence available, sentencing policy statements, and the need for restitution. *Id.* § 3553(a)(3), (5), (7).

[4] **[5]** **[6]** **[7]** Ultimately, it falls on the district court to weigh and balance the various factors and to "make an individualized assessment based on the facts presented." *Gall,* 552 U.S. at 50, 128 S.Ct. 586; *see also id.* at 52, 128 S.Ct. 586 (viewing "every case as a unique study in the human failings that sometimes mitigate, sometimes magnify, the crime and the punishment to ensue" (citation omitted)). The open-endedness of the § 3553(a) factors leaves ample room for the court's discretion. *See United States v. Wachowiak,* 496 F.3d 744, 748 (7th Cir.2007). Once the court chooses a sentence, § 3553(c) requires the district judge to "state in open court the reasons" for imposing it. The explanation need not be exhaustive as long as it "allow[s] for meaningful appellate review and ... promote[s] the perception of fair sentencing." *United States v. Omole,* 523 F.3d 691, 697 (7th Cir.2008) (quoting *Gall,* 552 U.S. at 50, 128 S.Ct. 586). The court is free to select a sentence outside the guidelines range, *see Kimbrough v. United States,* 552 U.S. 85, 91, 128 S.Ct. 558, 169 L.Ed.2d 481 (2007), but it must explain and support the magnitude of the variance, *United States v. Molton,* 743 F.3d 479, 484 (7th Cir.2014).

[8] **[9]** **[10]** **[11]** **[12]** We review a district court's choice of sentence in two steps. *Gall,* 552 U.S. at 51, 128 S.Ct. 586. First, we assess *de novo* whether the court followed proper procedures. *United States v. Nania,* 724 F.3d 824, 830 (7th Cir.2013). If the decision below is procedurally sound, then we ask whether the resulting sentence is "substantively reasonable." *Id.* Unlike the

***856** sentencing judge, we may presume on appeal that a within-guidelines sentence is reasonable. *Rita,* 551 U.S. at 341, 127 S.Ct. 2456. But we may not presume that a sentence outside the guidelines range is *unreasonable. Gall,* 552 U.S. at 51, 128 S.Ct. 586. Instead, we must decide whether the district court's justification is sufficient, applying a deferential abuse of discretion standard. *Id.* at 40, 128 S.Ct. 586; *Molton,* 743 F.3d at 484. We will not substitute our judgment for that of the district court. *Wachowiak,* 496 F.3d at 751. For we are mindful that substantive reasonableness occupies "a range, not a point," *id.,* and that "the sentencing judge is in the best position to apply the § 3553(a) factors to the individual defendant," *Omole,* 523 F.3d at 698.

[13] **[14]** **[15]** Thus, we will uphold a variant (*i.e.,* outside-the-guidelines) sentence so long as the district court's reasoning (1) rests on reliable evidence, *United States v. England,* 555 F.3d 616, 622 (7th Cir.2009); (2) is consistent with § 3553(a), *Molton,* 743 F.3d at 484; and (3) yields a sentence "within the broad range of objectively reasonable sentences in the circumstances," *Wachowiak,* 496 F.3d at 750. A variant sentence is most likely to pass muster if it is based on considerations particular to the defendant or the case, as opposed to "normal incidents of the offense or the judge's wholesale disagreement with the guidelines." *Wachowiak,* 496 F.3d at 750. In general, a disagreement about how much weight to give each § 3553(a) factor does not warrant reversal. *See Molton,* 743 F.3d at 485; *accord United States v. Fernandez,* 443 F.3d 19, 32 (2d Cir.2006) ("The weight to be afforded any given argument made pursuant to one of the § 3553(a) factors is a matter firmly committed to the discretion of the sentencing judge....").

A. Procedural Reasonableness

While the government primarily takes aim at the substance of Warner's sentence, it also claims in several footnotes that the district judge procedurally erred by overlooking two of the § 3553(a) factors: the need to deter other tax-evaders and to avoid unwarranted sentencing disparities. Setting aside the question whether the government preserved this argument, *see Harmon v. Gordon,* 712 F.3d 1044, 1053 (7th Cir.2013) ("[A] party can waive an argument by presenting it only in an undeveloped footnote."), we reject it on the merits.

[16] Failure to consider the § 3553(a) factors or to adequately explain the choice of sentence can amount to procedural error. *See Gall,* 552 U.S. at 51, 128 S.Ct. 586. But the "sentencing court need not comprehensively discuss each of the factors," *United States v. Villegas–Miranda,* 579 F.3d 798, 801 (7th Cir.2009), or march through them "in checklist fashion, explicitly articulating its conclusions regarding each one," *United States v. Shannon,* 518 F.3d 494, 496 (7th Cir.2008).

[17] The district court here addressed the § 3553(a) factors and explained their relevance to Warner's sentence, exactly as it was supposed to do. In particular, the court expressly addressed both deterrence (which it found sufficient) and sentencing disparities (finding "the variety of comparisons made by both sides" unhelpful because Warner was "very unique"). The government's real complaint is that the district court did not, in its view, *adequately* address its arguments. But that issue goes to the substance of Warner's sentence. As a procedural matter, the court's explanation was more than sufficient.

B. Substantive Reasonableness

[18] That brings us to the heart of this appeal. We begin our review for substantive ***857** reasonableness by stating the obvious: Warner's sentence is well below the guidelines recommendation. He received both a shorter sentence (24 rather than 46 to 57 months) and a lighter one (probation rather than prison). Although, as noted above, Warner was eligible for probation under 18 U.S.C. § 3561, the guidelines advised imprisonment rather than probation due to the length of his sentencing range. *See* USSG § 5B1.1(a).

We must decide whether the district court's explanation justifies Warner's sentence, including the magnitude of its deviation from the guidelines. *Molton,* 743 F.3d at 484. No one disputes that he deserved a below-guidelines sentence. The dispute centers instead on *how far* below the guidelines the court should have gone. Warner requested probation. The government proposed over a year and a day in prison—which would have made Warner eligible for good-time credit, likely reducing his actual time served to less than a year. *See* 18 U.S.C. § 3624(b)(1). While the court was not strictly bound by their recommendations, it was well within the court's discretion to use that range as a benchmark. *See Gall,* 552 U.S. at 49–50, 128 S.Ct. 586 (directing the court to determine whether the § 3553(a) factors "support *the sentence requested by a party* " (emphasis added)). The real choice before the district court, then, was between probation and roughly a year in prison—not 46 to 57 months.

Did the district court choose reasonably between those alternatives? The government says no. It argues that in analyzing the § 3553(a) factors, the court made numerous errors and ultimately put too much weight on Warner's charitable contributions and letters of support (factor 1), and too little weight on the seriousness of his offense (factor 2(A)), general deterrence (factor 2(B)), and sentencing disparities (factor 6). We address each factor in turn.

1. Characteristics of the Defendant

[19] **[20]** Section 3553(a)(1) instructs the sentencing judge to consider "the history and characteristics of the defendant." A defendant's record of charity may justify a lenient sentence. Though our earlier cases required "exceptional" good works, *United States v. Repking,* 467 F.3d 1091, 1095 (7th Cir.2006) (per curiam), the Supreme Court has since "reject[ed] ... an appellate rule that requires 'extraordinary' circumstances to justify a sentence outside the Guidelines range," *Gall,* 552 U.S. at 47, 128 S.Ct. 586. Accordingly, to survive appellate review, a defendant's good works must be sufficient to justify the variant sentence, but they need not necessarily be exceptional.

Relying mainly on Warner's letters of support, the district court found his charitable works and the generosity they bespeak overwhelming—indeed, unprecedented in the district judge's experience. This was the primary mitigating factor that drove the court toward a lenient sentence. The government attacks the court's assessment on two grounds.

First, the government questions the value of Warner's letters because many of them came from his employees, former employees, business associates, and attorneys; and because some of the good deeds they report took place after Warner knew he was under investigation. But the district court addressed both points. It noted the source of the letters and yet found them sincere and credible. And it specifically found that Warner's generosity went back many years, that his motivations were sincere, and that he was not trying to game the system or create a record to use at sentencing. Given the record before us, these findings are not clearly erroneous. *See United States v. Gordon,* 513 F.3d 659, 666 (7th Cir.2008).

***858** Second, the government argues that Warner's charity amounts to no more than "writing checks [and] donating excess inventory," which is "nothing unique" considering his "enormous wealth." Though Warner says he donated $140 million, about 8% of his net worth, the government asserts the correct figure is $35.7 million, about 2% of his net worth.[3] The government raised this dispute below in a footnote, so the district court understandably did not resolve it.

Whatever the correct figure may be, the government misses the point of the district court's remarks. Although it praised Warner for giving away many millions of dollars, the court did not focus on the number of checks Warner wrote or their dollar amounts. It focused instead on what Warner's charitable acts reveal about his *character,* which is exactly what § 3553(a)(1) directs us to consider. For example, the court read the letter from Ms. Vasilakos first and in its entirety, even though the $20,000 Warner donated for her treatment was a relatively small sum. What was remarkable was that Warner helped a total stranger and that his "generosity went further than simply donating." The court also highlighted Warner's insistence that the Children's Hunger Fund not publicize his philanthropy, as well as Warner's kindness to his employees. None of the court's comments fixated on the amount of money involved. What struck the court was that Warner displayed such "humanity and concern for the welfare of others" and acted with "the purest of intentions," often "quietly and privately." *Cf.* Matt. 6:3–4(RSV) ("[W]hen you give alms, do not let your left hand know what your right hand is doing, so that your alms may be in secret.")

The government was free to challenge the district court's assessment of Warner's character below, but we will not disturb the court's findings on appeal. As we stated above, they have ample support in the record and are not clearly erroneous. Nor did the district court err by placing as much weight as it did on Warner's character. Though we ourselves might have given this factor less weight compared to others, the court did not abuse its discretion. *See Gall,* 552 U.S. at 51, 128 S.Ct. 586 ("The fact that the appellate court might reasonably have concluded that a different sentence was appropriate is insufficient to justify reversal of the district court."); *Fernandez,* 443 F.3d at 32 (committing the assignment of weight to the § 3553(a) factors to the sentencing judge's discretion).

Our conclusion is consistent with the cases cited by the government, *Repking* and *United States v. Vrdolyak,* 593 F.3d 676 (7th Cir.2010). In *Repking,* we vacated as substantively unreasonable a below-guidelines one-day sentence for a bank president who misappropriated funds. 467 F.3d at 1091–92. The district judge's offhanded reference to "unspecified 'good works' " that were "entirely consistent with a bank's business development plan" did not justify such leniency. *Id.* at 1093, 1096. This case is different: among other mitigating facts, the district court specified in detail with reference to the record what good works Warner did and what they revealed about him as a person. The court found, moreover, that Warner was motivated by genuine benevolence rather than ulterior aims.

In *Vrdolyak,* we reversed a below-guidelines probationary sentence for conspiracy ***859** to commit mail and wire fraud. 593 F.3d at 684. The defendant there had "a history of ethical misconduct," but the district court ignored it; it also overlooked the defendant's wealth. *Id.* at 682. Warner, by contrast, has a clean history apart from his tax evasion, and the district court recognized both his crime and his wealth. Moreover, because *Vrdolyak* was a procedural challenge, we expressed "no view on what a proper sentence would be." *Id.* at 684. But that is precisely the question before us now; *Vrdolyak* does not speak to it.

Nor are we allowing Warner to use his wealth as a "getout-of-jail card," *id.* at 682, as the government charges. The district court looked behind the numbers to Warner's character and found him to be a genuinely benevolent person. A non-wealthy defendant who showed similar qualities would be entitled to similar treatment (all else being equal). And a rich defendant who gave large gifts without real concern for others, or who did so cynically to give himself an argument at sentencing, would not deserve the same leniency.

2. Seriousness of the Offense

Section 3553(a) demands "a sentence sufficient, but not greater than necessary, to comply with the purposes" of sentencing. One of those purposes is "to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment." 18 U.S.C. § 3553(a)(2)(A). The district court here recognized Warner's crime as "a serious one" and respect for the law as "fundamental." According to the government, however, this was mere lip service, for Warner's sentence does not justly punish him or convey the seriousness of evading $5.6 million in taxes.

In another case, justice might demand a harsher sentence, but here it does not. To begin with, the government itself took a fairly lenient approach to Warner's punishment. It charged him with a single count of tax evasion for a single year and elected to treat his conduct in the other years as relevant for sentencing purposes rather than to charge them as separate crimes. Additionally, as we noted above, the government sought a sentence well below the guidelines range. Both decisions were within the government's prosecutorial discretion, and we do not second-guess them. But they started the district court down a path toward leniency.

It was reasonable for the district court to follow that path here. For a sentencing judge must consider not only the seriousness but also the "nature and circumstances of the offense." 18 U.S.C. § 3553(a)(1). The court noted several mitigating circumstances in Warner's case. His crime was isolated and uncharacteristic: he had kept only one offshore account containing "a small fraction" (about 6%) of his total wealth. He was 69 years old, had no prior criminal history, and posed no danger to society. In particular, the court found, there was "no question of him violating the tax laws in the future." Moreover, he cooperated by pleading guilty and promptly paying both full restitution and the FBAR penalty, although, it is true, his cooperation was incomplete (e.g., he resisted the government's subpoena and did not disclose the source of his offshore assets).

The district court also appropriately took into account Warner's attempt to enter the OVDP in September 2009. It is true that Warner already knew about the UBS investigation and Schumacher's indictment, so he was on notice of some probability that his own account would be discovered. That lessens the mitigating force of his attempted disclosure but does not eliminate it. Many other offshore-accountholders were similarly on notice, given the IRS's widely publicized prosecutions ***860** and enforcement efforts; yet many of them were eventually admitted into the OVDP anyway. The salient fact, in the district court's view, is that Warner came forward before he knew the IRS had his name or that he was under investigation. It was reasonable to consider this a mitigating fact. *Cf. United States v. Tenzer,* 213 F.3d 34, 42–43 (2d Cir.2000) (treating as mitigating a defendant's failed attempt to enter an IRS voluntary disclosure program).

In these circumstances, we think probation was a sufficiently serious sentence. The Supreme Court reminded us in *Gall* that probation involves a "substantial restriction of freedom," and faulted the court below for discounting that fact. 552 U.S. at 48, 128 S.Ct. 586. For two years Warner will live under restrictions on his movement and activities, and he must perform at least 500 hours of community service. Moreover, he paid a $100,000 fine, the highest possible amount for a violation of 26 U.S.C. § 7201.

In addition, Warner paid full restitution and a $53.6 million FBAR penalty. Technically the FBAR penalty is civil rather than criminal in nature. *See* 31 U.S.C. § 5321. But it stems from the same conduct as his criminal conviction; in fact, the government specifically cited his FBAR violations in the information as evidence of his criminal tax evasion. Further, the FBAR penalty was part of Warner's plea agreement. It is therefore one of the circumstances that informs our assessment of his sentence's adequacy. *Cf.* USSG § 5E1.2(d)(5) (instructing the court, when determining fines, to consider "any collateral consequences of conviction, including civil obligations arising from the defendant's conduct"); *United States v. Anderson,* 267 Fed.Appx. 847, 850 (11th Cir.2008) (per curiam) (upholding a probationary sentence for insider trading based in part on the defendant's payment of restitution and a civil penalty to the SEC).

The government now tries to downplay Warner's FBAR penalty, claiming it represents only a fraction of the liability he faced. According to the government, it could have charged Warner a separate penalty for *each year* he hid his account. Even assuming the relevant statute, 31 U.S.C. § 5321(a)(5)(C)-(D), would allow separate annual penalties, the six-year limitations period would have restricted the government's recovery to two or maybe three years. *See* 31 U.S.C. § 5321(b)(1). In addition, the government would have had to prove that Warner's violations were willful. *Id.* § 5321(a)(5)(C). Moreover, if $53.6 million were insufficient, the government could have insisted on more before entering into the plea agreement.

The government points out, citing *Gall,* that "custodial sentences are qualitatively more severe than probationary sentences of equivalent terms." 552 U.S. at 48, 128 S.Ct. 586. That is true, and in that sense incarceration sends a stronger message than probation does. But § 3553(a) does not command courts to send the strongest message possible; it commands them to impose a sentence that is "sufficient, *but not greater than necessary* " in the circumstances of each case. 18 U.S.C. § 3553(a) (emphasis added). The district court concluded that in Warner's case a probationary sentence met that standard. That conclusion was reasonable.

3. General Deterrence

[21] Another important goal of sentencing is "to afford adequate [general] deterrence to criminal conduct." 18 U.S.C. § 3553(a)(2)(B). White collar criminals seem like "prime candidates for general deterrence," *United States v. Peppel,* 707 F.3d 627, 637 (6th Cir.2013), because they (presumably) act rationally, calculating ***861** and comparing the risks and the rewards before deciding whether to engage in criminal activity. The guidelines thus make "deterring others from violating the tax laws ... a primary consideration." USSG § 2T1.1, intro. cmt. And they seek to increase the proportion of offenders who receive prison sentences above pre-guidelines levels. *See* USSG § 2T1.1, cmt. (background). Although the guidelines' policies are not controlling, *see United States v. Bonner,* 440 F.3d 414, 417 (7th Cir.2006), we have no quarrel with the general proposition that effective deterrence of tax crimes requires a credible threat of imprisonment. *Cf. United States v. Heffernan,* 43 F.3d 1144, 1149 (7th Cir.1994) (recognizing the need for significant penalties to compensate for the rewards and difficulty of detecting economic crimes). But that does not necessitate imprisonment in every case.

While incarcerating Warner undoubtedly would have sent a *stronger* message, the message sent by his existing sentence is, in our view, strong enough to satisfy § 3553(a)(2)(B). We reach this conclusion for two reasons. First, the veteran district judge found Warner to be one of a kind. Almost by definition, very few defendants will make that kind of impression on a sentencing judge. So Warner's sentence tells others very little, if anything, about what treatment they would receive for a similar crime. In particular, other, more typical defendants should take no comfort in the fact that Warner avoided imprisonment.

Second, even without a prison sentence, Warner's payment of a $53.6 million penalty already provides a measure of deterrence. *See United States v. Sklena,* 692 F.3d 725, 732 (7th Cir.2012) (recognizing that a large civil penalty can have a "deterrent effect ... similar to that of a criminal sentence"). From an economic point of view, deterrence is sufficient when the penalty for a crime multiplied by the probability of apprehension equals the harm done—in this case, the taxes evaded. *See DirecTV, Inc. v. Barczewski,* 604 F.3d 1004, 1010 (7th Cir.2010) (citing Gary S. Becker, *Crime and Punishment: An Economic Approach,* 76 J. Pol. Econ. 169 (1968)); *United States v. Rogan,* 517 F.3d 449, 454 (7th Cir.2008) (citing A. Mitchell Polinsky and Steven Shavell, *Punitive Damages: An Economic Analysis,* 111 Harv. L.Rev. 869 (1998)). If the prospect and severity of punishment are high enough, then the risks of tax evasion exceed the rewards, and so would-be offenders will refrain (at least in theory).

[22] Warner's FBAR penalty was nearly ten times the size of the tax loss he caused (not accounting for interest). The missing variable is the probability of apprehending the offshore tax-evader. Even without that figure, though, it is reasonable to think, as the district court did, that a tenfold penalty is sufficient in Warner's case. Congress apparently intended FBAR penalties to have a deterrent effect, *see* 31 U.S.C. § 5321(a)(5)(C), and it has employed multiples lower than ten to stem other types of economic harm, *see, e.g.,* 15 U.S.C. § 15(a) (authorizing treble damages for antitrust violations); 18 U.S.C. § 1964(c) (treble damages for RICO violations); 31 U.S.C. § 3729(a)(1) (treble damages for False Claims Act violations). The fact that Warner's penalty was only 3% of his net worth does not, as the government contends, blunt its deterrent force. For "[t]he wrongdoer's wealth plays no role" in the economic approach to deterrence outlined above. *DirecTV,* 604 F.3d at 1010.

The government points to *United States v. Engle,* where the Fourth Circuit, citing the guidelines' view that deterrence requires a real risk of incarceration, vacated a probationary sentence for tax evasion. 592 F.3d 495, 502 (4th Cir.2010). *Engle,* ***862** however, was at best a " 'mine-run' tax-evasion case." *Id.* at 503. The defendant there, unlike Warner, did not pay a large penalty or possess unique characteristics that could justify a low sentence. On the contrary, the facts in *Engle* "could perhaps be viewed as warranting an *above*-Guidelines sentence," *id.* at 503 (emphasis added), which no one suggests would have been appropriate here.

Finally, the government takes issue with the district court's statement that Warner's highly publicized prosecution and attendant humiliation provided some deterrence. The government argues that humiliation is a normal consequence of a fraud conviction. While Warner's prosecution has been more public than most, we agree that this fact deserves little, if any, weight. *See Repking,* 467 F.3d at 1096. But as we read the transcript, Warner's humiliation played no significant role in the court's sentencing determination. And in any event his sentence would stand without it.

4. Sentencing Disparities

The government's final contention is that Warner's sentence creates "unwarranted sentence disparities" in violation of § 3553(a)(6). The government points to four former UBS clients who received prison terms of a year and a day with tax losses lower than Warner's: Peter Troost (who evaded approximately $1 million), Christopher Berg ($270,000), Federico Hernandez ($500,000), and Richard Werdiger ($400,000). The government insists that Warner should have received a prison term at least as long as theirs. The district court disagreed—again, because Warner is unique.

We uphold the district court's conclusion. Section 3553(a)(6) forbids not all sentencing disparities but only "unwarranted" ones "among defendants with similar records who have been found guilty of similar conduct." 18 U.S.C. § 3556(a)(6). Warner is not similar to the government's comparators. None of them offered evidence of significant charity or otherwise impressed the district court with their personal character, as Warner did. None of them, with the exception of Werdiger, tried to enter the OVDP or paid an FBAR penalty comparable to Warner's. Two of them were convicted on numerous counts: six in Werdiger's case, five in Hernandez's. And in all four instances the government sought a sentence within the advisory guidelines range.[4] These were "mine run" cases. *Rita,* 551 U.S. at 351, 127 S.Ct. 2456. Warner's case is not.

Furthermore, probation is a common sentence in offshore tax evasion cases. The evidence introduced below shows that roughly half of the defendants convicted since 2008 have received terms of probation rather than imprisonment. And, of course, thousands more have avoided criminal prosecution altogether by entering the OVDP. The government correctly emphasizes that the defendants sentenced to probation were different from Warner: for example, they caused smaller tax losses, and several of them gave more information to the government. But they are at least *as similar* as the government's comparators. Paul Zabczuk, for example, tried to disclose his offshore account through the ***863** OVDP, was rejected, and received three years' probation despite the government's request for an 18–month prison sentence. And Igor Olenicoff hid millions of dollars in offshore accounts, paid the IRS $52 million, and received two years' probation based in part on his "exemplary community service" and "humanitarian causes."[5] Both of them, however, caused much lower tax losses than Warner.

Ultimately, these examples prove the district court's point: Warner is unique, and neither side's comparisons are very helpful. As a result, his sentence does not cause any *unwarranted* disparities among *similar* defendants. And for the same reason, it does not restrict the government's ability to obtain a prison sentence in other, more typical cases, even where the tax loss at issue is less than Warner's.

5. Choice of Sentence

The district court recognized that the various § 3553(a) factors "run in different directions" and that it was up to the court to "weigh ... and balance them." In the end, it concluded that the mitigating factors outweighed the factors favoring incarceration, so it sentenced Warner to probation.

None of the errors that have led us to upend other sentences on substantive grounds are present here. In *England,* for example, the district court's sentence rested on a purported finding that the defendant would have attempted to murder the witnesses against him had he not been in custody. 555 F.3d at 621–22. That was nothing more than speculation, so we vacated the sentence. *Id.* at 623; *see also United States v. Bradley,* 628 F.3d 394, 399 (7th Cir.2010) (per curiam) (where the judge assumed the defendant had committed undiscovered crimes and would commit more if released). Here, by contrast, the record amply supports the district court's factual findings.

We vacated the sentence in *United States v. Roberson* because of a legal error: the district court imposed a 1–month sentence for bank robbery to avoid an 84–month statutory minimum on a related firearm offense. 474 F.3d 432, 433–34 (7th Cir.2007). A disagreement with Congress is not a valid basis to give a lenient sentence. *Id.* at 434–35. No such impermissible considerations intruded into the court's decision here, however.

We have also occasionally vacated sentences that were obviously unreasonable or arbitrary. In *United States v. Goldberg,* the district court gave a one-day sentence for child pornography based on "idiosyncratic penological views" that placed nearly exclusive emphasis on rehabilitation, rather than a "careful, impartial weighing of the statutory sentencing factors"; we reversed. 491 F.3d 668, 673–74 (7th Cir.2007). In *Omole,* the court gave a sentence 51 months below the guidelines range, but that result "directly contradict[ed]" the court's finding that the defendant had "contempt for the court" and "utter lack of feeling for other human beings." The court even told the defendant that "you've caught a break that I'm not at all sure you deserve." These contradictions compelled us to reverse. 523 F.3d at 698–700. And in *Repking,* which we discussed above, the court grossly overstated the impact of the defendant's unspecified good works and restitution payments. 467 F.3d at 1093, 1095–96.

By contrast, the district court's rationale here rests on specific facts about Warner rather than any peculiar penological theory; it is fully consistent with the sentence ***864** imposed; and the factors the court emphasized bear the weight it gave them.

This case more closely resembles *Wachowiak,* where we affirmed a below-guidelines prison sentence for receiving and sharing child pornography based on mitigating facts found by the district judge: the defendant never produced any images, showed genuine remorse, and could count on family support to help him through rehabilitation. In addition, like Warner, he had a clean record, "excellent" character (evidenced by testimony and letters), and a low risk of recidivism. 496 F.3d at 745–47. These factors were "particularized to the individual circumstances of the case"—as were Warner's. *Id.* at 750. Even though we might have been harsher, we concluded that the district court's decision fell within the range of reasonable sentences. *Id.* at 754–55.

The Supreme Court's decision in *Gall* is also instructive. The defendant there pled guilty to limited participation in an ecstasy distribution ring. The district judge sentenced him to three years' probation, well below the guidelines range of 3037 months in prison. 552 U.S. at 41–45, 128 S.Ct. 586. The judge emphasized that the defendant had no significant criminal history, had voluntarily withdrawn from the conspiracy, and was “doing everything in his power to forge a new life.” *Id.* at 44, 128 S.Ct. 586. Additionally, a “small flood” of letters attested to his good character. *Id.* at 43, 128 S.Ct. 586. The Eighth Circuit thought the crime demanded a more serious sentence and reversed. The Supreme Court disagreed, holding that “the Court of Appeals should have given due deference to the District Court's reasoned and reasonable decision that the § 3553(a) factors, on the whole, justified the sentence.” *Id.* at 59–60, 128 S.Ct. 586.

Due deference leads us to the same conclusion here. Considering (1) Warner's excellent character, as shown by his long history of charity and kindness to others; (2) the isolated and uncharacteristic nature of his tax evasion; (3) his attempt to enter the OVDP; (4) his guilty plea and prompt payment of his liabilities; (5) his $53.6 million FBAR penalty, which is nearly ten times the tax loss; and (6) the fact that the government charged him with only one count and itself sought a well-below-guidelines sentence, we conclude that Warner's probationary sentence is reasonable.

III. CONCLUSION

Because the district court did not abuse its considerable discretion, we AFFIRM Warner's sentence.

FLAUM, Circuit Judge, concurring in the judgment.
I concur in the judgment and write separately to express my considerable unease with the outcome of this appeal and the signal that it may send about how the criminal justice system treats wealthy tax evaders. In my view, Warner's commendable charitable spirit does not obviate the appropriateness of some period of incarceration. He purposely sought to deprive the federal government of millions of dollars of tax revenue simply to amass more of his enormous wealth. As Judge Kocoras put it, Warner's acts “go[ ] to the essence of how we govern ourselves.” I agree wholeheartedly, and, therefore, Warner's non-custodial sentence—regardless of his philanthropy—causes me concern.

Nevertheless, we review the sentence imposed for an abuse of discretion. And the deference we afford the sentencing judge here must be informed by the leniency with which the government approached Warner's prosecution. Despite years of willful tax evasion, the government chose to charge Warner with just one count. And further, with a Sentencing Guidelines range of 46–57 months, the government ***865** recommended a relatively modest period of incarceration (“in excess of a year and a day”). For me, these two debatable acts of prosecutorial discretion point toward an affirmance in this case, as they provided a uniquely limiting context for the district judge's exceptional exercise of leniency. Without this backdrop, I would be inclined to vacate the sentence imposed and remand for resentencing. However, in light of a veteran jurist's thoughtful and thorough consideration of the case, I am compelled to conclude that Warner's sentence falls within a sentencing judge's broad band of discretion.

All Citations

792 F.3d 847, 116 A.F.T.R.2d 2015-5175, 2015-2 USTC P 50,379

Footnotes

[1] *See generally* http://www.justice.gov/tax/offshore-compliance-initiative (last visited July 9, 2015).

[2] Information on the 2009 disclosure program and its successors is available on the IRS's webpage at http://www.irs.gov/uac/2009–Offshore–Voluntary–Disclosure–Program (last visited July 9, 2015).

[3] Warner's figure includes the retail value of toys he donated to charities; the government claims those toys should be valued at their actual cost to the defendant. Warner's figure also includes donations for which, according to him, he did not claim deductions on his tax returns; the government's figure does not include those additional donations.

[4] *See United States v. Troost,* No. 1:13–cr–00185 (N.D. Ill.), plea agreement at 6, 11 (ECF No. 12), sent. hr'g tr. at 26–30 (ECF No. 23), judgment (ECF No. 19); *United States v. Berg,* No. 5:12–cr–00877–LHK (N.D. Cal.), gov't sent. mem. at 3 (ECF No. 15), sent. hr'g tr. at 50–53 (ECF No. 27), judgment (ECF No. 20); *United States v. Hernandez,* No. 1:10–cr–

00334–DC (S.D.N.Y.), gov't sent. mem. (ECF No. 11), judgment (ECF No. 12); *United States v. Werdiger,* No. 1:10–cr–00325–PGG (S.D.N.Y.), judgment (ECF No. 30), sent. hr'g tr. at 32, 45–55 (ECF No. 31).

[5] *See United States v. Zabczuk,* No. 0:10–cr–60112–WPD (S.D. Fla.), sent. hr'g tr. at 4, 9, 22–23 (ECF No. 35); *United States v. Olenicoff,* No. 8:07–cr–00227–CJC (C.D. Cal.), plea agreement at 4–5 (ECF No. 11), sent. hr'g tr. at 4–6, 8–9, 23 (ECF No. 18).

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United States District Court,
C.D. California.

UNITED STATES of America
v.
$4,656,085.10 IN BANK FUNDS.

No. SACV 12–0219–DOC (JPRx).
|
Jan. 27, 2014.

Attorneys and Law Firms

Frank D. Kortum, Office Of US Attorney, Los Angeles, CA, for United States of America.

PROCEEDINGS (IN CHAMBERS): ORDER DENYING MOTION TO SET ASIDE DEFAULT JUDGMENT [46][47]

Honorable DAVID O. CARTER, District Judge.

***1** Julie Barrera, Courtroom Clerk.

Before the Court are Claimant Michael Brander and Evergreen Capital LLC's (together, "Defaulted Claimants' ") Motions to Set Aside Default Judgment of Forfeiture ("Motion" or "Mot.") (Dkts.46, 47). After considering the moving papers, opposition, and reply, and all filings attached thereto, the Court hereby DENIES the Motion.

I. BACKGROUND

Claimant Michael Brander ("Mr.Brander") was getting divorced from his wife, Sheila Brander. Compl. ¶ 8. In May 2008, during the course of divorce proceedings, Mr. Brander drove from Alaska to Panama with several cashier's checks that totaled approximately $3,250,000, opened an account in the name of Dakota Investment, and deposited checks into the account. *Id.* The Government contends, and Mr. Brander admits, that his purpose in moving the funds to Panama was to conceal them from his wife. *Id.;* Mot. at 1–2.

Mr. Brandner also failed to file a Report of Foreign Bank and Financial Accounts ("FBAR") with the Internal Revenue Service. Compl. ¶ 9. Mr. Brandner was allegedly told that he was required to file a FBAR, but he failed to do so. *Id.* Over the next few years, Mr. Brander shifted a total of $4,656,085.10 to his account in Panama, including through wire transfers.

On September 12, 2011, the Government seized the funds. On February 9, 2012, the Government filed a Complaint for forfeiture against the funds, alleging that they were subject to forfeiture as proceeds of wire fraud because they were involved in one or more money laundering transactions, and because Mr. Brander failed to file a FBAR. *Id.* at 13.

Mr. Brandner admits that he was "served copies of the Verified Complaint for Forfeiture in this case in February, 2012." Brandner Decl. ¶ 5. He explains that "his attorney at the time" advised him that he should not respond to the Complaint because his doing so "would increase the chances of federal criminal charges being filed against him." Mot. at 3; Brandner Decl. ¶ 5.

On June 4, 2012, the Clerk of the Court entered default against Defaulted Claimants. Default by Clerk (Dkt.13). On July 18, 2012, this Court entered default judgment against Defaulted Claimants. Order, July 18, 2012 (Dkt.23).

Now, Mr. Brandner moves the Court to set aside the default judgment. *See generally* Mot.

II. DISCUSSION

Under Federal Rule of Civil Procedure 60(b)(1), district courts have the discretion to relieve a party from a judgment or order for reason of "mistake, inadvertence, surprise, or excusable neglect." *TCI Group Life Ins. Plan v. Knoebber,* 244 F.3d 691, 695 (9th Cir.2001). The Ninth Circuit has admonished district courts that, as a general matter, Rule 60(b) is "remedial in nature and ... must be liberally applied." *Falk v. Allen,* 739 F.2d 461, 463 (9th Cir.1984) (per curiam). But, "[t]his does not mean, of course, that the moving party is absolved from the burden of demonstrating that, in a particular case, the interest in deciding the case on the merits should prevail over the very important interest in the finality of judgments." *TCI Group,* 244 F.3d at 696. There must still be "good cause" for vacating default judgments. *Id.* Good cause is absent when: the defendant's culpable conduct led to the default; the defendant has a meritorious defense; or reopening the default judgment would prejudice the plaintiff. *Id.* These three factors are disjunctive, and the district court may deny the motion "if any of the three factors was true." *Franchise Holding II, LLC v. Huntington Rests. Group, Inc.,* 375 F.3d 922, 926 (9th Cir.2004) (quoting *Am. Ass'n of Naturopathic Physicians v. Hayhurst,* 227 F.3d 1104, 1108 (9th Cir.2000)).

***2** Defaulted Claimants explain that, "the primary reason that [they] did not file a claim and Answer to the forfeiture Complaint was that [they] w[ere] advised by [their] then attorney not to do so ." Mot. at 3. In addition, "[Mr. Brandner] was advised by his doctors to attempt to limit his stress." *Id.* The Government argues that this conduct is, in fact, culpable. Opp'n at 6–7; Sur–Reply at 2–3. The Court agrees.

"[A] defendant's conduct is culpable if he has received actual or constructive notice of the filing of the action and *intentionally* failed to answer." *TCI Group,* 244 F.3d at 697 (citing *Alan Neuman Prods. v. Albright,* 862 F.2d 1388, 1392 (9th Cir.1988)). In other words, a defaulted claimant's conduct was culpable "where there is no explanation of the default inconsistent with a devious, deliberate, willful, or bad faith failure to respond." *TCI Group,* 244 F.3d at 698 (citations omitted).

Here, Defaulted Claimants admit that they made an intentional decision not to respond. Brandner Decl. ¶ 5. Indeed, they consulted their lawyer. This is not a case where, like in *Hayworth v. Haddock,* No. 06–CV–1713, 2008 U.S. Dist. LEXIS 104171, at *8–9 (E.D.Cal. Dec. 15, 2008), defendants lacked actual or constructive notice of the action. Rather, Defaulted Claimants made a considered decision-albeit, perhaps, a bad one-with the advice of an attorney. Unfortunately, this type of prudential mistake is not enough to relieve Defaulted Claimants of the default judgment against them. *See Franchise Holdings,* 375 F.3d at 926 ("If a defendant has received actual or constructive notice of the filing of the action and failed to answer, its conduct is culpable.").

Therefore, the Court finds that Defaulted Claimants were culpable in their failure to respond to the Complaint.

III. DISPOSITION

For the reasons explained above, the Court hereby DENIES Defaulted Claimant's Motions to Set Aside Default Judgment.

The Clerk shall serve this minute order on the parties.

All Citations

Not Reported in F.Supp.2d, 2014 WL 552864

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NOT FOR PUBLICATION
United States District Court,
E.D. New York.

Louis GALPERN and Eva Galpern, Plaintiffs,
v.
DE VOS & CO. PLLC, Attorneys and Counselors and Lloyd De Vos, Esq., Defendants.

No. 10–CV–1952 (CBA)(JMA).
|
Sept. 30, 2011.

Attorneys and Law Firms

David H. Singer, David H. Singer & Associates LLP, New York, NY, for Plaintiffs.

Lloyd De Vos, Lloyd De Vos & Co. LLP, New York, NY, for Defendants.

MEMORANDUM & ORDER

AMON, Chief Judge.

***1** This case arises out of a dispute over legal fees. Plaintiffs Louis Galpern ("Galpern") and Eva Galpern (collectively the "Galperns" or "plaintiffs") bring claims based upon their contention that defendants Lloyd De Vos ("De Vos") and De Vos & Co. PLLC ("DVC" and collectively "defendants") over-billed plaintiffs and sought extra fees in violation of the terms of their retainer agreement with the Galperns. They also assert related causes of action based upon defendants' efforts to collect claimed unpaid legal fees. Defendants move for summary judgment on plaintiffs' claims and defendants' counterclaims and to strike plaintiffs' jury demand. Plaintiffs move for summary judgment with respect to defendants' counterclaim and defendants' second, third, fourth, and seventh affirmative defenses.

BACKGROUND AND PROCEDURAL HISTORY

On February 21, 2009, DVC sent a retainer letter (the "Retainer Agreement") to the Galperns that contained the terms under which DVC was prepared to provide legal services to them. (Pl. 56.1 Stmt. ¶ 1; Def. 56.1 Stmt. ¶ 1.) In a letter dated February 21, 2009, which the parties refer to as the "Retainer Agreement," the defendants set out two potential fee arrangements. (De Vos Aff. ¶ 10; Am. Compl., Exhibit A.) The first option was a fixed fee of $60,000. (*Id.*) In the second option, defendants would proceed on a time and disbursement basis of $500.00 per hour for De Vos's time and $300.00 per hour for the time of Sherry Ellenzweig, an associate at DVC. (*Id.*) The fees in the second option were to be capped at $75,000.00 unless the matter was referred to the United States Department of Justice. (*Id.*) To accept the second option, plaintiffs had to submit a check to defendants for $15,000.00. (*Id.*) Both parties acknowledge that an agreement was reached pursuant to which DVC would perform legal services. (Pl. 56.1 Stmt. ¶ 2; Def. 56.1 Stmt. ¶ 2.) Louis Galpern states that he chose the second alternative and paid Lloyd De Vos $15,000.00. (Galpern Aff. ¶ 14.) Defendants provide no facts controverting that assertion.

According to Galpern, in February 2009, he received notice that UBS might be releasing information regarding his foreign bank accounts to the Internal Revenue Service (the "IRS"). (Galpern Aff. ¶ 4.) He states that he was aware from various newspaper articles that the IRS had an amnesty program with respect to foreign bank accounts, and he wanted to take advantage of the amnesty program. (*Id.* ¶ 5.) It is for that reason, he states, that he entered into the Retainer Agreement with defendants. (*Id.* ¶ 6 .) He asserts that Lloyd De Vos explained to him that Amended Tax Returns and Foreign Bank Account Reports ("FBARs") would have to be filed and that they relied on defendants to comply with the requirements of the Voluntary Disclosure Program. (*Id.* ¶ 7.) Galpern states that Lloyd De Vos advised him that it was important that amended tax returns be filed as soon as possible and that the deadline for taking advantage of the Voluntary Disclosure Program was September 15, 2009. (*Id.* ¶ 8.) He attests that Lloyd De Vos advised him that all tax returns and FBARs had to be filed by that date and that it was imperative that the Galperns' tax returns be filed as rapidly as possible to prevent a criminal referral. (*Id.* ¶¶ 8–9.)

***2** Between February 26, 2009 and October 14, 2009, Galpern states that he paid defendants a total of $56,000.00. (*Id.* ¶¶ 14, 20.) In conversations in August and September 2009, Galpern states that De Vos told him that the IRS had extended the filing due date to October 15, 2009. (*Id.* ¶ 37.) Galpern states that on October 14, 2009, he was advised that he could pick up the tax returns and FBARs for timely filing in order to comply with the Voluntary Disclosure Program. (*Id.* ¶ 42.) At a meeting at defendants' office on October 14, 2009, he states, defendants demanded payment of $112,000.00. (*Id.* ¶ 43.) Plaintiffs have submitted copies of defendants' invoices, which total $160,643.97 for the relevant time period, (Singer Aff., Exs. A–H.), and Galpern acknowledges that he received invoices totaling $168,937.46 in charges, which, less the $56,000.00 Galpern states that he had paid, would correspond to roughly $112,000.00 in unpaid charges at that time. (Galpern Aff. ¶ 56.) Galpern states that defendants refused to give him the amended tax returns and FBARs unless he agreed to pay the sum defendants claimed was owing. (*Id.* ¶ 43 .) Galpern states that he left defendants' office at that time. (*Id.* ¶ 44.)

Galpern states that De Vos called him later that day and told him to return to defendants' office, which the Galperns did. (*Id.* ¶ 47.) Both parties acknowledge that at that meeting plaintiffs agreed to pay DVC an additional $50,000.00 in legal fees in settlement of all outstanding fees owed to DVC for services through that date. (Pl. 56.1 ¶ 3; Def. 56.1 ¶ 3.) Both Galpern and De Vos state that after that agreement was reached, defendants turned over the tax returns and FBARs to plaintiffs. (Galpern Aff. ¶ 54; De Vos Aff. ¶ 8.) Defendants performed additional work after October 14, 2009, and submitted an invoice for an additional $3,000.00. (Def 56.1 ¶ 6–7; Pl. 56.1 ¶ 6; Singer Aff., Ex. I.) Plaintiffs, however, have not paid defendants the $50,000.00 or the $3,000.00 invoiced for additional work. (Galpern Aff. ¶ 55; Def. 56.1 ¶ 5.)

Galpern states that on or about December 30, 2009, Lloyd De Vos filed a proceeding against him in Zurich, Switzerland, which resulted in the seizure of his bank account in Switzerland in the approximate amount of $50,000.00. (Galpern Aff. ¶ 61.) In that proceeding, Galpern contends, De Vos made a representation that Galpern was indebted to De Vos in an amount in excess of $50,000.00. (*Id.* ¶ 62.)

Plaintiffs filed this action in New York State Supreme Court. The action was removed on April 30, 2010. On August 27, 2010, plaintiffs filed an amended complaint, alleging four counts. The first cause of action appears to be for breach of contract. In the second cause of action, plaintiffs appear to allege that defendants breached their fiduciary duty by using information obtained from the plaintiffs to seize the plaintiffs' foreign bank account in an *in rem* proceeding in Switzerland. The third cause of action alleges over-billing, and the fourth cause of action alleges that De Vos made fraudulent statements to the court in Switzerland. Defendants now move for summary judgment on the complaint in full or, in the alternative, to strike plaintiffs' jury demand. Plaintiffs cross-move for summary judgment on defendants' counterclaim and defendants' second, third, fourth and seventh affirmative defenses.

STANDARD OF REVIEW

***3** Summary judgment is appropriate if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56; *accord Celotex Corp. v. Catrett,* 477 U.S. 317, 322–23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); *Belfi v. Prendergast,* 191 F.3d 129, 135 (2d Cir.1999). The Court's function is not to resolve disputed issues of fact, but only to determine whether there is a genuine issue to be tried. *See Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 249, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

The Court is required to view the evidence in the light most favorable to the nonmoving party. *See Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 157, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970). Nevertheless, the nonmoving party cannot rest on mere allegations or denials, but must instead set forth specific facts showing there is a genuine issue for trial. Fed.R.Civ.P. 56(e); *Nat'l Westminster Bank USA v. Ross,* 676 F.Supp. 48, 51 (S.D.N.Y.1987) (speculation, conclusory allegations, and mere denials are not enough to raise genuine issues of fact). No genuine issue exists unless there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party. If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted. *Anderson,* 477 U.S. at 249–50 (citations omitted).

DISCUSSION

I. Summary Judgment as to the Amended Complaint

Defendants Lloyd De Vos and De Vos & Co. move for summary judgment on each of the plaintiffs' causes of action. [1]

1. First Cause of Action

Plaintiffs allege that on October 14, 2009 defendants breached their contract by refusing to turn over their work product unless plaintiffs paid fees in excess of the $75,000.00 cap specified in the Retainer Agreement. Defendants argue that they could not have breached that contract because the plaintiffs and defendants agreed on October 14 that plaintiff would pay $50,000.00 to settle all outstanding legal fees in exchange for defendants' work product. Plaintiffs counter that any agreement reached on October 14, 2009 was procured through duress and therefore unenforceable. Both parties acknowledge that plaintiffs agreed to the accord. Thus, the only question, as the claim is argued to this court, is whether the accord was procured by duress.

Under New York law, "[a] contract is voidable on the ground of duress when it is established that the party making the claim was forced to agree to it by means of a wrongful threat precluding the exercise of his free will." *Austin Instrument v. Loral Corporation,* 29 N.Y.2d 124, 130, 324 N.Y.S.2d 22, 272 N.E.2d 533 (1971). In order to plead duress, the party must satisfy four elements: "(1) a threat; (2) which was unlawfully made; (3) and caused involuntary acceptance of contract terms; (4) because the circumstances permitted no other alternative." *Kamerman v. Steinberg,* 891 F.2d 424, 431 (2d. Cir.1989) (citing *Gulf & W. Corp. v. Craftique Prod., Inc.,* 523 F.Supp. 603, 610 (S.D.N.Y.1981)).

***4** Defendants argue that plaintiffs cannot satisfy the second and fourth elements: that the alleged threat was unlawfully made and that the circumstances permitted no other alternative. Generally, "tak[ing] action which is legally permissible" does not constitute an unlawful threat. *Kamerman v. Steinberg,* 891 F.2d 424, 432 (2d Cir.1989) (citing *Hammelburger v. Foursome Inn Corp.,* 54 N.Y.2d 580, 593 n. 4, 446 N.Y.S.2d 917, 431 N.E.2d 278 (1981)). For example, an attorney threatening to stop representing a client until he is paid is typically lawful, provided the withdrawal would not cause prejudice to the client. *Ehrlich v. Tullo,* 274 A.D.2d 303, 710 N.Y.S.2d 572, 573 (App. Div., 1 st Dep't.2000) (explaining an attorney's " 'threats' to cease representing [the defendant, client, as attorney] unless [the attorney's fees] were paid were not wrongful," but noting that the client "would not have been prejudiced had her attorney actually withdrawn"); *see also Duane Morris LLP v. Astor Holdings Inc.,* 61 A.D.3d 418, 877 N.Y.S.2d 250, 252 (App. Div., 1 st Dep't.2009) (finding an attorney's threat to cease representation of the client until paid was not unlawful). Where the attorney is demanding excessive and unreasonable fees, however, such action may be deemed unlawful. *See First Nat'l Bank of Cincinnati v. Pepper,* 547 F.2d 708, 714–15 (2d Cir.1976) (finding attorney's actions in withholding documents until the plaintiffs agreed to pay fees was unlawful because the amount attorney demanded was excessive and unreasonable). The reasonableness of defendants' demands is a contested issue, *see infra* Section I.3.

Even if a threatened action is considered "unlawful" for purposes of duress, the party claiming duress must also show that they had no other alternative than to agree to the contract in question. This element "places a burden on the threatened party to show that the threatened breach would result in irreparable harm." *Indus. Recycling Sys., Inc. v. Ahneman Assoc., P.C.,* 892 F.Supp. 547, 550 (S.D.N.Y.1995). The party must show, for example, that there was no other source of supply for the withheld items and that there were no available adequate remedies at law, namely a breach of contract action. *See e.g., Austin Instrument, Inc. v. Loral Corp.,* 29 N.Y.2d 124, 130–31, 324 N.Y.S.2d 22, 272 N.E.2d 533 (1971); *Sosnoff v. Carter,* 165 A.D.2d 486, 568 N.Y.S.2d 43, 46 (App.Div., 1st Dep't.1991); *U S West Fin. Servs., Inc. v. Tollman,* 786 F.Supp. 333, 339–40 (S.D.N.Y.1992); *Universal Reinsurance Co., Ltd. v. St. Paul Fire and Marine Ins. Co.,* No. 95 Civ. 8436(WHP), 1999 WL 771357, at *10 (S.D.N.Y. Sept.29, 1999).

Defendants argue that plaintiffs cannot make a showing of duress because plaintiffs were not required to submit the tax returns and FBARs in order to qualify for the Voluntary Disclosure Program and, in any event, plaintiffs were not eligible. Defendants submit three memoranda issued by the Internal Revenue Service on March 23, 2009 that purportedly constitute the framework of the Voluntary Disclosure Program (De Vos Aff., Ex. 3), as well as a set of Frequently Asked Questions, or FAQs, about the Program, issued by the IRS on May 6, 2009 and updated on June 24, 2009 (De Vos Aff., Ex. 4). Defendants argue that these documents support their contention that plaintiffs need not have submitted the tax returns and were not eligible for the amnesty. Louis Galpern, however, has submitted an affidavit in which he states defendants specifically advised him that he and his wife were eligible to participate in the IRS's Voluntary Disclosure Program and that "Amended Tax Returns and Foreign Bank Account Reports would have to be filed," that "the deadline for taking advantage of the Amnesty Program was September 15, 2009, and that all tax returns and Foreign Bank Account Reports (FBARS) had to be filed by then." (Galpern Aff. ¶¶ 7–8.) Galpern states that De Vos later advised him that the filing date for the Voluntary Disclosure Program had been extended to October 15, 2009. (Galpern Aff. ¶ 37.)

***5** Additionally, plaintiffs provide a letter from Lloyd De Vos to Louis Galpern in which De Vos writes, "It will be *necessary* as we go through this process of addressing this matter to prepare amended Federal and State tax returns." (Galpern Aff., Ex. A, at 3 .) (emphasis added). The letter does not indicate the date by which the tax returns needed to be filed. However, it does specify that "[t]here is time sensitivity in [preparing the amended tax returns and FBARs] because of our concern that your actions appear to be voluntary and that a criminal referral not be issued as a result of disclosures from the Swiss Federal Tax Administration to the Internal Revenue Service that took place last Wednesday, February 16, 2009, in Switzerland." (*Id.*) Thus, based on the statements allegedly made by De Vos, it would have been reasonable for Galpern to infer that the documents in question were required to be filed prior to the deadline for voluntary disclosure.

Although a claim of duress is evaluated under an objective standard, *see Berman v. Parco,* No. 96 Civ. 0375, 1996 WL 465749, at *8 (S.D.N.Y. Aug. 15, 1996); *DuFort v. Aetna Life Ins. Co.,* 818 F.Supp. 578, 583 (S.D.N.Y.1993), a court will consider a party's objective choices based on the facts and circumstances as they were reasonably understood by the party at the time of the decision. Thus, where a party to a contract "soundly and reasonably believed [he] faced irreparable harm, with no other feasible remedy than to" agree to a defendant's demand, it could be sufficient to constitute duress. *First Nat'l Bank of Cincinnati v. Pepper,* 547 F.2d 708, 715 (citing *First Nat'l Bank of Cincinnati v. Pepper,* 454 F.2d 626 (2d Cir.1972)).

Although the case is not cited by either party, the Second Circuit Court of Appeals considered similar circumstances in *First National Bank,* 547 F.2d at 715. There, the Second Circuit considered the case of a lawyer, Pepper, who threatened to retain corporate documents unless certain fees were paid. Pepper had helped arrange a deal with the prospective purchaser of a corporation. Pepper, however, threatened that he would not turn over corporate papers and stock certificates that were required for the deal to close unless he was paid fees in the amount of $100,000.00. *Id.* at 713. The court found, first, that Pepper was entitled to the payment of some fees. *Id.* at 713–14. However, the court found that the claim for duress could proceed because the particular demand at issue was excessive. *Id.* at 714–15.

The court next turned to the question of whether shareholders, who had agreed to a settlement with Pepper so as to consummate the sale, had "no reasonable alternative" to settling. *Id.* at 715. The court found that the buyer might have temporarily delayed the closing, but that even under that circumstance, the shareholders had to be certain they could deliver in a timely fashion. *Id.* To deliver on the closing, Pepper's availability was essential. *Id.* However, Pepper's own representative stated that Pepper was about to leave on vacation, and that Pepper usually took a month or two off and traveled abroad. *Id.* Pepper later claimed that he in fact had no intention to engage in international travel during the relevant period. *Id.* at 715. The court found, however, that the shareholders were entitled to rely on the statements of Pepper's representative. *Id.* Thus the question was not whether Pepper would in fact have been available, but whether the shareholders could reasonably believe, based on the representations made, that Pepper may not be available. *Id.*

***6** Here, likewise, defendants argue that plaintiffs were in fact under no pressure to file the amended tax returns and FBARs, as they were not required to file the documents and, in any event, were not even eligible for the voluntary disclosure program. But under the circumstances, the Galperns were entitled to rely on the representations of their attorney, who appears to have at least strongly implied that the documents must be filed and that the Galperns were required to do so by October 14, 2009, or else face potential financial and criminal liability.

Defendants also contest plaintiffs' characterization of the nature of their representation, arguing that Galpern's assertion that he entered into the Retainer Agreement with defendants "for the purpose of taking whatever steps were necessary to meet all the terms and conditions of the Amnesty Program" (Galpern Aff. ¶ 6.) is false. Defendants argue that plaintiffs could not have hired them for their assistance in participating in the Voluntary Disclosure Program because the Voluntary Disclosure Program for UBS AG accountholders was not introduced until March 23, 2009. However, the documents do indicate that defendants were hired to assist plaintiffs with some form of voluntary disclosure. Indeed, a letter from Lloyd De Vos to Louis Galpern, dated February 23, 2009, before the Voluntary Disclosure Program was allegedly announced, discusses the possibility of negotiated settlement with the IRS and that it was important that the Galperns' actions "appear to be voluntary". (*See* Galpern Aff., Ex. A, at 2–3.)

Moreover, defendants' invoices indicate that De Vos was in fact working on tasks related to voluntary disclosure. The invoices state that on February 25, 2009, for example, the defendants made "multiple telephone calls with IRS to establish voluntary disclosure procedures." (Pl.Aff., Ex. A.) Another invoice describes some of the defendants' activities on March 4, 2009 as follows: "E-mails to and from Urs [sic] regarding identification of documents turned over by UBS to IRS; Review Amnesty proposals." (Pl. Affirmation Exhibit B.) On March 5, 2009, the invoices list: "E-mail from and to Urs [sic] regarding confirmation of handover of files by UBS to IRS." (*Id.*) Even if defendants were not hired for the express purpose of complying with the specific Voluntary Disclosure Program allegedly announced in March 2009, that does not negate the assertions made in Galpern's affidavit that Galpern had multiple conversations with De Vos subsequent to the announcement in which he alleges that he expressed concern that the returns were not ready on a timely basis, but was assured that the IRS had extended the filing due date for the Voluntary Disclosure Program to October 15, 2009 (Galpern Aff. ¶ 37), and that he was advised that on October 14, 2009 he could pick up the tax returns and FBARs for timely filing in order to comply with Program (Galpern Aff. ¶ 42).

Defendants next argue that any predicament plaintiffs found themselves in as a result of defendants' decision to withhold the tax returns and FBARs was the result of the plaintiffs' own conduct, and therefore cannot make out a claim of duress. "Mere hard bargaining positions, if lawful, and the press of financial circumstances not caused by defendant, will not be deemed duress. The alleged duress must be proven to have been the result of defendant's conduct and not of plaintiff's own necessities." *U.S. West,* 786 F.Supp. at 340. However, this is not a case of mere hard bargaining. Although it is true that plaintiffs were potentially subject to criminal prosecution because they allegedly evaded United States taxes, it was the defendants' conduct in withholding the tax returns and FBARs that caused the immediate crisis.

***7** Finally, defendants argue in their reply brief that plaintiffs cannot maintain a claim of duress because plaintiffs in fact negotiated with defendants. Galpern attests that he left defendants' office when first asked to pay more money and later came back to the office, at which point the parties agreed to a reduced fee demand of $50,000.00. (Galpern Aff. ¶¶ 44, 47, 50.) However, defendants have cited no case law standing for the proposition that a party subject to duress cannot have conducted any negotiations. Nor have defendants cited case law that suggests that there can be no claim for duress where a party leaves a negotiation and subsequently returns.

Certainly, the fact that a party participates in negotiations can be evidence that their free will was not overcome. *See, e.g., Duane Morris LLP v. Astor Holdings Inc.,* 61 A.D.3d 418, 877 N.Y.S.2d 250 (App. Div., 1 st Dep't 2009) (finding client's free will was not overborn where client admitted participating in significant negotiations with attorney over legal fees and was represented by independent counsel). Courts have found, however, that parties that agree to a settlement of disputed claims may be subject to duress. *See, e.g., First Nat'l Bank,* 547 F.2d at 715. Defendants have presented no evidence regarding the contents or timing of any such negotiations except that the parties eventually agreed to a settlement sometime on the same day that the plaintiffs made their demand. On the current record, the Court finds that there are disputed issues of material fact and accordingly will not grant summary judgment.

Although the issue was not raised by the parties, the Court notes here that under the theory of duress, a contract is voidable, not void. *Universal,* 1999 WL 771357, at *10 (citing *Indus. Recycling Sys., Inc. v. Ahneman Assoc., P.C.,* 892 F.Supp. 547, 550 (S.D.N.Y.1995). "It is well-settled that 'one who would repudiate a contract procured by duress, must act promptly, or will be deemed to have elected to affirm it.' " *Indus. Recycling Systems,* 892 F.Supp. at 551 (quoting *Fayard v. Henry Holt & Co.,* 726 F.Supp. 438, 447 (S.D.N.Y.1989)). The Court must determine "whether the party claiming duress acted reasonably under the circumstances in asserting the claim." *U.S. West,* 786 F.Supp. at 340. "The burden on a party seeking to avoid contractual obligations on the grounds of economic duress 'increases proportionately with the delay in initiating suit or otherwise repudiating the contract in question, since it is well established under New York law that a party asserting duress must do so promptly .' " *VKK Corp. v. National Football League,* 244 F.3d 114, 123 (2d Cir.2001) (quoting *Int'l Halliwell Mines, Ltd. v. Cont'l Copper and Steel Indus., Inc.,* 544 F.2d 105, 108 (2d Cir.1976)).

Here, no claim of duress was made until the amended complaint was filed in August 2010, a total of ten months after the alleged accord. In *Universal Reinsurance,* the court found that pleading duress nine months after the agreement was not prompt enough to render the agreement void. *Universal,* 1999 WL 771357, at *10; *see also DiRose v. PK Mgmt. Corp.,* 691 F.2d 628, 634 (2d Cir.1982) (collecting cases in which delays ranging from six months to two years constituted forfeiture of duress claim). Moreover, the Galperns acknowledge that after the alleged accord, they requested that defendants' perform additional work for them, work for which the defendants were not remunerated. In a December 7, 2009 letter from Lloyd De Vos, submitted by the Galperns, De Vos states that he received a telephone call from the Galperns on November 20, 2009, and that they "promised that we would receive the $53,000 for past services referred to in our letter of November 14, 2009 by wire transfer no later than Tuesday, November 24, 2009." As plaintiffs agreed to pay in November, not just the accord's amount but also the $3,000 for the services rendered in the month following the accord, plaintiffs delay in pleading duress may not be reasonable.

***8** Because the parties have not briefed this issue, supplementary briefing is necessary as to whether the Galperns have acted promptly enough to repudiate the accord they claim was procured under duress.

2. Second Cause of Action

Plaintiffs' second cause of action alleges that defendants breached their fiduciary duty by using plaintiffs' confidential foreign bank account information to seize plaintiffs' assets. Plaintiffs further allege that defendants breached their fiduciary duty by bringing a collection action outside of New York. Defendants argue that summary judgment is proper because an attorney may use confidential information obtained during the representation in order to collect a fee and that jurisdiction for the collection action was not limited to New York.

To plead a breach of fiduciary duty, a plaintiff must allege that there was a breach of a duty owed to the plaintiffs and that the plaintiffs incurred an injury as a result of the breach. *Ulico Cas. Co. v. Wilson, Elser, Moskowitz, Edelman & Dicker,* 56 A.D.3d 1, 865 N.Y.S.2d 14 (App. Div., 1 st Dep't.2008) (citing *Prudential Ins. Co. of Am. v. Dewey, Ballantine, Bushby, Palmer & Wood,* 60 N.Y.2d 377, 590 (1992)). New York courts recognize the fiduciary nature of the relationship between an attorney and his or her client. *Ulico,* 865 N.Y.S.2d at 21 ("It is well-settled that the relationship of client and counsel is one of unique fiduciary reliance and that the relationship imposes on the attorney the duty to deal fairly, honestly and with undivided loyalty ... including maintaining confidentiality, avoiding conflicts of interest, operating competently, safeguarding client property and honoring the clients' interests over the lawyer's." (citations omitted)).

One fiduciary duty an attorney owes to his or her client centers upon maintaining the confidentiality of the information obtained during a representation. Under New York Rule of Professional Conduct 1.6, "a lawyer shall not knowingly reveal confidential information, as defined in this Rule, or use such information to the disadvantage of a client or for the advantage of the lawyer or a third person." N.Y. Comp.Codes R. & Regs. tit. 22, § 1200 (2011). However, under Rule 1.6(b)(5)(ii), a lawyer may use the confidential information "to collect a fee." [2] *Id.; see also* Model Rules of Prof'l Conduct R. 1.6 (2006 ed.).

Courts have held that the duty of confidentiality may be waived in a collection action to the extent that it is "necessary to establish or collect [such fees]," and consequently such action does not constitute a breach of fiduciary duty. *See Eckhaus v. Alfa–Laval, Inc.,* 764 F.Supp. 34, 37 (S.D.N.Y.1991) ("confidences or secrets necessary to establish or collect the lawyer's fee" may be revealed); *see also Treasure Lake Assoc. v. Oppenheim,* 165

F.3d 15, 1998 WL 7774477, at *2 (2d Cir.1998) ("The defendant [ ] [attorneys] did not have a fiduciary duty to refrain from suing [plaintiff] to recover legal fees after their representation of [plaintiff] had ended.").

***9** With respect to plaintiffs' allegations regarding the limit on jurisdiction, plaintiffs argue:

> the written Retainer Agreement never indicated that the Plaintiffs would use information obtained during the attorney/client relationship with the Plaintiffs in breach of their fiduciary duty to institute an action in a foreign jurisdiction with respect to a New York Plaintiff retaining a New York attorney to perform services wholly within the State of New York.

(Pl. Mem 11.) Plaintiffs assert that these actions constitute "a classic example of an attorney using his superior knowledge of the law to the disadvantage of his client." Plaintiffs rely on the following provision from the Retainer Agreement:

> By asking us to perform legal services, you understand that we retain both a charging and a retaining lien under New York law on all matters and files in respect of which we have acted on your behalf for any sums due and owing to us. This lien shall attach to any of your money or property, including but not limited to all records or property in our possession. In the event of our termination or withdrawal, all unpaid fees and disbursement shall immediately become due.

(Am. Compl., Ex. A, at 3.) The plain meaning of that clause, however, in no way limits the jurisdiction in which defendants were permitted to pursue a collection action.

Although an attorney "must shoulder the burden of demonstrating that a fee contract is fair, reasonable, and fully known and understood by the client," *Ween v. Dow,* 35 A.D.3d 58, 822 N.Y.S.2d 257, 261 (App.Div., 1st Dep't.2006) (citing *Jacobson v. Sassower,* 66 N.Y.2d 991, 993, 499 N.Y.S.2d 381, 489 N.E.2d 1283 (1985)), the Court is aware of no rule of law, and the parties have cited none, suggesting that an attorney is required to provide notice to a client as to every forum where the attorney might pursue a collection action. *See Carey v. Mui–Hin Lau,* 140 F.Supp.2d 291, 296 (S.D.N.Y.2001) ("An attorney has the burden of proving that the arrangement for compensation was fair and reasonable and fully comprehended by the client. However, under New York law, a private retainer agreement is viewed as presumptively fair in the absence of fraud, deceit, overreaching, or undue influence.") (citing *Cohen v. Ryan,* 34 A.D.2d 789, 311 N.Y.S.2d 644, 645 (App.Div., 2d Dep't, 1970)); *see also Uy v. Bronx Mun. Hosp. Ctr.,* 182 F.2d 152 (2d Cir.1999) (internal quotations omitted); *Baye v. Grindlinger,* 78 A.D.2d 690, 432 N.Y.S.2d 624, 625 (App. Div., 2d Dep't 1980).

If plaintiffs deposited substantial assets in foreign bank accounts, it is not surprising that a creditor would seek to collect on a debt in that forum. Additionally, the mere assertion that certain liens exist under New York law in the Retainer Agreement cannot be transformed into a blanket choice of forum clause in the event of a fee dispute. Even if the quoted language is read to be a choice of law clause selecting New York law, such a clause would not prevent the defendants from filing a collection action in another jurisdiction. Accordingly, summary judgment is granted on the second cause of action.

3. Third Cause of Action

***10** In the third cause of action, plaintiffs allege that defendants over-billed for legal fees incurred during the time that the defendants represented the plaintiffs in 2009. "Overbilling and padding of costs can constitute a breach of contract and give rise to a cause of action in favor of a client against an attorney." *See O'Connor v. Blodnick, Abramowitz & Blodnick,* 295 A.D.2d 586, 744 N.Y.S.2d 205, 206 (App. Div., 2d Dep't 2002) (citing *Graphic Offset Co. v. Torre,* 78 A.D.2d 788, 433 N.Y.S.2d 13, 14 (App. Div., 1 st Dep't 1980)). Overbilling may also create a cause of action for breach of fiduciary duty. *See U.S. Ice Cream Corp. v. Bizar,* 240 A.D.2d 654, 659 N.Y.S.2d 492, 493–94 (App. Div., 2d Dep't 1997) (finding allegation that attorney charged client fees so excessive that client forced to enter into settlement with opposing party sufficient to raise cause of action for breach of fiduciary duty).

Defendants argue that to state a plausible claim for relief, plaintiffs must allege that they in fact overpaid for the services rendered. But plaintiffs do allege that they paid $56,000.00 to the defendants (Am.Compl.¶¶ 20–21) and that defendants' billing was excessive even with respect to the amount plaintiffs paid. For example, plaintiffs allege that defendants billed for consultations conducted prior to their entering into the Retainer Agreement. (Am.Compl.¶ 62). Plaintiffs attach invoices from DVC corroborating that assertion. (Singer Aff., Exs. A–J). They also allege that work was assigned to Ellenzweig at $300 per hour that the parties had agreed should be assigned to an accountant with a lower hourly rate. (Galpern Aff.; Mem. in Opp. at 12).

The manner in which the defendants assigned work and the diligence with which it was completed are disputed. The plaintiffs' amended complaint and supporting affidavits adequately allege facts that, taken in the light most favorable to them, establish that they overpaid for the services rendered. In the alternative, defendants again argue that plaintiffs' allegations of excessive billing are refuted by the accord allegedly forged on October 14, 2009. However, as stated before, the validity of the accord is contested based on the plaintiffs' claim of duress. Accordingly, the Court will not grant summary judgment on the third case of action at this time.

4. Fourth Cause of Action

The fourth cause of action alleges that defendants made fraudulent statements in pursuing their *in rem* action before the Swiss court. Defendants argue that summary judgment is proper because plaintiffs failed to plead fraud with particularity. Defendants also contend that the undisputed facts show that the alleged statements were not fraudulent.

As a preliminary matter, the Court has its doubts that plaintiffs in the Galperns' position have a free-standing tort claim for damages against a defendant merely for procuring an allegedly fraudulent default judgment against them. At most, it would seem that plaintiffs may seek to attack the validity of the foreign judgment. *See, e.g., Clarkson Co., Ltd. v. Shaheen,* 544 F.2d 624, 630–31 (2d Cir.1976). And such a claim would require not simply the “mere assertion of the party that the judgment was erroneous in law or in fact” or “a mere assertion of fraud,” but rather “[c]lear and convincing evidence of fraud.” *Id.* at 631. The parties have not addressed this issue. In any event, however, plaintiffs fail to state fraud with particularity as required by Fed.R.Civ.P. 9(b) and cannot establish the substantive elements of any cause of action for fraud, which thus entitles the defendants to judgment as a matter of law.

A. Particularity

***11** Defendants first argue that plaintiffs failed to plead fraud with particularity. “[In] all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.” Fed.R.Civ.P. 9(b). Thus, Fed.R.Civ.P. 9(b) requires that fraud claims be pleaded with a level of specificity beyond the usual “short and plain statement” standard of Fed.R.Civ.P. 8. A complaint alleging fraud must: “(a) specify the statements that the plaintiff contends were fraudulent; (b) identify the speaker; (c) state where and when the statements were made; and (d) explain why the statements were fraudulent.” *See Rombach v. Chang,* 355 F.3d 164, 170 (2d Cir.2004) (quoting *Mills v. Polar Molecular Corp.,* 12 F.3d 1170, 1175 (2d Cir.1993)).

Plaintiffs do not satisfy the second prong.[3] The Second Circuit has held that the complaint must specifically “link[ ] the alleged fraudulent statements to particular [defendants];” thus, asserting in the complaint, as plaintiffs do in this case, that “defendants” made the statements is not sufficient to satisfy Rule 9(b). *Mills,* 12 F.3d at 1175; *DiVittorio v. Equidyne Extractive Industries, Inc.,* 822 F.2d 1242, 1249 (2d Cir.1987) (allegations of fraud were insufficient where the complaint did not link any of the defendants to the alleged fraudulent statement). In *Mills,* the Second Circuit further found that even if the plaintiff alleged that the company, one of the defendants, made the statements, it would not be specific enough to meet the particularity requirement against the company or its directors, the other named defendants. 12 F.3d at 1175 (“The mere fact that the Directors were controlling persons at Polar, [the company], does not link them to the statements; the plaintiffs also had to allege that the Directors personally knew of, or participated in, the fraud.”). Thus, the amended complaint does not properly plead the identity of the speaker in the fraud cause of action.

B. Substantive Elements of Fraud

Even if the complaint is read to allege a particular speaker, defendants argue that summary judgment is proper because the alleged statement was not fraudulent. To plead fraud under New York law, “a party must establish that a material misrepresentation, known to be false, has been made with the intention of inducing its reliance on the misstatement, which caused it to reasonably rely on the misrepresentation, as a result of which it sustained damages." *Nigro v. Lee,* 63 A.D.3d 1490, 882 N.Y.S.2d 346, 348 (App.Div., 3d Dep't.2009) (citing *Cohen v. Colistra,* 233 A.D.2d 542, 649 N.Y.S.2d 540 (1996)).

Defendants argue that because plaintiffs agreed on October 14, 2009 to pay the $50,000.00 as part of the alleged accord and DVC subsequently performed services for which they billed $3,000.00, plaintiffs cannot show that a statement that defendants were owed such money was fraudulent. The Court agrees. Although the validity of the accord is now disputed, "a representation based on a good faith misinterpretation of the legal effect of an agreement does not provide a basis for a fraud claim." *Allen v. WestPoint–Pepperell, Inc.,* 945 F.2d 40, 44 (2d Cir.1991) (citing *George Backer Mgmt. Corp. v. Acme Quilting Co.,* 46 N.Y.2d 211, 220, 413 N.Y.S.2d 135, 385 N.E.2d 1062 (1978)).

***12** Plaintiffs allege in a conclusory fashion that defendants knew or should have known that their statement to the Swiss court was false; however, they acknowledge that they in fact agreed to pay the defendants that sum of money. There are no factual allegations supporting the claim that the defendants knowingly misrepresented the validity of the accord. Moreover, when a contract or agreement is made under economic duress it is voidable, not void *ab initio. Universal,* 1999 WL 771357, at *10 (citing *Indus,,* 892 F.Supp. at 550). Plaintiffs did not file this action until March 2010 and did not claim duress until August 2010. There is no evidence in the record that they disputed the validity of the accord prior to that point. Accordingly, the Court finds that defendants' alleged statement to the Swiss court cannot have constituted a knowing misrepresentation at the time it was made. It therefore could not, as a matter of law, be fraud.

II. Summary Judgment as to Defendants' Counterclaim and Afirmative Defenses

Plaintiffs move for summary judgment as to defendants' counter-claim and defendants' second, third, fourth, and seventh affirmative defenses. Defendants cross-move for summary judgment with respect to the counter-claim.

1. Counterclaim

Counterclaim-plaintiffs (Lloyd De Vos and De Vos & Co.) and counterclaim-defendants (the Galperns) both move for summary judgment as to the counterclaim, which alleges that De Vos & Co. are to be reimbursed for legal fees for the present action in accordance with the Retainer Agreement. The relevant portion of the Retainer Agreement reads:

> Should we be brought into any legal action involving you or any related company either as a witness or as a party, you agree to reimburse us for our fees and disbursements for the time and expenses we are required to expend or deem necessary to expend in connection with that matter as if these services were provided to you.

Counterclaim-plaintiffs argue that summary judgment is proper because of the clear import of this provision and because the provision was not modified by the October 14, 2009 accord. Counterclaim-defendants submit that summary judgment in their favor is proper because the provision is invalid under New York law.

In *Ween v. Dow,* 822 N.Y.S.2d 261 (App. Div., 1st Dep't 2006), the court held that a reimbursement provision in a retainer agreement between an attorney and his client in which the attorney would be reimbursed for fees incurred in a collection action brought against the client was invalid. *Id.* at 261–262. The court began by explaining that "with regard to attorney fee arrangements, the courts, as a matter of public policy, give particular scrutiny to the reasonableness of the fee arrangements between attorneys and clients pursuant to their interest in, and statutory power to, regulate the practice of law." *Id.* at 261. In upholding this policy, the court examined the provision at issue and determined that it was unlawful for two reasons. *Id.* at 261–262. First, it lacked mutuality because the clients were not afforded the same right to reimbursement as the attorneys if they brought an action against the attorney.[4] *Id.* Second, "[a]side from its lack of mutuality, the clause, even if not so designed, has the distinct potential for silencing a client's complaint about fees for fear of retaliation for the nonpayment of even unreasonable fees." *Id.* Upholding *Ween* as controlling in federal court, the Southern District of New York stated, "*Ween* [i]s a per se bar on nonreciprocal fee provisions." *In re Ernst,* 382 B.R. 194, 198 (S.D.N.Y.2008).

***13** Counterclaim-plaintiffs argue that *Ween*' s holding is limited to reimbursement agreements in which the attorney grants himself the right to reimbursement in actions that the attorney brings himself, whereas the provision at issue here affords the attorney reimbursement only in those actions brought by the client or third parties in which the attorney becomes involved. However, the provision nevertheless lacks mutuality by granting only the attorney the right to be reimbursed and by not affording the client the same right should the client be brought into a subsequent action and prevail. Second, although it is true that "fear of retaliation for the nonpayment of even unreasonable fees" is not implicated by this particular provision, other deterrent effects are.[5] Indeed, for all it appears, the provision at issue in this case requires that a client pay a legal fee *even if the client wins.* The provision thus deters even perfectly meritorious actions by offsetting the potential recovery by the costs of litigation.

Accordingly, the reimbursement provision of the Retainer Agreement is invalid as applied in this action.[6] The Court grants summary judgment for counterclaim-defendants as to the counterclaim.

2. Second Affirmative Defense

Plaintiffs also move for summary judgment as to several of defendants' affirmative defenses. The second affirmative defense alleges that plaintiffs have failed to state a claim against DVC. Since the first and third causes of action state a claim for which relief may be granted, summary judgment is entered as to the second affirmative defense with respect to those causes of action.

3. Third Affirmative Defense

The third affirmative defense alleges that the plaintiffs failed to state a claim against De Vos as an individual. De Vos moved for summary judgment on this defense and the Galperns moved for summary judgment against it. De Vos is not a party to the retainer agreement. Plaintiffs argue that under N.Y. LLC Law § 1205, since De Vos is a principal attorney, manager, shareholder and partner of DVC, he is "personally and fully liable and accountable for any negligent or wrongful acts or misconduct committed by him" while rendering professional services on behalf of the professional limited liability company ("PLLC").

Although the statute does hold shareholders or officers personally liable for certain acts, the provision is "simply a reflection of the common law rule that a shareholder is liable for those torts of the corporation in which he is a participant." *We're Assocs. Co. v. Cohen, Stracher & Bloom, P.C.,* 103 A.D.2d 130, 132–36, 478 N.Y.S.2d 670 (App. Div., 2d Dep't 1984). "[I]ndividual defendants are not liable for a breach of agreement made with the Corporation ....“ *Tannenbaum v. Rechenbaum & Silberstein, P.C.,* 226 A.D.2d 700, 642 N.Y.S.2d 43, 44 (App.Div.1996); *see also See San Diego Cty. Employees Retirement Ass'n v. Mauonis,* 749 F.Supp.2d 104, 128 (S.D.N.Y.2010) ("Under New York law, an individual who signs a contract on behalf of a corporation, indicates her representative capacity on the contract, and exhibits no intention to assume personal liability for the corporation's breaches is not subject to personal liability.") (quoting *Hudson Venture Partners, LP v. Patriot Aviation Group, Inc.,* 1999 WL 76803, at *6 (S.D.N.Y.1999)). The Galperns therefore may not hold Lloyd De Vos personally liable for their first claim, which is based on breach of contract. The first cause of action as asserted against Lloyd De Vos is dismissed.

***14** The Galperns' other remaining claim is for over-billing. As noted above, over-billing claims have been held to sound in both breach of contract, *O'Connor v. Blodnick, Abramowitz & Blodnick,* 295 A.D.2d 586, 744 N.Y.S.2d 205, 206 (App. Div., 2d Dep't 2002), and breach of fiduciary duty, *See U.S. Ice Cream Corp. v. Bizar,* 240 A.D.2d 654, 659 N.Y.S.2d 492, 493–94 (App. Div., 2d Dep't 1997). Under New York law, breach of fiduciary duty is a tort. *Marino v. Grupo Mundial Tenedora, S.A.,* 2011 WL 1142887, *4 (S.D.N.Y.2011). The parties have not briefed whether § 1205 applies to over-billing claims sounding in breach of fiduciary duty. Accordingly, the Court does not think it appropriate to dismiss the third cause of action against Lloyd De Vos at this time.

4. Fourth Affirmative Defense

Defendants' fourth affirmative defense argues that the plaintiffs failed to plead fraud with particularity. Pursuant to the analysis *supra* Section I.4 regarding the fourth cause of action, summary judgment for plaintiffs is denied.

5. Seventh Affirmative Defense

Defendants' seventh affirmative defense asserts that plaintiffs' claims are barred by the doctrines of res judicata and collateral estoppel due to the judgment rendered in Switzerland. Res judicata, or claim preclusion, bars relitigation of a claim "where the earlier decision was a final judgment on the merits rendered by a court of competent jurisdiction, in a case involving the same parties or their privies, where the same cause of action is asserted in the later litigation." *Amalgamated Sugar Co. v. NL Industries, Inc.,* 825 F.2d 634, 639 (2d Cir.1987) (citing *In re Teltronics Services, Inc.,* 762 F.2d 185, 190 (2d Cir.1985)). Collateral estoppel bars litigants from relitigating any fact or issue that has been litigated and necessarily decided in a prior proceeding that produced a final judgment on the merits. *See Bank of New York v. First Millenium, Inc.,* 607 F.3d 905, 918 (2d Cir.2010); *Kaufman v. Eli Lilly & Co.,* 65 N.Y.2d 449, 455, 492 N.Y.S.2d 584, 482 N.E.2d 63 (1985). The party seeking the benefit of collateral estoppel with respect to an issue must demonstrate that the issue decided in the prior proceeding is identical to the issue in the subsequent action, but the party resisting the application of collateral estoppel "has the burden of establishing the absence of a full and fair opportunity to litigate the issue." *Evans v. Ottimo,* 469 F.3d 278, 281–82 (2d Cir.2006) (internal quotation marks omitted).

The plaintiffs' motion is denied because this issue has not been sufficiently briefed for the Court to make a reasoned judgment. Here, the plaintiffs assert only that the Swiss court lacked jurisdiction based on the purported forum selection clause in the Retainer Agreement. As this Court decided above, however, the Retainer Agreement does not limit the forums in which either party may bring an action against the other. Whether the Swiss *in rem* default judgment has preclusive effect in this action is a complex legal question. Because the briefing on this issue is so scant, and because the Court has so few of the facts underlying the Swiss proceeding before it, the Court will not grant summary judgment as to seventh affirmative defense at this time.

III. Jury Demand

***15** Defendants move to strike plaintiffs' jury demand of the amended complaint as untimely under Fed.R.Civ.P. 38(b). Plaintiffs submit that their amended complaint presented two new causes of action, changed the issues, and therefore revived their right to demand a jury.

Under Rule 38(b), a party may demand a jury "no later than 14 days after the last pleading directed to the issue is served." *Id.* "[F]ailure to demand a jury trial within the period designated by Rule 38(b) constitutes a waiver of that right as to all issues raised in the complaint." *Lanza v. Drexel & Co.,* 479 F.2d 1277, 1310 (2d Cir.1973) (en banc). In some instances, however, an amended pleading may revive the right to demand a jury. "Where ... an amended pleading covers the same 'general area of dispute' as was covered in the original pleading, the filing of an amended complaint does not revive the right to demand a jury." *Sea Carriers Corp. v. Empire Programs, Inc.,* 2007 WL 221521, at *1 (S.D.N.Y.2007) (citing *Tuff–N–Rumble Mgmt., Inc. v. Sugarhill Music Publ'g, Inc.,* 75 F.Supp.2d 242, 245 (S.D.N.Y.1999)).

By contrast, an amended complaint may revive the right to a jury trial if it presents new "factual issues ... [not] fully discussed in the original pleadings," or "new legal theories [not] based on facts previously pleaded." *Swan Brewery Co. Ltd. v. U.S. Trust Co. of N.Y.,* 143 F.R.D. 40, 44 (S.D.N.Y.1992) (citing *Lanza,* 479 F.2d at 1310; *Rosen v. Dick,* 639 F.2d 82, 94–96 (2d Cir.1980); *Royal Am. Mgrs., Inc. v. IRC Holding Corp.,* 885 F.2d 1011, 1018 (2d Cir.1989). Here, each of the new causes of action arises out of the same facts and circumstances, and to the extent new legal theories are asserted, they arises out of those same facts. Accordingly, the jury demand is struck.

CONCLUSION

For the reasons stated, the Court denies summary judgment for De Vos & Co. with respect to the first and third causes of action; grants summary judgment in favor of De Vos & Co. and Lloyd De Vos with respect to the second and fourth causes of action; grants summary judgment in favor of Lloyd De Vos individually with respect to the first cause of action; denies summary judgment for Lloyd De Vos with respect to the third cause of action; grants summary judgment in favor of the Galperns with respect to the counter-claim; grants summary judgment on the second affirmative defense as it applies to the first and third causes of action; and strikes the Galperns' jury demand.

SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2011 WL 4597491

Footnotes

[1] Lloyd De Vos also asserts that all claims against him as an individual must be dismissed. The Court agrees. This issue is discussed *infra* Section II.3.

[2] Plaintiffs assert that a portion of Rule 1.6 was repealed. That portion has no relevance to this case.

[3] Defendants also argue that plaintiffs do not satisfy the requirements of the first and third prongs. The Court disagrees. Under Rule 9(b), "the 'mere gist' of the nature of the fraudulent statements is insufficient;" the complaint should allege "the precise nature of the statements." *Brown v. Royal Caribbean Cruises, Ltd.,* 2000 WL 34449703, at *4–5 (S.D.N.Y.2000). However, quoting the exact words of the alleged statements is unnecessary. *Giuliano v. Everything Yogurt, Inc.,* 819 F.Supp. 240, 244 (E.D.N.Y.1993). Here, the amended complaint alleges the specific amount of money the defendants stated was owed to them by the plaintiffs to the Swiss court and the specific amount of money that was seized from their bank account as a result of the default judgment.

Plaintiffs also satisfy the third prong by adequately pleading when the statements were made. In *Shaw v. Shaw,* the Southern District found that a complaint alleging that statements were made "[i]n or around 1993," however "vague," was sufficient to satisfy the "when" requirement dictated by the Second Circuit. 356 F.Supp.2d 383, 386 (S.D.N.Y.2005). Here, the plaintiffs allege that the statements were made "on or about December 30, 2009 ."

[4] The Court does not consider the validity of the clause in a situation where the attorney is sued by a third-party.

[5] Of course, that fear is implicated by the following provision in the retainer agreement, which is nearly identical to that rejected in *Ween.*

[6] The Court is not entirely convinced that, despite its capacious language, this provision was meant to apply at all to fee disputes between clients and attorneys. Accordingly, the Court reiterates that its holding is limited to De Vos's attempt to invoke the provision in this particular action.

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505 F.2d 1
United States Court of Appeals, Seventh Circuit.

FATTORE COMPANY, INC., Plaintiff-Appellee,
v.
METROPOLITAN SEWERAGE COMMISSION OF the COUNTY OF MILWAUKEE, Defendant-Appellant.

Nos. 73-1660 and 73-1661.
|
Argued May 24, 1974.
|
Decided Oct. 25, 1974.

Synopsis

Contractor brought action to recover damages under a changed condition and equitable adjustment provision of contract to construct sewer tunnel for municipal government. After remand, 454 F.2d 537, the United States District Court for the Eastern District of Wisconsin, Myron L. Gordon, J., found that contractor was entitled to an equitable adjustment of $1,500,000 and was entitled to prejudgment interest, and both contractor and defendant sewerage commission appealed. The Court of Appeals, Laramore, Senior Judge, held that contractor was not required, in order to recover, to list with mathematical precision the amount of every item of damage flowing from the wrong, that evidence supported finding that contractor was entitled to an equitable adjustment of $1,500,000, that resolving of damage issue on basis of jury verdict with regard to monetary loss suffered by contractor as direct result of commission's wrong was proper, that profit was payable on specific cost items involved and that prejudgment interest could be awarded as of contract's final payment date.

Affirmed.

Attorneys and Law Firms

***2** Ewald L. Moerke, Jr., Stewart G. Honeck, Milwaukee, Wis., for Metropolitan Sewerage Comm.

Elwin J. Zarwell, Richard W. Cutler, peter W. Bunde and Ronald L. Wallenfang, Milwaukee, Wis., for Fattore Co.

Before PELL and STEVENS, Circuit Judges, and LARAMORE, Senior Judge.[*]

Opinion

LARAMORE, Senior Judge.

This case is before the court on appeal by each party; both the plaintiff and defendant requesting review of the District Court's findings regarding damages due and the defendant also requesting review of a finding favoring the payment of prejudgment interest.[1]

***3** The main issues in this case are the amount of damages under a changed condition and equitable adjustment provision of a municipal government construction contract and prejudgment interest on such a claim. The District Court, after carefully considering the evidence in its totality, found plaintiff entitled to a 'jury verdict' equitable adjustment of $1,500,000. The finding was based on this court's reasoning in the first appeal that a broad exculpatory clause should not operate to render another clause meaningless, freeing defendant from its liability.[2] The judgment included superintendence, overhead expense, home office expense, profit and any and all other items aside from interest. Prejudgment interest was awarded at the rate of five per cent per annum from and after June 18, 1964,[3] the date all plaintiff's accounting data necessary to compute the equitable adjustment under the changed conditions clause was complete and the retained percentage was paid.

[1] Plaintiff presented its damages,[4] in a very detailed accounting, as the difference between the actual costs[5] incurred, adjusted downward for events unrelated[6] to the changed condition, and its bid.[7] Plaintiff argues its method for computing damages is the most reliable and is clearly supported by the evidence; therefore, the 'jury' type verdict awarded is inappropriate, surpassed by plaintiff's proof. In effect, plaintiff contends that it used reasonable costs, not total costs, because it only used items affected by the changed conditions. Accordingly, the increase in cost was directly related to the increase in time required to complete the contract due to the changed condition.[8] Plaintiff also contends that it is correct and has always been appropriate for an equitable adjustment to include a profit[9] because it would be 'inequitable' for one to do two extra years work under the circumstances involved in this case, with a substantial increase in investment, for no additional return.

Defendant contends plaintiff, in effect, used the normally unacceptable total cost method of computing damages and that the total cost method is not acceptable because here there is an alternative in reasonable costs which the plaintiff failed to prove. Further, there is no right to recover the costs unreasonably incurred, when the changed geological conditions were discovered, by abandoning the shield technique for hand mining.[10] Accordingly, failure to ***4** use the proper proof of damages, reasonable costs, requires dismissal of the case. It is further alleged that even if the equitable adjustment were applicable, it would be error to include profit because such an adjustment should only permit the contractor to break even on extra costs due to changed conditions. The defendant also asserts award of prejudgment interest is contrary to law because there is a genuine dispute regarding the amount due; it cannot be determined with the reasonable certainty necessary to bring it within the definition of liquidable or liquidated damages entitling it to an award of prejudgment interest.

The defendant's argument aimed at barring correction of a wrong for failure of proof, is untenable based on the principle that a judicially recognized wrong is not a bar to recovery of damages that would be difficult to establish with precision. Given the plaintiff's adequate proof, including the correlation between the increase in time and expense due to the changed condition, it would be unjust to only permit recovery for a recognized wrong by holding plaintiff to a near impossible standard of requiring him to list with mathematical precision the amount of every item of damage flowing from that wrong. See also, Dale Construction Co. v. United States, 161 Ct.Cl. 825 (1963); Luria Bros. & Co. v. United States, 369 F.2d 701, 712-713, 177 Ct.Cl. 676, 695-696 (1966); Adams v. United States, 358 F.2d 986, 993, 175 Ct.Cl. 288, 299 (1966); Specialty Assembling & Packing Co. v. United States, 355 F.2d 554, 572-573, 174 Ct.Cl. 153, 184 (1966).
[2] It is well settled that the one liable for established and proven harm shall not escape monetary responsibility because the one harmed failed to prove his damages with mathematical precision. This view is in consonance with the Supreme Court case, Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, at 562-563, 51 S.Ct. 248 at 250, 75 L.Ed. 544 (1931), which stated:

* * * The rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount. * * * it will be enough if the evidence shows the extent of the damages as a matter of just and reasonable inference, although the result be only approximate.

[3] In addition, recognition of defendant's argument concerning damages would have the effect of negating both the first decision in this case, Fattore Co. v. Metropolitan Sewerage Commission of Milwaukee, supra, which found plaintiff was entitled to relief, and the policy considerations upon which the changed conditions and equitable adjustment provisions are based. The purposes for institution and utilization of these two provisions includes eliminating the contractor's need for placing large contingencies and unknown costs into his pricing for the great risk he may be taking by encountering adverse subsurface conditions, Kaiser Industries Corporation v. United States, 340 F.2d 322, 169 Ct.Cl. 310 (1965), and providing administrative remedies involving negotiation for what otherwise would amount to a breach of contract requiring litigation for resolution.[11] The bidder will neither enjoy windfalls nor suffer ***5** disaster. The municipal government benefits or pays according to the occurrence of adverse conditions. Foster Construction C.A. & Williams Bros. Co. v. United States, 435 F.2d 873, 887, 193 Ct.Cl. 587, 614 (1970). The contract solicitation procedure followed by defendant in this case is the common one for reducing costs by making the borings and providing the information to the bidders. In such a situation '* * * it is settled that the (municipal) government is deemed to warrant the adequacy of its plans and specifications to the extent that compliance therewith will result in satisfactory performance.' Jefferson Construction Company v. United States, 392 F.2d 1006, 1011, 183 Ct.Cl. 720, 727 (1968).

Foster Construction C.A. & Williams Bros. Co., supra, 435 F.2d at 875, held:

* * * all that is required is that there be enough of an indication on the face of the contract documents for a bidder reasonably not to expect 'subsurface or latent physical conditions at the site differing materially from those indicated in this contract.'[12]

[4] **[5]** Equally settled is the '* * * axiom that the parties may, by virtue of their contract, convert into a dispute arising under the contract a claim which is the result of deficient plans or specifications and, in the absence of an agreement, would be a sufficient predicate for an action based on a breach of the (municipal) government's implied warranty. Additional compensation which may be awarded for the damages incurred as a result of the deficient plans is limited by that conversion to the specific equitable adjustment provided for in the contract.' (Jefferson Construction Co. v. United States, supra, 392 F.2d at 1011.) Accordingly, the parties here are bound by their contract and are, therefore, protected and limited to the amount of damages permitted through the operation of the equitable adjustment in that contract.

[6] Given the inherently imprecise nature of an equitable adjustment, the existence of sufficient evidence for a court to come to a fair and reasonable conclusion, and the quantum issue presented in this case, the District Court's 'jury verdict' must stand.

'Jury verdicts' have always been supported if there was clear proof that the contractor was injured and there was no more reliable method for computing damages provided that the evidence adduced was sufficient to enable a court or jury to make a fair and reasonable approximation. Specialty Assembling & Packing Co. v. United States, supra; see, River Construction Corp. v. United States, 159 Ct.Cl. 254, 271 (1962); Western Contracting Corp. v. United States, 144 Ct.Cl. 318, 320, 333-336 (1958); Brand Investment Co. v. United States, 58 F.Supp. 749, 751, 102 Ct.Cl. 40, 45 (1944), cert. denied, 324 U.S. 850, 65 S.Ct. 853, 89 L.Ed. 1410 (1945).

The record in this case is replete with evidence upon which a jury or court could fairly and reasonably determine the approximate amount of damages.

[7] Plaintiff, by selecting and compiling all the costs of certain items that directly related to the changed condition, has rhetorically labeled its cost presentation as reasonable because this selective process does not include 'all' of the costs. However, the 'total cost' concept, even when applied to selective items and rhetorically labeled 'reasonable' based on selectivity of items, cannot be accepted. See, F. H. McGraw & Co. v. United States, 130 F.Supp. 394, 131 Ct.Cl. 501 (1955) and ***6** Oliver-Finnie Co. v. United States, 279 F.2d 498, 150 Ct.Cl. 189 (1960) for complete rejection of the total cost concept.

Total costs cannot be generally accepted as the end for determining an equitable adjustment in a fixed-price contract because it would undermine the prospective costing approach thus negating the contract's basic incentive character. [13]

F. H. McGraw & Co. v. United States, supra, 130 F.Supp. at 400, held:

This method of proving damage is by no means satisfactory, because, among other things, it assumes plaintiff's costs were reasonable and that plaintiff was not responsible for any increase in cost, and because it assumes plaintiff's bid was accurately computed, which is not always the case by any means.

[8] A pure total cost method, even when applied to selective items, would allow for correction of bidding errors and reward possible inefficiency. [14] However, the defendant failed to offer an alternative for measuring damages in this case. [15] In this absence of a more reliable method for computing damages, justice, in this case, could only be done by resorting to the jury type verdict. [16] Western Construction Corp. v. United States, supra; Dale Construction Co. v. United States, 168 Ct.Cl. 692, 729 (1964); Houston Ready-Cut House Co. v. United States, 96 F.Supp. 629, 119 Ct.Cl. 120 (1951); Riess & Weinsier, Inc. v. United States, 116 F.Supp. 562, 126 Ct.Cl. 713 (1953).

The District Court addressed itself to the heart of the matter, the monetary loss suffered by the contractor as the direct result of the Commission's wrong, and in so doing avoided the danger of accepting the total costs as the true loss following from the wrong. Although it did not fully articulate its computations, the District Court's effort represents what we find to be its best judgment on the record before it, and this is all that the parties have a right to expect. Specialty Assembling & Packing Co. v. United States, supra.

[9] The short answer on the issue of including profit in the equitable adjustment is that profit is allowed on contract adjustments involving changed conditions and equitable adjustments. When the dispute arises under an equitable adjustment clause and is confined to that clause, profit is payable on the specific cost items involved. United States v. Callahan Walker Construction Co., 317 U.S. 56, 61, 63

S.Ct. 113, 87 L.Ed. 49 (1942); Bruce Construction Corp. v. United States, 324 F.2d 516, 163 Ct.Cl. 97 (1963).

Also, in General Builders Supply Co. v. United States, 409 F.2d 246, 249, 187 Ct.Cl. 477, 485 (1969), it was held that an equitable adjustment can cover an allowance for a profit on work actually done but does not encompass unearned or anticipated profits.

[10] The award of prejudgment interest in this case is just and proper. The major principles and guidelines for making such an award in Wisconsin were well stated in Laycock v. Parker, 103 Wis. 161, 79 N.W. 327, 335 (1899):

* * * The true principle, which is based on the sense of justice in the ***7** business community and on our statute, is that he who retains money which he ought to pay to another should be charged interest upon it. The difficulty is that it cannot well be said one ought to pay money, unless he can ascertain how much he ought to pay with reasonable exactness. Mere difference of opinion as to amount is, however, no more a reason to excuse him from interest than difference of opinion, whether he legally ought to pay at all, which has never been held an excuse. * * * So, if there be a reasonably certain standard of measurement by the correct application of which one can ascertain the amount he owes, he should equally be held responsible for making such application correctly and liable for interest if he does not.

The ability to ascertain the amount payable with reasonable certainty is of primary importance if there is to be a recognized liquidable sum upon which prejudgment interest can be computed. Well kept cost figures existed in this case for all contract input, including those relating to the changed conditions, as of June 18, 1964. Defendant was free to inspect these records and the District Court found them generally acceptable. It also found that plaintiff did not pad the job with unreasonable costs and that the costs incurred correlated in a general way with the changed conditions.[17] Under these circumstances, one can conclude that at a minimum, the defendant, had it chosen to inquire, could have determined at least the upper limit of its liability with reasonable certainty.[18] If defendant had acted upon the possibilities presented herein, a fixed and determinate amount could have been tendered[19] and interest stopped. The amount of the claim was known or readily determinable. Valiga v. National Foods Co., 58 Wis.2d 232, 254, 206 N.W.2d 377, 389 (1973).

Defendant argues a 'genuine dispute' regarding the amount due eliminates reasonable certainty, thus thwarting payment of prejudgment interest. Congress Bar & Restaurant, Inc. v. Transamerica Insurance Co., 42 Wis.2d 56, 165 N.W.2d 409. By accepting this argument, we are faced with the danger of encouraging defendant to understate liability on clearly due and payable claims in order to create bargaining leverage as to such claims.[20] Dahl v. Housing Authority of City of Madison, 54 Wis.2d 22, 194 N.W.2d 618. If the requirement is a mere fact of disagreement concerning the amount due, this sham type operation of putting the amount into dispute would eliminate a right to interest on items clearly established, obviously due and clearly payable without resorting to litigation. Dahl v. Housing Authority of City of Madison, supra; Laycock v. Parker, supra.

As the exculpatory clauses have not and should not be interpreted to restrict the application of the changed conditions clause, Fattore Co. v. Metropolitan Sewerage Commission of Milwaukee, supra, so the raising of a dispute where no 'genuine' dispute exists should not deny one the interest due him. We find the District Court was correct in determining the sum liquidable or liquidated and subject to prejudgment interest. A liquidable claim should draw interest from the date payment was due, and at the time all the accounting data was ***8** available to make the determination. In this case the final payment date was June 18, 1964,[21] not the date first demand was made.

Accordingly, the judgment of the District Court is

Affirmed.

All Citations

505 F.2d 1

Footnotes

* Senior Judge Don N. Laramore of the United States Court of Claims is sitting by designation.

[1] This case is the second part of a bifurcated trial that originated, based on diversity of citizenship, in United States District Court for the Eastern District of Wisconsin. The issues developed from a dispute regarding a 'changed' condition and liability under the 'changed' conditions and equitable adjustment provisions of a government contract involving the construction of a sewer tunnel for the defendant. On the merits, the District Court, theorizing that a broad exculpatory clause dominated, found the defendant free from liability under the changed conditions clause. On the subsequent appeal the issues were divided into the questions of liability and amount. This court reversed and remanded to the District Court for a determination of the amount of the equitable adjustment. See, Fattore Co. v. Metropolitan Sewerage Commission of Milwaukee, 454 F.2d 537 (7 Cir. 1971).

The facts considered relevant to the issues are stated in the opinion. For a more detailed discussion of the facts germane to liability and remand on damages see Fattore Co., id.

[2] 'Moreover, in the presence of a Changed Conditions' clause such as Paragraph 20, broad exculpatory clauses do not preclude the contractor-bidder from relying upon the existence of subsurface conditions of the nature indicated by the contract specification.' Id., at 542. See also, Woodcrest Construction Co. v. United States, 408 F.2d 406, 410, 187 Ct.Cl. 249 (1969) and cases cited therein.

[3] At the first trial defendant argued as an affirmative defense that final payment, precluding plaintiff's claim for equitable adjustment, occurred on June 18, 1964. Plaintiff, while accepting the retained percentage unequivocally reserved the right to pursue its equitable adjustment due to the 'changed condition.' The District Court found for the defendant and this court reversed, based on a determination of objective factors considered in the light of attending circumstances, that such was not the parties' intentions. Fattore Co. v. Metropolitan Sewerage Commission of Milwaukee, supra.

[4] $2,015,491.52.

[5] $4,972,170.00.

[6] As an example, a manhole collapse occurred; it delayed mining work approximately eight days.

[7] $2,946,822.00.

[8] The mining portion of the job was actually completed in 121 weeks, rather than the approximated 40 weeks anticipated mining time on which the bid was based. There was a direct correlation between the increase in expenses and the increase in time to finish the job.

[9] Bennett v. United States, 371 F.2d 859, 178 Ct.Cl. 61 (1967); General Builders Supply Co. v. United States, 409 F.2d 246, 187 Ct.Cl. 477 (1969).

[10] This contention was clearly rejected in this court's first opinion regarding liability: 'However, the actual underground conditions encountered in the performance of the work differed materially from those indicated by the defendant's test borings. Solid rock and mixed face were encountered at the sewer grade throughout the first 496 feet of the tunnel. Therefore, the shield method of tunneling and constructing the concrete sewer had to be abandoned, and once abandoned, it is impossible to again begin using the shield when conditions permit. The plaintiff was unable to use the shield and as a result the tunneling costs were substantially increased.' Fattore Co. v. Metropolitan Sewerage Commission of Milwaukee, supra, 454 F.2d at 539-540.

[11] The facts in both this case and Fattore Co. v. Metropolitan Sewerage Commission of Milwaukee, supra, make it clear defendant refused to resort to these government contract devices to alleviate the potential harm; i.e., the Commission engineers refusal to act on the changed conditions and a failure to attempt negotiation of the equitable adjustment.

[12] Generally, in the type of construction contract situation presented in this case, the doctrine of implied warranty of specifications will render the government liable for a changed condition. See, United Contractors v. United States, 368 F.2d 585, 598, 177 Ct.Cl. 151, 165-166 (1966); Peter Kiewit Sons' Co. v. United States, 74 F.Supp. 165, 167-168, 109 Ct.Cl. 517, 520-523 (1947); H. L. Yoh Co. v. United States, 288 F.2d 493, 153 Ct.Cl. 104 (1961).

[13] See, Spector, An Analysis of the Standard 'Changes' Clause, 25 F.Bar Jrnl. 177 (1965).

[14] Id., note 13.

[15] Note 11, supra; note 19, infra.

[16] The District Court began with the plaintiff's total cost and moved to a more reasonable figure by reducing it for what it considered, based on the evidence, to be questionable or dubious amounts, as in the case of the equipment costs which were found to be excessive by a large amount.

This use of 'total costs' does not appear unreasonable. It recognizes the fact that total costs have probative value and should be offered as evidence on the issue of reasonable costs. See, Spector, An Analysis of the Standard 'Changes' Clause, 25 F.Bar Jrnl. 177 (1965), supra, at note 13. On the other hand, it does not go to the other extreme of accepting the incurred cost approach for determining an equitable adjustment. See, McBride, Confusion in the Concept of Equitable Adjustments in Government Contracts, 22 F.Bar Jrnl. 235 (1962).

[17] See note 8, supra.

[18] Reasonably certain standards of measurement of less precision than the records existing in this case have been upheld for determining that a liquidable sum existed. See, Necedah Mfg. Corp. v. Juneau County, 206 Wis. 316, 237 N.W. 277, 283, 240 N.W. 405, where determination of the liquidable sum was left to the inquiry and judgment of real estate experts.

[19] After liability was determined, defendant did very little to facilitate ascertaining quantum. It chose instead, by the arguments presented herein, to continue a strategy of avoiding liability.

[20] The opposite danger (not present in this case) also exists of encouraging plaintiff to overstate claims as a bargaining tool for pretrial negotiations. Dahl v. Housing Authority of City of Madison, supra.

[21] See note 3, supra.

End of Document

2012 WL 2919450
Only the Westlaw citation is currently available.
United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
Stephen M. KERR; Michael Quiel;
Christopher M. Rusch, Defendants.

No. CR 11–2385–PHX–JAT.
|
July 17, 2012.

Attorneys and Law Firms

Monica B. Edelstein, Timothy J. Stockwell, U.S. Dept of Justice, Washington, DC, for Plaintiff.

ORDER

JAMES A. TEILBORG, District Judge.

***1** Pending before the Court is Government's Motion for Determination of Crime Fraud Exception ("Motion"). Doc. 67. Defendant Stephen Kerr filed a Response to Government's Motion for Determination of Crime Fraud Exception ("Response"). Doc. 76. Government filed a Reply to Defendant Kerr's Response ("Reply"). Doc. 80. The Court now rules on the Motion.

I. BACKGROUND

On December 8, 2011, Stephen Kerr ("Kerr"), Michael Quiel ("Quiel"), and Christopher M. Rusch ("Rusch") (collectively, "Defendants") were indicted for conspiracy to defraud the United States pursuant to 18 U.S.C. § 371. Both Kerr and Quiel were charged separately with two counts of willful failure to file Reports of Foreign Bank and Financial Accounts ("FBARs") in violation of 31 U.S.C. § 5314 and § 5322(a), as well as two counts of willful filing of false returns for tax years 2007 and 2008 in violation of 26 U.S.C. § 7206(1). *See* Doc. 3.

On or about April 27, 2010, a Grand Jury issued subpoenas duces tecum to Rusch and his law firm, the Law office of Chris Rusch, requesting records related to several foreign entities and bank accounts used by Kerr and Quiel to further their alleged criminal conduct. Rusch and his law firm produced the requested records on or about May 3, 2010 pursuant to the subpoenas, after which counsel for both Kerr and Quiel objected on the basis of attorney-client privilege. In light of Kerr and Quiel's failure to produce a privilege log or return non-privilege materials to the Government, the Government employed a taint team to review the allegedly attorney-client privileged materials produced by Rusch and moved the court to conduct an in camera inspection of the materials.

On or about August 19, 2011, District Court Judge Martone ruled that the grand jury subpoenas requiring Rusch to produce documents were proper and that Defendants had failed to properly assert attorney-client privilege. Doc. 43–2 at 2–3. The Ninth Circuit subsequently declined to review the issue. As a result, this Court has not addressed whether the crime-fraud exception applies to *any* communications between Rusch, Kerr, and Quiel, including those made orally and in document form.

On April 27, 2012, Government filed this Motion for a ruling on whether the oral communications between Rusch, Kerr, and Quiel regarding legal advice and disclosures as they relate to the allegations contained in the indictment remain protected by the attorney-client privilege due to the application of the crime-fraud exception. Doc. 67.

II. LEGAL STANDARD

A. Waiver of Attorney–Client Privilege

Generally, "[c]onfidential disclosures by a client to an attorney made in order to obtain legal assistance are privileged." *Fisher v. United States,* 425 U.S. 391, 403, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976) (citation omitted). The purpose of attorney-client privilege "is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Upjohn Co. v. United States,* 449 U.S. 383, 389, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981). But it is well-established that "[t]he privilege which protects attorney-client communications may not be used both as a sword and a shield." *Chevron Corp. v. Pennzoil Co.,* 974 F.2d 1156, 1162–63 (9th Cir.1992) (citing *United States v. Bilzerian,* 926 F.2d 1285, 1292 (2d Cir.1991)). "Disclosing a privileged communication or raising a claim that requires disclosure of a protected communication results in waiver as to all other communications on the same subject." *Hernandez v.*

Tanninen, 604 F.3d 1095, 1100 (9th Cir.2010); *see United States v. Nobles,* 422 U.S. 225, 95 S.Ct. 2160, 45 L.Ed.2d 141 (1975); *Weil v. Inv./Indicators, Research & Mgmt.,* 647 F.2d 18, 24 (9th Cir.1981) ("[V]oluntary disclosure of the content of a privileged attorney communication constitutes waiver of the privilege as to all other such communications on the same subject."); *Chevron Corp.,* 974 F.2d at 1162 ("Where a party raises a claim which in fairness requires disclosure of the protected communication, the privilege may be implicitly waived.").

***2** Finally, a three-pronged test is used when determining whether attorney-client privilege has been waived:

> First, the court considers whether the party is asserting the privilege as the result of some affirmative act, such as filing suit. Second, the court examines whether through this affirmative act, the asserting party puts the privileged information at issue. Finally, the court evaluates whether allowing the privilege would deny the opposing party access to information vital to its defense.

United States v. Amlani, 169 F.3d 1189, 1195 (9th Cir.1999) (internal citations omitted).

B. Crime–Fraud Exception to Attorney–Client Privilege

"Because the attorney-client privilege is not to be used as a cloak for illegal or fraudulent behavior, it is well established that the privilege does not apply where legal representation was secured in furtherance of intended, or present, continuing illegality." *United States v. Hodge & Zweig,* 548 F.2d 1347, 1354 (9th Cir.1977) (citing *United States v. Friedman,* 445 F.2d 1076, 1086 (9th Cir.1971)). Thus, "[t]he government bears the burden of proving that the attorney-client privilege does not apply because of the crime-fraud exception." *United States v. Martin,* 278 F.3d 988, 1001 (9th Cir.2002) (citing *United States v. Laurins,* 857 F.2d 529, 540 (9th Cir.1988)).

For the crime-fraud exception to apply, the government must show that communications were made "in furtherance of an intended or present illegality and that there is some relationship between the communications and the illegality." *Id.* (quotations and citations omitted); *see also Hodge & Zweig,* 548 F.2d at 1354; *United States v. Bauer,* 132 F.3d 504, 509 (9th Cir.1997). Thus, there must be more than mere suspicion of illegal activity on the part of the government. *Id.* However, "the exception only applies when there is reasonable cause to believe that the attorney's services were utilized in furtherance of the ongoing unlawful scheme." *Id.* (citing *In re Grand Jury Proceedings,* 87 F.3d 377, 381 (9th Cir.1996)). Reasonable cause requires "evidence that, if believed by the jury, would establish the elements of an ongoing violation." *United States v. Chen,* 99 F.3d 1495, 1503 (9th Cir.1996). For example, "coordinated actions [between] codefendants are strong circumstantial evidence of an agreement." *United States v. Hernandez,* 876 F.2d 774, 778 (9th Cir.1989). "But proof beyond a reasonable doubt is not necessary to justify application of the crime-fraud exception." *Id.* at 1503 (citing *In re Grand Jury Proceedings,* 87 F.3d at 381). Instead, the Government must make a prima facie showing that a crime has been committed, and demonstrate a nexus between the prima facie showing and the communications sought. *In re Sealed Case,* 754 F.2d 395, 399 (D.C.Cir.1985).

Additionally, "[t]he attorney need not himself be aware of the illegality involved; it is enough that the communication furthered, or was intended by the client to further, that illegality." *Friedman,* 445 F.2d at 1086 (citing *Clark v. United States,* 289 U.S. 1, 15, 53 S.Ct. 465, 77 L.Ed. 993 (1933); *United States v. Hoffa,* 349 F.2d 20, 38 (6th Cir.1965) aff'd, 385 U.S. 293, 87 S.Ct. 408, 17 L.Ed.2d 374, (1966)).

***3** Finally, "an adversarial minitrial is not required to determine whether the government shows a prima facie foundation for application of the crime-fraud exception." *In re Grand Jury Proceedings (Doe),* 983 F.2d 1076 (9th Cir.1993) (citing with approval *In re Grand Jury Proceedings (Vargas),* 723 F.2d 1461, 1467 (10th Cir.1983) ("[T]he determination of whether the government shows a prima facie foundation ... can be made ex parte and a preliminary minitrial is not necessary.") (internal quotations omitted)). Moreover:

> [S]o long as the district court may, in its discretion, decide whether the government's prima facie showing has been made and ma take whatever steps it deems necessary to convince itself of the applicability of the crime-fraud exception, it is

> difficult to see how specification of any further requirements could reduce the chance of mistake. Requiring the district court to hear the client's rebuttal to the government's prima facie proffer would in many cases serve no purpose because the government's proof is clear.

Id. Thus, once the Court finds reasonable cause to believe that an attorney's services were employed in furtherance of a crime, "the seal of secrecy is broken." *Clark,* 289 U.S. at 15.

III. ANALYSIS

Attorney-client privilege may be waived where a party raises a claim or defense that, in fairness, requires the disclosure of protected communication. *See Chevron Corp.,* 974 F.2d at 1162. In *Chevron,* the plaintiff sought to compel disclosure of documents that supported the defendant's affirmative claim that "[i]nsofar as the decision to proceed with an investment in Chevron was based upon tax considerations, it was made in reliance upon the advice of our tax counsel." *Id.* at 1163. In response, the defendant refused to supply the documents, arguing that the communications were protected by attorney-client privilege. The Ninth Circuit disagreed, holding that the defendant could not "invoke the attorney-client privilege" to deny the plaintiff of the information it needed to demonstrate the defendant's violation of disclosure requirements. *Id.* As a result, the defendant was found to have implicitly waived the attorney-client privilege with respect to all relevant communications.

Similarly, to the extent that Kerr claims that both his and Quiel's failure to file FBARs and their filing of allegedly false tax returns were based on the advice of counsel, Kerr places at issue the reporting and tax advice they received from Rusch. As Kerr argues in his Response, "the defendants were merely following Rusch's advice and did not engage in 'willful' misconduct, as required by the relevant statute." Doc. 76 at 7. Consequently, Kerr cannot invoke the attorney-client privilege to deny the government the very communications and information it must refute in order to prove that Defendants conspired to defraud the United States, willfully failed to file FBARs, and willfully filed false tax returns for tax years 2007 and 2008.

***4** The Government also contends that Kerr further waived attorney-client privilege by disclosing "privileged communications contained in emails the government does not have in its possession." Doc. 80 at 6. For example, Kerr's Response references an email sent by Rusch to Defendants on October 12, 2006. Kerr claims that in this email "Rusch told the defendants that ... they would have limited FBAR reporting requirements" and that "Rusch assured the defendants that the scenario was 'very clean' and that any U.S. reporting would be based on the Swiss tax return." Doc. 76 at 4. Kerr also argues that in an email sent April 16, 2007, "Rusch told Quiel and his accountant how to report on his 2006 FBAR. Quiel followed these instructions." *Id.*

Due to Kerr's voluntary disclosure of these emails in support of a reliance defense, the Government argues that "[Kerr] cannot now claim that the government is only entitled to that which he is willing to disclose and nothing more." Doc. 80 at 6. The Court agrees. Under the *Amlani* test, Kerr effectively waived attorney-client privilege because: (1) he asserted the privilege as a result of some affirmative act; (2) he placed privileged information at issue; and (3) allowing the claim of privilege would deny the government access to vital information. *See Amlani,* 169 F.3d at 1195.

Finally, pursuant to Rule 47.1 of the Criminal Rules of Practice of the United States District Court for the District of Arizona, Quiel's failure to serve and file the required answering memoranda to Government's Motion may be deemed a consent to the granting of the motion and the Court may dispose of the motion summarily. D. Ariz LRCrim 47.1 (*adopting* D. Ariz. LRCiv 7.1 and 7.2; *see* D. Ariz. LRCiv 7.1(i)). Consequently, this Court deems Quiel's failure to file a responsive motion as consent to the Court granting Government's Motion.

With Defendants' attorney-client privilege implicitly waived, this Court need not address Kerr's contingent request for an evidentiary hearing or requirement that Government make a more detailed offer of proof in the event that Government's Motion is granted.

Accordingly,

IT IS ORDERED that Kerr's disclosures and his assertion of the reliance defense waives the attorney-client privilege for all communications between Rusch and Kerr on issues directly relevant to Count I of the Indictment. Accordingly, the Government's Motion for Determination of Crime–Fraud Exception as to Kerr (Doc. 67) is denied as moot; the Motion is granted as to Quiel because it has been consented to.

DATED this 16th day of July, 2012.

All Citations

Not Reported in F.Supp.2d, 2012 WL 2919450

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2016 WL 1399519
United States District Court, C.D. California.

UNITED STATES of America
v.
Shoaleh YERMIAN.

Case No. SACV 15-0820-DOC (RAOx)
|
Signed March 18, 2016

Attorneys and Law Firms

Benjamin L. Tompkins, AUSA – Office of US Attorney, Los Angeles, CA, for United States of America.

PROCEEDINGS (IN CHAMBERS): ORDER GRANTING DEFENDANT'S APPLICATION FOR DEFAULT JUDGMENT [16]

THE HONORABLE DAVID O. CARTER, JUDGE

***1** Before the Court is Plaintiff United States of America's ("Plaintiff") Application for Entry of Default Judgment ("Application") (Dkt.16). The Court finds this matter appropriate for resolution without oral argument. Fed.R.Civ.P. 78; L.R. 7–15. Having reviewed the moving papers and considered the parties' arguments, the Court hereby GRANTS the Motion.

I. Background

On May 27, 2015, Plaintiff commenced an action against Defendant Shoaleh Yermian ("Defendant" or "Yermian") to collect unpaid federal penalty assessments and interest. *See* Complaint ("Compl.") (Dkt.1).

Plaintiff states that Defendant had a Swiss Bank account from 2006 to 2008. Compl. ¶ 9. Plaintiff alleges that Defendant violated the law by failing to report this bank account by failing to file Treasury Form TD F 90–22.1, Report of Foreign Bank and Financial Accounts ("FBAR") with the Internal Revenue Service. *Id.* ¶ 7, 10. Plaintiff further alleges that Defendant failed to timely report the interest or capital gains she earned from this foreign bank account. *Id.* ¶ 11.

On June 4, 2013, the IRS assessed Defendant with three $10,000 penalties for her failure to file an FBAR for tax years 2006 through 2008. *Id.* ¶ 13. Notice and a demand for payment of the penalty was sent to Defendant on that same day. *Id.* Interest has accrued on the penalty and remains unpaid. *See id.* ¶ 14.

On November 9, 2015, the Court granted Plaintiff's Renewed Ex Parte Application for Service by Publication ("Renewed Application") (Dkt.12). The United States subsequently served Defendant via publication in accordance with California Government Code § 6064. *See* Proof of Publication (Dkt.13–1) at 1. Further, on December 3, 2015, the United States emailed Defendant the summons and complaint, and served the same documents via registered mail and first class to Defendant's last known address, Defendant's nephew, and to Daniel Yermian's Beverly Hill address. *See* Declaration of Benjamin L. Tompkins ("Tompkins Decl.") (Dkt.13) ¶¶ 5–7.

Plaintiff requested an entry of default against Defendants on February 2, 2016 (Dkt.14), which was entered by the Clerk the following day (Dkt.15). Plaintiff then filed the present Application on March 7, 2016.

II. Legal Standard

Federal Rule of Civil Procedure 55(b) provides that the Court may, in its discretion, order default judgment following the entry of default by the Clerk. Local Rule 55 sets forth procedural requirements that must be satisfied by a party moving for default judgment. Upon entry of default, the well-pleaded allegations of the complaint are taken as true, with the exception of allegations concerning the amount of damages. *See, e.g., Geddes v. United Fin. Group,* 559 F.2d 557, 560 (9th Cir. 1977). However, "necessary facts not contained in the pleading, and claims which are legally insufficient, are not established by default." *Cripps v. Life Ins. Co. of N. Am.,* 980 F.2d 1261, 1267 (9th Cir. 1992). Where the pleadings are insufficient, the Court may require the moving party to produce evidence in support of the motion for default judgment. *See TeleVideo Sys., Inc. v. Heidenthal,* 826 F.2d 915, 917–18 (9th Cir. 1987).

***2** When deciding whether to enter default judgment, courts consider seven factors:

(1) the possibility of prejudice to the plaintiff; (2) the merits of plaintiff's substantive claim; (3) the sufficiency of the complaint; (4) the sum of money at stake in the action;

(5) the possibility of a dispute concerning material facts; (6) whether the default was due to excusable neglect; and (7) the strong policy underlying the Federal Rules of Civil Procedure favoring decisions on the merits.

Eitel v. McCool, 782 F.2d 1470, 1471–72 (9th Cir. 1986). If a plaintiff seeks money damages, "[t]he plaintiff is required to provide evidence of its damages, and the damages sought must not be different in kind or amount from those set forth in the complaint." Fed.R.Civ.P. 54(c). "When 'proving-up' damages, admissible evidence (including witness testimony) supporting ... damage calculations is usually required." *Amini Innovation Corp. v. KTY Int'l Mktg.,* 768 F.Supp.2d 1049, 1054 (C.D.Cal.2011).

III. Discussion

A. Procedural Requirements

Plaintiff has satisfied the requirements of Local Rules 55–1 and 55–2 and Federal Rule of Civil Procedure 55(b). Plaintiff has requested and received an entry of default against Defendants. Plaintiff has stated, by declaration, that the individual Defendant is not an infant or incompetent person and that the Servicemembers Civil Relief Act, 50 U.S.C. § 521, is not implicated here. Tompkins Decl. ¶ 5. Having determined Plaintiff's procedural compliance, the Court turns to the substance of Plaintiff's Application.

B. *Eitel* Factors

The Court will now consider each *Eitel* factor in turn.

1. Possibility of Prejudice to Plaintiff

The first *Eitel* factor requires the Court to consider the harm to Plaintiff if a default judgment is not granted. See *PepsiCo, Inc. v. California Sec. Cans,* 238 F.Supp.2d 1172, 1177 (C.D.Cal.2002). Absent default judgment, Plaintiff would lack any other recourse for recovery since Defendant had failed to appear or defend this suit. *Id.*; *Philip Morris USA, Inc. v. Castworld Products, Inc.,* 219 F.R.D. 494, 499 (C.D.Cal.2003). Therefore, the first factor supports granting default judgment against Defendant.

2. Merits of Plaintiff's Claim and Sufficiency of the Complaint

Courts often consider the second and third *Eitel* factors together. *See PepsiCo,* 238 F.Supp.2d at 1175; *see also HTS, Inc. v. Boley,* 954 F.Supp.2d 927, 941 (D. Ariz. 2013). The second and third *Eitel* factors look to whether Plaintiff's complaint has sufficiently stated a claim for relief. In its analysis of the second and third *Eitel* factors, the Court will accept as true all well-pleaded allegations regarding liability. *See Fair Hous. of Marin,* 285 F.3d at 906. The Court will therefore consider the merits of Plaintiffs' claim, and the sufficiency of its pleadings together.

Here, the United States asserts claims for willful failure to file Reports of Foreign Bank and Financial Accounts in violation of 31 U.S.C. § 5314. Section 5314 of Title 31 of the United States Code authorizes the Secretary of the Treasury to require United States citizens to report certain transactions with foreign financial agencies. 31 U.S.C. § 5314. Under the implementing regulations of § 5314, "[e]ach United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship" to the IRS for each year in which such relationship exists, and shall provide such information on the FBAR Form. 31 C.F.R. § 1010.350(a). United States citizens who have an interest in a foreign bank, securities, or other financial account must report that interest to the IRS by June 30 of the year following any calendar year in which the aggregate balance of such account exceeded, at any time during the year, $10,000. 31 C.F.R. § 1010.306(c). If any person willfully fails to timely report interest in a foreign bank, securities, or other financial account to the IRS, then the maximum penalty shall be increased to the greater of either (1) $100,000, or (2) fifty percent of the balance in the account at the time of the violation. 31 U.S.C. § 5321(a)(5)(C)–(D).

***3** As summarized by a court in this Circuit, a FBAR claim consists of four elements: (1) an individual "is a United States person; (2) he or she has a financial interest in, or signature or other authority over, a bank, securities, or other financial account; (3) the bank, securities, or other financial account is in a foreign country; and (4) the aggregate amount in the accounts exceeds $10,000 in U.S. currency at any time during the year." *U.S. v. Hom,* 45

F.Supp.3d 1175, 1178 (N.D.Cal.2014). Here, the United States has sufficiently alleged all of these elements. *See* Compl. ¶¶ 9–11. The United States has supplemented its allegations with supporting documentation. *See generally* Renewed Application Exs. A–C; Application Ex. 1. The second and third *Eitel* factors thus weigh in favor of granting default judgment.

3. Sum of Money at Stake

The fourth *Eitel* factor requires the Court to weigh the amount of money at stake against the seriousness of Defendants' conduct. “Default judgment is disfavored where the sum of money at stake is too large or unreasonable in relation to defendant's conduct.” *Vogel v. Rite Aid Corp.,* 992 F.Supp.2d 998, 1012 (C.D.Cal.2014).

Plaintiff seeks $440,860.22 in damages against Defendant and $12,817 in attorney's fees and costs. App. at 6. While the amount Plaintiff seeks is significant, the Court finds that in light of Plaintiff's serious allegations, the amount is reasonable. Thus, the factor weighs slightly in favor of default.

4. Possibility of a Dispute Concerning Material Facts

The fifth *Eitel* factor requires the Court to consider whether it is likely that there would be a dispute as to material facts. Where a plaintiff's complaint is well-pleaded and the defendant makes no effort to properly respond, the likelihood of disputed facts is very low. *See Landstar Ranger, Inc. v. Parth Enterprises, Inc*., 725 F.Supp.2d 916, 921 (C.D.Cal.2010). “Because all allegations in a well-pleaded complaint are taken as true after the court clerk enters default judgment, there is no likelihood that any genuine issue of material fact exists.” *Elektra Entm't Grp. Inc. v. Crawford,* 226 F.R.D. 388, 393 (C.D.Cal.2005). As discussed above, Plaintiff has pleaded the necessary elements of its claims. Therefore, the risk of disputed facts is minimal, and therefore this factor weighs in favor of default.

5. Possibility of Excusable Neglect

While there is always a possibility that a defendant might show up claiming excusable neglect, where a defendant “[was] properly served with the Complaint, the notice of entry of default, as well as the papers in support of the instant motion,” this factor favors entry of default judgment. *Shanghai Automation Instrument Co. Ltd. v. Kuei,* 194 F.Supp.2d 995, 1005 (N.D.Cal.2001). Despite being properly served with Plaintiff's Complaint, Defendant has made no effort to defend this suit. Furthermore, it has been over one month since the Clerk entered default as to the Defendant. The likelihood of excusable neglect is low, and this factor favors default judgment.

6. Policy Favoring Decision on the Merits

Although decisions on the merits are preferred, this does not prevent a court from entering judgment where the defendants refuse to respond. *PepsiCo,* 238 F.Supp.2d at 1177. Here, because Defendant has failed to respond to Plaintiff's Complaint, the Court is unable to make a decision on the merits. This failure to appear does not preclude the entry of default judgment.

7. Conclusion

Taken together, the *Eitel* factors weigh in favor of granting default judgment against the Defendant.

C. Damages

Plaintiffs requesting default judgment “must also prove all damages sought in the complaint.” *Dr. JKL Ltd. v. HPC IT Educ. Ctr.,* 749 F.Supp.2d 1038, 1046 (N.D.Cal.2010) (citing *Philip Morris USA, Inc. v. Castworld Prods., Inc.,* 219 F.R.D. 494, 498 (C.D.Cal.2003)). Rule 55 does not require the court to conduct a hearing on damages, so long as it ensures there is an adequate basis for the damages awarded in the default judgment. *Action S.A. v. Marc Rich & Co. Inc.,* 951 F.2d 504, 508 (2d Cir. 1991). “The Court considers Plaintiff's declarations, calculations, and other documentation of damages in determining if the amount at stake is reasonable.” *Truong Giang Corp. v. Twinstar Tea Corp.,* No. 06–CV–03594, 2007 U.S. Dist. LEXIS 100237, 2007 WL 1545173, at *12 (N.D.Cal. May 29, 2007).

***4** A person who fails to file a required FBAR may be assessed a civil monetary penalty. See 31 U.S.C. § 5321(a)

(5)(A). The amount of the penalty is capped at $10,000 unless the failure was willful. See 26 U.S.C. § 5321(a)(5)(B)(i), (C).

Here, the United States seeks a total of $32,142.79. App. at 8. The United States' records indicate the requested amount consists of a principal amount of $29,459.18, a late-payment payment as authorized by 31 U.S.C. § 3717 and 31 CFR § 5.5(a) in the amount of $2,300.23, and interest as authorized by 31 U.S.C. § 3717 in the amount of $383.38. *See* App. Ex. 1 at 2. Based on the Court's review of the relevant statutes and the government's records, the Court finds the amount requested in reasonable.

IV. Disposition

In light of the above, the Court GRANTS Plaintiff's Application. Judgment shall be entered in favor of Plaintiff against Defendant in the amount of $32,142.79. An order entering final judgment will be filed concurrently with this Order.

The Clerk shall serve this minute order on the parties.

All Citations

Not Reported in Fed. Supp., 2016 WL 1399519, 117 A.F.T.R.2d 2016-1064

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2013 WL 5442960
United States District Court,
N.D. California.

John C. Hom, John C. Hom
& Associates, Inc., Plaintiffs,
v.
United States of America, Defendant.

No. C 13–02243 WHA
|
September 30, 2013

Attorneys and Law Firms

John C. Hom, San Rafael, CA, pro se.

Thomas Ford Koelbl, U.S. Department of Justice, Washington, DC, Thomas M. Newman, United States Attorney's Office, San Francisco, CA, for Defendant.

ORDER GRANTING MOTION TO DISMISS

WILLIAM ALSUP, UNITED STATES DISTRICT JUDGE

INTRODUCTION

***1** In this action against the United States for unauthorized disclosures of plaintiffs' tax information, defendant moves to dismiss the complaint or alternatively moves for a more definite statement. To the extent stated below, defendant's motion to dismiss is **GRANTED**.

STATEMENT

Pro se plaintiffs John C. Hom and John C. Hom & Associates, Inc. filed this action for damages for violations of 26 U.S.C. 6103 in May 2013. Plaintiffs are seeking $40,874,000 in damages and "at least" $500,000 in punitive damages (Dkt. No. 1 at 21–22). Defendant United States now moves to dismiss or alternatively moves for a more definite statement under FRCP 12(b)(6) (Dkt. No. 13).

Plaintiffs' complaint alleges that the IRS conducted an investigation of plaintiffs' tax returns. The IRS then opened a Foreign Bank Account Report ("FBAR") investigation under 31 U.S.C. 5314 because it discovered Hom's online gambling activity and use of foreign bank accounts (Dkt. No. 1 at 2). Plaintiffs allege that tax return information, discovered during the tax return investigation, was inappropriately disclosed for the purpose of the FBAR investigation.

ANALYSIS

Failure to state a claim is grounds for dismissal under FRCP 12(b)(6). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim for relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 570 (2007)). FRCP 8(a) requires " 'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the ... claim is and the grounds upon which it rests.' " *Twombly,* 550 U.S. at 555 (quoting *Conley v. Gibson,* 355 U.S. 41, 47 (1957)). At a minimum, a plaintiff must provide "the 'grounds' of his 'entitle[ment] to relief' [which] requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action.' *Ibid.* To ensure that pro se litigants do not lose their right to a hearing on the merits because of a technical procedural requirement, our court of appeals construes pro se pleadings liberally. *Balistreri v. Pacifica Police Dep't,* 901 F.2d 696, 699 (9th Cir.1990).

1. UNAUTHORIZED DISCLOSURE UNDER SECTION 6103.

Plaintiffs are authorized to file this suit under 26 U.S.C. 7431. Plaintiffs argue that, under 26 U.S.C. 6103, the use of information discovered in the tax return investigation cannot be used for an FBAR investigation. Section 6103(a) states:

> [r]eturns and return information shall be confidential, and except as authorized by this title —
>
> > (1) no officer or employee of the United States ... shall disclose any return or return information obtained by him in any manner in connection with his services as such an employee or otherwise or under the provisions of this section....

Defendant's motion to dismiss argues that Section 6103(h)(1) provides an exception that allows such a disclosure:

> [r]eturns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.

***2** Tax administration is defined as "the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes ... and includes assessment, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes, or conventions." 26 U.S.C. 6103(b)(4).

Thus, the issue here is whether Section 5314 is either an internal revenue law or related statute (either designation would make the disclosure permissible). The United States argues that Section 5314 is a "related statute" under Section 6103 (Dkt. No. 13 at 6). This is correct. Congress intended for Section 5314 to fall under "tax administration." *See* STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., GENERAL EXPLANATION OF THE TAX LEGISLATION ENACTED IN THE 108TH CONGRESS, 378 (Comm. Print 2005) ("The Congress ... believed that improving compliance with this reporting requirement is vitally important to sound tax administration ..."). Section 5314 is therefore a related statute under Section 6103 and the disclosures at issue in this action were lawful.

Plaintiffs' opposition argues that the IRS did not follow the proper procedure pursuant to the Internal Revenue Manual ("IRM") Sections 4.26.17.2 and 4.26.14.2.2. The IRM states: "[w]ithout a related statute determination, Title 26 information cannot be used in the Title 31 FBAR examination. Any such use could subject the persons making the disclosure to penalties for violating the disclosure provisions protecting Title 26 return information." IRM 4.26.17.2(1)(G). Plaintiffs argue that defendant IRS failed to properly obtain a related statute determination because they did not follow the stated procedure for doing so.

Plaintiffs' argument fails because the IRM holds no legal significance. Our court of appeals has held that "[t]he Internal Revenue Manual does not have the force of law and does not confer rights on taxpayers." *Fargo v. Comm'r of Internal Revenue,* 447 F.3d 706, 713 (9th Cir.2006). Even assuming that the IRS did not follow its own procedures, plaintiffs have no claim for relief.

Plaintiffs also argue that the IRS reports contained false statements and that these false statements are "actionable" under Section 6103 of Title 26. In support of this argument, plaintiffs cite *Aloe Vera v. United States,* 699 F.3d 1153 (9th Cir.2012). *Aloe Vera* is not dispositive here because that decision analyzed the disclosure under Section 6103(k)(4), which exempts information that is authorized by treaty. *Id.* at 1163. The treaty in *Aloe Vera* authorized the disclosure of "pertinent" information. The court in *Aloe Vera* held that "knowingly false information" could not be pertinent under the treaty. *Id.* at 1163–64. *Aloe Vera* is irrelevant here because neither Section 6103(k)(4) nor the treaty are at issue.

Plaintiffs finally argue that the type of information the IRS was soliciting from them suggested that defendant's purpose was "penalty assessment not tax administration" (Dkt. No. 1 at 20). This distinction is meaningless for the purposes of Section 6103. Under Section 6103, the term "Tax administration ... includes assessment, collection, enforcement...."

Even if by "penalty" plaintiffs mean that defendant IRS was acting maliciously and without merit, this argument fails as well. Plaintiffs have not alleged sufficient facts to support such an argument.

***3** Defendant's disclosures were lawful under Section 6103(h)(1) and the motion by the United States is therefore **GRANTED**.

2. JOHN C. HOM & ASSOCIATES, INC. CANNOT PROCEED PRO SE.

Plaintiffs were previously informed at the September 12 case management conference that a corporation cannot be a pro se litigant. Individual plaintiff cannot continue to represent plaintiff corporation by appealing to California Procedure Code Section 1 16.540(b). Section 116.540 pertains to small claims actions. This is not a small claims action and plaintiffs cannot make it one by asking that the corporation's damages be limited to $5000.

CONCLUSION

For the reasons set forth above, defendant's motion to dismiss is **GRANTED**.

Any amendment would be futile, so plaintiffs' claims are **DISMISSED WITHOUT LEAVE TO AMEND**. Judgment will be entered by separate order.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2013 WL 5442960, 112 A.F.T.R.2d 2013-6271, 2013-2 USTC P 50,529

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2010 WL 3980310
United States District Court,
N.D. Indiana,
South Bend Division.

UNITED STATES of America
v.
James A. SIMON.

Cause No. 3:10cr56RM.
|
Oct. 8, 2010.

Attorneys and Law Firms

Jesse M. Barrett, South Bend, IN, for United States of America.

Carmen M. Piasecki, Nickle and Piasecki, South Bend, IN, Frank J. Gray, Gray & Friend LLP, Fort Wayne, IN, for Defendant.

OPINION AND ORDER

ROBERT L. MILLER, JR., District Judge.

***1** James Simon is under indictment on four counts of filing false income tax returns, 26 U.S.C. § 7206(1), four counts of failure to file reports of foreign bank and financial accounts, 31 U.S.C. §§ 5314 & 5322, eleven counts of mail fraud involving private financial aid, 18 U.S.C. § 1341, and four counts of fraud involving federal financial aid, 20 U.S.C. § 1097. The charges revolve around the government's allegation that Mr. Simon and his wife received what were purported to be loans from organizations with which he was affiliated, and treated that money as personal income that he did not report on his personal income tax returns for the calendar years 2003 to 2006, and concerning which he filed no reports of foreign bank and financial accounts for the calendar years 2004–2007, and that he didn't include in applications for need-based financial aid from two private schools for his children. Mr. Simon has pleaded not guilty to each of the charges.

On September 28, the court heard argument on five motions by Mr. Simon: a motion for disclosure of grand jury transcripts, which is now moot; a motion to suppress and for a *Franks* evidentiary hearing; a motion for a bill of particulars; a motion to dismiss the counts relating to reports of foreign bank accounts; and a motion to dismiss the indictment based on tainted grand jury proceedings. Some of the motions are based on multiple grounds. For the reasons set forth in this opinion, the court denies each of the motions, except for the motion to suppress based on the manner of the search warrant's execution and the delay in returning seized material. The court also grants the government's motion to exclude expert testimony concerning the reasonableness of the application for the warrant based on Internal Revenue Service policies.

I

The court begins with the motion to suppress. On November 2, 2007, Internal Revenue Service Special Agent Paul Muschell submitted a search warrant affidavit to United States District Judge Theresa Springmann, who authorized the search of the Simon residence. On either November 4 or November 6 (the parties' submission disagree about the date the warrant was executed, but the date isn't pertinent to the issues now before the court), thirteen agents conducted a search of the Simon residence from around 7:30 a.m. to around 5:00 p.m. Denise Simon, Mr. Simon's wife, was present when the agents arrived. She called her husband and asked that her attorney be allowed to attend the search. Her attorney, Robert Nicholson, arrived about an hour later. The agents seized computers, computer-related devices, and financial documents; some computer-related items were imaged at the Simon home and left there.

A few days after the warrant was executed, Mrs. Simon died at her own hand.

Mr. Simon argues that all evidence obtained as a result of the search of his home and seizure of financial records, computers and other documents, and all derivative evidence should be suppressed because it was obtained in violation of his Fourth Amendment rights. Mr. Simon's motion to suppress is one of the motions based on a variety of arguments. Mr. Simon says:

- ***2** Special Agent Muschell's affidavit contained false and misleading statements of fact and omitted facts that were material to the probable cause finding;
- The affidavit didn't establish probable cause for the offenses listed;

- the search warrant lacked sufficient specificity, and resulted in a "general search" of the Simon residence, in violation of the 4th Amendment;

- the warrant was unreasonable because it authorized intrusion into the defendant's residence and was issued contrary to guidelines contained in the Internal Revenue Service manual for search and seizure; and

- the warrant was executed in an unreasonable manner (agents exceeded scope of the warrant and seized unauthorized items).

The government agrees that an evidentiary hearing is needed with respect to the reasonableness of the warrant's execution. Mr. Simon seeks an evidentiary hearing concerning the statements and omissions in the affidavit and also seeks to present evidence concerning the IRS manual for search and seizure.

A

A court evaluating probable cause asks if there was a fair probability, given the totality of the circumstances, that evidence of a crime would be found in the place to be searched. *United States v. Orozco,* 576 F.3d 745, 748 (7th Cir.2009); *see also United States v. Walker,* 237 F.3d 845, 850 (7th Cir.2001) ("a practical, common-sense decision"). The supporting affidavit must set forth enough facts to lead a reasonably prudent person to believe that the requested search will find evidence of a crime. *United States v. Romo,* 914 F.2d 889, 898 (7th Cir.1990). The affidavit is reviewed in a common sense manner, not hypertechnically. *United States v. Walker,* 237 F.3d at 850.

"The Fourth Amendment requires an evidentiary hearing on the veracity of a warrant affidavit, and ultimately on the constitutionality of the search, when a defendant requests such a hearing and 'makes a substantial preliminary showing that a false statement knowingly and intentionally, or with reckless disregard for the truth, was included by the affiant in the warrant affidavit, and [ ] the allegedly false statement is necessary to the finding of probable cause.' " *United States v. Harris,* 464 F.3d 733, 738 (7th Cir.2006) (*quoting Franks v. Delaware,* 438 U.S. 154, 155–56, 98 S.Ct. 2674, 57 L.Ed.2d 667 (1978)). "A defendant may also challenge an affidavit by showing that the affiant intentionally or recklessly omitted material information." *Id.; see also Shell v. United States,* 448 F.3d 951, 958 (7th Cir.2006); *United States v. Williams,* 737 F.2d 594, 604 (7th Cir.1984). "[T]o make a substantial preliminary showing, the defendant must identify specific portions of the warrant affidavit as intentional or reckless misrepresentations, and the defendant should submit sworn statements of witnesses to substantiate the claim of falsity." *Id.; see also Franks v. Delaware,* 438 U.S. at 171. A court then considers the affidavit, eliminating any false statements and incorporating omitted material facts, and determines whether probable cause existed. *United States v. Harris,* 464 F.3d at 738.

1

***3** Discussion of Mr. Simon's attacks on the affidavits requires the court to recite an unfortunate degree of detail. Some of what Special Agent Muschell related in the affidavit related to what he has learned about tax offenders and their ways during his years as an IRS agent and as an accountant before that. He explained that tax offenders often use offshore entities, offshore trusts, foreign shell corporations, and foreign bank accounts, that sham loan transactions (those in which the borrower isn't really obligated to repay the loan) often are used to hide income, that tax offenders often use "tax haven" countries that are deemed "tax havens" because of their bank secrecy laws, like Cyprus, Gibraltar, and the Cook Islands, and that tax offenders often add layers to the scheme to try to make it harder to trace funds. Agent Muschell then explained computer terminology and how tax offenders are known to have used computers, and added that it can take weeks to find financial information in computers.

The affidavit then turned to James and Denise Simon, who were affiliated with several domestic entities, foreign trusts, foreign shell entities, and offshore bank accounts, some of which were established in countries earlier identified as "tax havens". The affidavit reported that the Simons sent funds to offshore countries, then transferred the funds back into domestic bank accounts, with funds eventually winding up in Denise Simon's checking account. The affidavit also reported that the Simons received mail at an address in Huntertown, Indiana, and transferred mail to their residential address.

The affidavit says Mr. Simon transferred personal assets to the Simon Family Trust, located in the Cook Islands for the benefit of his family. The trustees were an attorney named Doug Miller and a Cook Islands firm. The family trust contained a 99 percent interest in JAS Partners, and contained about $4 million in 2000. Although required to file tax returns, the family trust hadn't done so from 2004 through 2006, during which years the Simons prepared their own personal and business tax returns. Special Agent Muschell's affidavit said Mr. Simon was president of William R. Simon Farms, Inc., which he and his family inherited when his mother died. That corporation owned two properties in Huntertown, Indiana; the Simons received mail at one of the properties and Mrs. Simon was seen obtaining an envelope from that property. Mr. Simon signed the corporation's tax returns of the Farm in 2000, 2001, and 2004, but the corporation didn't file a return for 2002, 2003, 2005, and 2006. According to the affidavit, Mr. and Mrs. Simon received farm subsidy income from the corporation in those years.

The affidavit reported that Mr. Simon is the managing director and Denise Simon is an authorized representative of JS Elekta Leasing, an international telecommunications corporation based in Cyprus. Mr. and Mrs. Simon opened, and were the only authorized signers on, a bank account for J.S. Elekta Leasing Limited. Agent Muschell said Mr. Simon had received funds from investors on behalf of JS Elekta Leasing's behalf since 2002, and that JS Elekta Leasing had never filed a tax return.

***4** The affidavit said the Simons had formed JAS Partners in 1981 in Colorado through attorney David Lockwood, who specializes in "achieving estate tax minimization and probate avoidance." Mr. Simon was quoted as saying JAS Partners was a "vehicle that engages in financial transactions: loans, money, et cetera, for the purpose of economic gain." JAS Partners reported little revenue, but significant business expenses and net losses from 2000 to 2005. The partnership's losses flowed through to the Simons' tax returns, so they reported adjusted gross incomes of -$37,364 in 2003, $5,130 in 2004, -$269,922 in 2005, and -$47,119 in 2006. Because of (and only because of) the partnerships' losses, the affidavit reported, Mr. and Mrs. Simon received earned income tax credits in 2003–04 and 2006, to which they would not have been entitled had they correctly reported their income. Special Agent Muschell's affidavit says Mrs. Simon's checking account received more than $500,000 in 2006 that came from companies affiliated with Mr. Simon. Some of these wire transactions referenced payment for "services," but those payments weren't reported as income.

The affidavit reported that Mr. Simon is the president and self-described managing director for Elekta Limited, which is based in Gibraltar and hasn't filed any tax return with the IRS. Mr. and Mrs. Simon opened, and were (along with Mr. Simon's sister) authorized signers on, an Elekta Limited bank account in 1997. In 2006, Mr. Simon transferred $2,700 from the Elekta Limited account to a Gibraltar company that specializes, inter alia, in "international tax and asset protection planning."

Mr. Simon, the affidavit continued, also was chief executive officer of Intellecom, the parent company of which is Ichua Limited, located in Cyprus. The affidavit reports that Mr. Simon, acting on Ichua Limited's behalf, had wired $417,000 in 2006 and 2007 to accounts the Simons controlled, and that most of that money went into Mrs. Simon's checking account. The Simons didn't disclose on their 2003 to 2005 tax returns that they had any interest in a foreign financial account, and from 2003 to 2006, didn't file Reports of Foreign Bank and Financial Accounts ("FBARs") disclosing their interest in foreign financial accounts.

Ichua Limited wired more than $270,000 to JS Elekta Leasing Limited in 2006 (referencing "services") and more than $370,000 to Elekta Limited which, in turn, wired more than $370,000 to JAS Partners, which transferred more than $350,000 to the personal bank account of Mrs. Simon, who also got more than $190,000 from Elekta Limited. Mrs. Simon, the affidavit says, spent between $34,000 and $120,000 per month in 2006, but the Simons reported total income of -$40,499.

Based on this affidavit, Judge Springmann found probable cause to issue a search warrant to look for financial records and other evidence of tax offenses in the Simon residence.

2

The court agrees with the government and Judge Springmann that Special Agent Muschell's affidavit established probable cause for the requested search. The affidavit set forth enough facts to lead a reasonable person to believe that the search of the residence would produce evidence that Mr. and Mrs. Simon had filed tax returns that were false because they omitted taxable income, and that Mr. and Mrs. Simon were required to file "FBARs" that they hadn't filed.

***5** Most of Mr. Simon's arguments to the contrary intertwine with his separate argument for a *Franks* hearing, making it difficult to isolate his arguments about the insufficiency of the affidavit as written. Essentially, Mr. Simon contends that the affidavit's factual allegations don't establish each element of tax evasion. This was not an affidavit for an arrest warrant, though. It sought a warrant to search the Simon residence for evidence of tax evasion and failure to comply with reporting requirements concerning foreign bank accounts. Setting aside for the moment the facts that Mr. Simon contends were missing or were false, Special Agent Muschell's affidavit contains more than enough facts to support a finding of probable cause for the requested search.

3

Mr. Simon contends that Special Agent Muschell's affidavit contained false and misleading statements of fact and omitted material facts. He seeks an evidentiary hearing pursuant to *Franks v. Delaware,* 438 U.S. 154, 98 S.Ct. 2674, 57 L.Ed.2d 667 (1978), to pursue that inquiry. As already noted, Mr. Simon must make a substantial preliminary showing that Special Agent Muschell made one or more false statements knowingly, intentionally, or with reckless disregard for the truth, and that the false statement was necessary to the finding of probable cause. *United States v. Harris,* 464 F.3d at 738.

Mr. Simon says two of the statements in the affidavit were false: Cyprus has a tax treaty with the United States and doesn't have bank secrecy laws, so it isn't a "tax haven" as Special Agent Muschell defined the term; and the Simon Family Trust, described as being located in the Cook Islands, actually is a domestic trust.

Mr. Simon says the affidavit omitted the following facts: that Mr. Simon lived overseas and has business operations in foreign countries; that neither Mr. nor Mrs. Simon had any criminal history; that Mr. and Mrs. Simon had been audited in the past, and had cooperated with the IRS and resolved the audits successfully; that the Simon Family Trust's assets were held in domestic financial institutions, not in the Cook Islands; that a person could have legitimate reasons for using offshore bank accounts; that the Simon Family Trust's trustee's address was in the United States, and the Trust was involved in litigation in the United States, so it had submitted to the jurisdiction of an American court; that the Family Trust's trustee, rather than Mr. and Mrs. Simon, was required to file tax returns for the trust; that the Simons' personal tax returns included income generated by the Family Trust; that the farm subsidies to William R. Simon Farms, Inc., in 2000, 2001, and 2004, were less than $5,000, and that the farm historically had shown losses on its tax returns; that J.S. Elekta Leasing, Ltd. and Elekta Limited might not be required to file tax returns; that taxable income is different than revenues and JAS Partners might have received nontaxable sources of income, such as loans; and that while Elkta, Ltd. received payments from services from Ichua, Ltd., Mrs. Simon and JAS Partners didn't receive payments for "services."

4

***6** The omissions of which Mr. Simon complains relate to matters that might, if included, make the inculpatory facts look less suspicious. For example, the Simons' use of offshore accounts seems less sinister if the reader also learns that there can be innocent reasons for using offshore accounts. But the Fourth Amendment doesn't require that an applicant for a search warrant include all facts that could support an innocent explanation for the apparently less innocent facts recited in the affidavit. *United States v. Rambis,* 686 F.2d 620, 623 (7th Cir.1982) (affidavit "need only allege specific facts establishing a reasonable probability that the items sought are likely to be at the location designated; [it] need not also negate every argument that can be asserted against that probability."); *see also United States v. Carmel,* 548 F.3d 571, 577 (7th Cir.2008) (affidavit described illegal use for object but omitted reference to a legal use for the same object; *Franks* hearing properly denied); *United States v. Fama,* 758 F.2d 834, 838 (2d Cir.1985) ("The fact that an innocent explanation may be consistent with the facts alleged ... does not negate probable cause.").

Nothing in Mr. Simon's submission suggests that the omitted facts go so far past the "innocent explanations" that needn't be included that Special Agent Muschell could be said to have omitted the specified facts "knowingly or intentionally, or with reckless disregard for the truth ...." *Franks v. Delaware,* 438 U.S. at 155–156.

That leaves the two statements that Mr. Simon says were false: that Cyprus is a "tax haven," and that the Simon Family Trust is located in the Cook Islands. First, the record contains precious little to support a finding that either statement is wrong. *See United States v. Souffront,* 338 F.3d 809, 823 (7th Cir.2003) ("The presumption of validity [of the affidavit] cannot be overcome by defendant's self-interested inferences and conclusory statements."); *see also Shell v. United States,* 448 F.3d 951, 958 (7th Cir.2006) (denying *Franks* hearing where defendant offered no support for the contention that the agent intentionally omitted information). The more important point is that even if those statements are disregarded, the affidavit contains more than enough factual information to lead a reasonable person to believe evidence of the specified criminal activities would be found at the Simon residence. The alleged omissions aren't material to the probable cause finding. *See United States v. Klump,* 536 F.3d 113, 120 (2d Cir.2008) (omission not material where innocent explanation doesn't negate probable cause); *United States v. Harris,* 464 F.3d at 738 (innocent explanation didn't materially detract from the totality of probable cause found in the affidavit); *United States v. Maro,* 272 F.3d 817,821 (7th Cir.2001) (unimportant allegation, even if viewed as intentionally misleading, doesn't trigger need for a *Franks* hearing).

5

***7** Special Agent Muschell's affidavit supported a finding of probable cause to search the Simon residence, and Mr. Simon hasn't made a showing sufficient to support his request for a *Franks* hearing. To the extent the motion to suppress is based on those arguments, it must be denied.

B

Mr. Simon contends that the search warrant was overly broad and had insufficient specificity. The warrant had two attachments. The first attachment described and depicted the Simon residence. The second (Attachment B) set forth the items to be seized: (1) business records and correspondence related to Intellcom, Ichua Limited, Elekta Limited, JS Elekta Leasing, JAS Partners, Ltd., Fort Wayne Telstat, and Klondike Data Services from 2000 through 2006; (2) state and federal tax returns, and related forms and schedules, from 2000 through 2007; (3) documents related to domestic and foreign travel; (4) financial records showing the obtaining and concealing of assets and the expenditure of money; (5) photographs of real or personal property; and (6) indicia of occupancy. Attachment B authorized the agents to seize computers and electronically stored information, making every effort to image the information on site, but allowing seizure for enough time for off-site access and copying.

Mr. Simon contends that Attachment B's descriptions of items to be seized didn't satisfy the Fourth Amendment's particularity requirement. The description "all business records" didn't limit the seizure authority to evidence of violations of the statutes in the application, giving the agents unfettered discretion rather than providing specific guidance. *See, e.g., United States v. Cardwell,* 680 F.2d 75 (9th Cir.1982), *citing Marron v. United States,* 275 U.S. 192, 196, 48 S.Ct. 74, 72 L.Ed. 231 (1927); *Alioto v. United States,* 216 F.Supp. 48 (E.D.Wis.1963) (warrant was overbroad when only limitation on seizure of business records was that they be instrumentalities or evidence of violation of general conspiracy and tax evasion statutes). With respect to tax returns and financial documents, the warrant wasn't limited to any person or entity. The same was true with respect to records of foreign or domestic travel and photos, which weren't even limited to a particular time period. As a result, Mr. Simon argues, agents seized documents beyond those authorized by the warrant, such as records of financial aid from the schools his children attended.

A warrant satisfies the particularity requirement if the warrant tells a reasonable executing officer what items are to be seized. *United States v. Hall,* 142 F.3d 988, 996 (7th Cir.1998). The particularity needed in one case might be impossible in another, so the courts recognize that the requisite specificity varies from case to case, depending on the complexity of the suspected criminal activity. *See Russell v. Harms,* 397 F.3d 458, 464 (7th Cir.2005); *United States v. Vitek Supply Co.,* 144 F.3d 476, 481 (7th Cir.1998); *Wag–Aero, Inc. v. United States,* 837 F.Supp. 1479, 1496 (E.D.Wis.1993). The description in the warrant must be as particular as the circumstances reasonably permit, *United States v. Bentley,* 825 F.2d 1104, 1110 (7th Cir.1987), allow so that an executing officer can identify the things to be seized with reasonable certainty. *United States v. Jones,* 54 F.3d 1285, 1290 (7th Cir.1995). Generic language is allowed if detailed particularity is impossible and the language used particularizes what is to be seized. *United States v. Hall,* 142 F.3d at 996.

***8** This warrant listed the Simons' business affiliations and limited the records search concerning those businesses to a particular time frame. It specified tax documents within a particular time frame. The other categories of items are limited by subject matter rather than by time frame. Greater specificity would be needed for a search of an accountant's office, but this warrant related to a residence.

Seizure of the financial aid documents neither exceeded the warrant's scope nor demonstrated an impermissible lack of particularity. The financial aid applications contained information from the Simons about taxable income, expenses, and loans, and included copies of tax returns. The warrant specified evidence of the obtaining and concealment of assets by Mr. and Mrs. Simon, and the financial aid documents appear to fall within that category of items.

C

Mr. Simon argues that the execution of the search warrant was unreasonable, among other reasons because the agents departed from the IRS' administrative guidelines on search warrants. Mr. Simon's argument, though, addresses the decision to obtain a warrant and the adequacy of Special Agent Muschell's affidavit, rather than the execution of the search itself. Mr. Simon notes, for example, that section 9.4.9.2 of the Internal Revenue Manual says "CID will employ the least intrusive means necessary to acquire evidence in tax and tax-related Title 18 investigations," and that search warrants are to be used when crucial evidence "cannot be obtained by any other means." Special Agent Muschell used the search warrant rather than using IRS summonses and/or grand jury subpoenas, or simple requests. Sections 9.4.9.2 and 9.4.9.3.1.2 of the IRS manual say that an affidavit for a warrant must show "objective evidence of the subject's attempt to obstruct the investigation", or "objective evidence indicating the subject may destroy the evidence", or "facts that establish that other attempts to acquire the records were ineffective." Special Agent Muschell's affidavit made no such references.

A search warrant obtained in contravention of the IRS manual, Mr. Simon argues, is unreasonable. This is especially so since the warrant was directed at the Simon residence, in which he and his family had the highest degree of privacy. There would have been no search had the manual been followed, because the government would have employed less intrusive means of investigation first.

The court doesn't understand the law the same way Mr. Simon does. Mr. Simon cites no authority for the proposition that investigators must proceed incrementally by using the least intrusive investigative means before moving to the next stage of their investigation. The IRS might have internal procedures to that effect, but those procedures confer no rights on the person being investigated. *United States v. Peters,* 153 F.3d 445, 452 n. 9 (7th Cir.1998). The search warrant was based on probable cause and described the place to be searched and the items to be seized with sufficient particularity. Recognizing that the court defers ruling on the reasonableness of the warrant's execution until after hearing evidence, the Fourth Amendment requires no more.

***9** That the Simon residence was the place to be searched doesn't change the analysis. No heightened standard of probable cause or reasonableness governs residential searches pursuant to search warrants. *See, e.g., United States v. Jones,* 54 F.3d 1285, 1289–1290 (7th Cir.1995); *United States v. Stone,* 471 F.2d 170, 175 (7th Cir.1972).

During argument on Mr. Simon's motion, the government moved to exclude the presentation, at the hearing concerning the method of execution of the warrant, of any expert testimony that the search and/or warrant did or didn't comport with the manual. Because the manual doesn't provide the yardstick by which reasonableness is judged for Fourth Amendment purposes, the court grants the government's motion.

D

Special Agent Muschell's affidavit supported a finding of probable cause to search the Simon residence, and

Mr. Simon hasn't made a showing sufficient to support his request for a *Franks* hearing. The warrant described with sufficient particularity the things to be seized, and the search was not made unreasonable by any failure to comply with the IRS manual. The court has deferred ruling on the aspect of Mr. Simon's motion that argues for suppression based on the execution of the warrant and retention of items seized; in all other respects, the motion to suppress is denied.

II

The court heard argument on the pending motions on September 28, Mr. Simon asked to submit supplemental authority on a couple of points, and the court afforded both sides until October 1 to file supplementary material. On October 5, as the court was drafting this opinion and after the court already had completed the section concerning the motion for a *Franks* hearing (this opinion would have been released a day earlier but for a gas leak that caused evacuation of an area of South Bend that includes the federal courthouse), Mr. Simon filed a motion for leave to file the affidavit of retired IRS agent George Scott in support of his motion to suppress. Mr. Simon explained that he didn't believe such an affidavit was required for his suppression motion, but the arguments at the hearing suggested the government disagreed. The government objected to Mr. Simon's motion to file the Scott affidavit.

The court has resolved the suppression motion (save issues concerning the warrant's execution) without relying on (though not without commenting on) the lack of an affidavit. Mr. Scott's affidavit wouldn't affect that ruling if the affidavit (as the court assumes) is limited to the issues previously raised. If the affidavit raises any new issues, it comes too late. In either event, there is no need to expand the record with Mr. Scott's affidavit, so the court denies Mr. Simon's motion to file the affidavit.

III

Mr. Simon asks the court to order the government to file a bill of particulars pursuant to FED. R.CRIM. P. 7(f) as to the amount of unreported income allegedly received from each of the entities referenced in ¶ 3 of the indictment for each tax year in question, and requiring an itemized statement of all of the expenditures alleged in ¶ 7 of the indictment (including dates, amounts and payee of each expenditure). The government responds that the indictment sufficiently alleges the elements of the offenses charged and provides significant detail regarding the source of the implicated funds and the manner in which they were spent, and that it's "open-file" discovery obviates the need for a bill of particulars in this case.

***10** The motion deals with paragraphs 3 and 7 of the tax counts (counts 1–4), The indictment is unusually rich in detail with respect to the tax counts. After alleging ¶ 2 that Mr. Simon was involved with Elekta Limited, JS Elekta Leasing Limited, Ichua Limited, JAS Partners, and William R. Simon Farms, Inc., the indictment alleges in ¶ 3 specific annual amounts of money Mr. Simon and his family are said to have received from the entities listed in ¶ 2:

> 3. From 2003 through 2006, Simon and/or his family received approximately $1,799,502.60 from Elekta Limited, JS Elekta Leasing Limited, Ichua Limited, JAS Partners, and William R. Simon Farms, Inc., as follows: $245,800 in 2003; $341,143.71 in 2004; $472,637.96 in 2005; and $739,920.93 in 2006.

Paragraph 4 alleges that Mr. Simon didn't report the $1,799,502.60 as income on his tax returns. Paragraphs 5 and 6 allege that Mr. Simon's personal accounting records referred to most of the money as "loans" or "advances," but set forth about eleven reasons why the money wasn't loaned or advanced.

Paragraph 7 then alleges, with striking specificity, how Mr. Simon and his family spent most of the money from those entities from 2003 to 2006, breaking the expenditures down into 31 categories, with 14 sub-categories.[1] The expenditures are alleged down to the penny; for example, the indictment alleges that Mr. Simon and his family spent $5,054.18 on make-up from 2003 to 2006.

This indictment, in other words, is a far cry from the usual allegation that a defendant, together with others known and unknown, conspired to distribute cocaine base in excess of 50 grams in 2007 and 2008 within the Northern District of Indiana and elsewhere.

Mr. Simon seeks still greater detail. He notes that ¶ 3 doesn't specify how much allegedly unreported income was received from each entity, either in total or for each tax year in question. Without that information, he says, he won't be able to prepare a defense to these allegations. With respect to the expenditures collected in ¶ 7, Mr. Simon says the Government should itemize each transaction, the dates thereof, and the payees, so he can investigate. Mr. Simon says the Government had produced more than 40,000 pages of documents by the time he filed his motion (more pages were produced at the hearing), but hasn't provided any kind of index, categorization, or organizational aid. Mr. Simon believes it would be grossly unfair and prejudicial to leave it to him to go through so much discovery without the detailed schedule of all of the expenditures that the government already must have prepared.

A bill of particulars is not designed to help a defendant organize discovery materials; a bill of particulars helps clarify a minimally sufficient indictment so that a defendant might understand the nature of the charge against him. *See United States v. Fassnacht,* 332 F.3d 440, 446–447 (7th Cir.2003); *United States v. Kendall,* 665 F.2d 126, 134 (7th Cir.1981) ("The test for whether a bill of particulars is necessary is 'whether the indictment sets forth the elements of the offense charged and sufficiently apprises the defendant of the charges to enable him to prepare for trial.' "). This indictment provides more than enough information to inform Mr. Simon of the charges and to allow him to prepare to defend those charges. Moreover, the government is correct that a bill of particulars is even less necessary when, as here, the government provides open file discovery. *United States v. Canino,* 949 F.2d 928,949 (7th Cir.1991); *United States v. Giese,* 597 F.2d 1170, 1180 (7th Cir.1979).

***11** The court denies Mr. Simon's motion for a bill of particulars.

IV

Mr. Simon moves to dismiss the indictment in its entirety on two grounds related to the grand jury. He contends the grand jury proceedings in this case were tainted because Special Agent Muschell gave misleading and false information to the grand jury and because the prosecutor gave misleading, confusing and inaccurate information to the grand jury, and didn't clarify and/or answer questions posed by the grand jury. He also seeks dismissal because the prosecutor excused a grand juror without court approval.

A

Mr. Simon contends that Special Agent Muschell led the grand jury to believe that $1.7 million had come into Mr. Simon's personal checking account, that Mr. Simon received transfers from the affiliated entities on a regular basis from 2003 to 2006, that Mr. Simon "did not report virtually any income" during those years, that the money was spent primarily on tennis lessons, that Mr. Simon had personally prepared affidavits for witnesses to sign, that money that actually went to affiliated entities went directly into Mr. Simon's checking account, that money "bounced around" before settling in Mr. Simon's bank account, that Mr. Simon pocketed "half" of the money investors were putting into the affiliated entities, and that no loan documents (or payments on the loans) were ever made. Mr. Simon believes the prosecutor misled the grand jury with respect to whether loans from certain people would be the basis of charges the grand jury was considering, whether loan documentation existed, whether promissory notes would be evidence of loans, and about a lawsuit Mr. Simon had filed against Special Agent Muschell and the IRS (relating to the search of his home and his wife's death).

To the extent Mr. Simon contends the indictment rested on false testimony, he must show (1) that the grand jury heard false testimony and (2) prejudice amounting to either "proof that the grand jury's decision to indict was substantially influenced, or that there is grave doubt that the decision to indict was substantially influenced, by testimony which was inappropriately before it." *United States v. Useni,* 516 F.3d 634,656 (7th Cir.2008); *United States v. Anderson,* 61 F.3d 1290, 1296 (7th Cir.1995). Mr. Simon hasn't met that burden. There might be a factual dispute between the parties with respect to documents that purport to be loan documents, but that's a matter for trial, not pretrial motion practice. None of the transcripts to which Mr. Simon points demonstrate that either the prosecutor or Special Agent Muschell made any false statements, or that the prosecutor failed to answer (or refused to allow) the grand jurors' questions.

Mr. Simon's complaints seem to rest instead on what he sees as skewed or slanted testimony and responses to grand jurors' questions. In presenting such an argument, Mr. Simon shoulders a heavy burden. A grand jury is an accusatory body rather than an adjudicatory body, *United States v. Mahalick,* 498 F.3d 475, 479–480 (7th Cir.2007), so its proceedings can't be judged by the same yardstick that applies to trials. The government isn't required to disclose even the existence of exculpatory evidence to the grand jury, *United States v. Williams,* 504 U.S. 36, 53, 112 S.Ct. 1735, 118 L.Ed.2d 352 (1992), or to provide instructions about material facts or legal terms. *United States v. Lopez–Lopez,* 282 F.3d 1, 8–9 (1st Cir.2002). The federal courts "have been reluctant to invoke the judicial supervisory power as a basis for prescribing modes of grand jury procedure. Over the years, we have received many requests to exercise supervision over the grand jury's evidence-taking process, but we have refused them all ...." *United States v. Williams,* 504 U.S. at 50.

***12** In *United States v. Hogan,* 712 F.2d 757, 760 (1st Cir.1983), the prosecutor called the target a "hoodlum" who should be indicted as a matter of equity, presented hearsay testimony about unrelated murders of which the target was suspected, recounted news accounts and rumors suggesting that the target had taken bribes while a police officer, presented speculative testimony about why the target hadn't engaged in a drug deal with an informant, and presented concededly false testimony about someone overhearing the target discussing a heroin deal in a phone call. Mr. Simon's complaints about the conduct before the grand jury that indicted him fall well short of that conduct. The parties have cited no other instance in which a federal court upheld an indictment's dismissal for prosecutorial misconduct falling short of actual false testimony, and the court's research has found none. *Cf. United States v. Feurtado,* 191 F.3d 420 (4th Cir.1999) (upholding district court's dismissal of indictment without prejudice, rejecting appellants' contention that indictment should have been dismissed without prejudice).

At the hearing on his motion, Mr. Simon indicated that he wanted to be able to question Special Agent Muschell at a hearing to learn why answers were framed as they were. The court invited Mr. Simon to file supplemental citation of authority to support the proposition that a defendant is entitled to an evidentiary pretrial hearing to question a grand jury witness about why answers were phrased in certain way, or why certain information wasn't given. No authority was submitted, and the court knows of none. The court won't allow such questioning.

B

One of the grand jurors reported that he or she had attended Mrs. Simon's funeral. The Assistant United States Attorney told the grand juror:

> In situations like this, what we typically do assuming we have enough grand jurors, which we do is ask someone who would be that familiar with that situation to excuse themselves from the deliberations. So I guess what you can do is you can step out and so you won't need to be involved in the deliberations on this particular case hearing more testimony or deliberating because of your sort of personal knowledge and relationship with the family or in-laws or that sort of thing.

Grand jurors inquired whether that grand juror, who had been an active questioner to that point (this was an active grand jury with respect to questions), could remain to ask questions of witnesses and then leave only for the deliberations; the foreperson of the grand jury asked the grand juror to step out before the witnesses were called. Another grand juror reported an acquaintance with the Simon family: the grand juror taught tennis to the Simon children, and the Simons were neighbors of the grand juror. The prosecutor made no suggestion that this second grand juror should recuse.

Based on these exchanges, Mr. Simon contends that the prosecutor improperly suggested that the grand juror excuse himself, although that grand juror was (in Mr. Simon's estimation) asking the best questions about Mr. Simon's financial matters and seemed to have the most insight into Mr. Simon' position with respect to loans and taxable income. Mr. Simon moves the court, pursuant to its inherent supervisory power over the grand jury, to dismiss the indictment with prejudice.

***13** Conceding the absence of any authority squarely on point, the government argues that a district court is not to inquire into grand jurors' bias after the grand jury has been selected, *see United States v. Adamo,* 742 F.2d 927, 936 n. 5 (6th Cir.1984), and that district judges are to have very little involvement with grand jury matters after calling the grand jurors together and administering their oaths. *United States v. Williams,* 504 U.S. at 48–50. The government views Mr. Simon's argument—that the prosecutor should have brought the arguably tainted grand jurors before the court rather than advise the grand jury himself—as inconsistent with those principles.

The government's argument on this point is staggered, if not knocked out altogether, by Federal Rule of Criminal Procedure 6(h), which authorizes judges to excuse seated grand jurors, either permanently or temporarily. Whatever limits law or custom may place on judges' involvement with the grand jury's day-to-day operations, the Rule contemplates that judges will, at least occasionally, be called upon to decide whether to excuse a juror, even on a temporary basis. Given the terms of Rule 6(h), it doesn't appear that it would have been improper for the government to refer the grand juror's potential recusal to a judge.

But Rule 6(h) doesn't answer any more of the questions posed by Mr. Simon's motion, because it doesn't limit the authority to excuse a grand juror to the court. It simply vests the court with such authority without revealing whether anyone else shares the authority. It doesn't declare that the prosecutor can never excuse a grand juror with respect to a single matter, or that the foreperson or deputy foreperson can't do so, or that a grand juror can't recuse herself with respect to a particular inquiry. By the same token, it doesn't deny the authority to permanently excuse a grand juror to any of those people, but it seems improbable that the law contemplates either the prosecutor permanently barring a seated grand juror from the room, or a seated grand juror's authority to excuse himself from any further duty.

If the inquiry proceeded further, it would be difficult to identify precisely who had final responsibility for the grand juror's recusal on the grand jury's final day with this case. The prosecutor never told the grand juror that recusal was required, but since grand juries look to prosecutors for guidance on the law, the prosecutor's statement about what is "typically" done in similar situations might have been indistinguishable from a command. On the other hand, the grand juror seems to have had no disagreement with the course the prosecutor recommended, and the action might be seen as self-recusal. Modest precedent for a voluntary, but prosecutor-driven, recusal is found in *United States v. Lopez,* 854 F.Supp. 50, 54–55 (D.P.R.1994) (AUSA said, "Mr. Foreperson, this is the case of Franklin Delano López. As in the past, we would request that you recuse yourself, and I would request that the deputy foreperson assume his duties"; issue in case arose when deputy foreperson wasn't there). And as already noted, it was the foreperson who finally directed the grand juror to step outside.

***14** The court needn't resolve either the factual issue or the threshold legal question about who can excuse a grand juror temporarily, because there is no authority for the premise of Mr. Simon's motion: that the court can dismiss an indictment if a grand juror was improperly excused from the proceedings and deliberations. A court can't dismiss an indictment for prosecutorial misconduct in grand jury proceedings if the misconduct didn't affect the defendant's substantial rights. *Bank of Nova Scotia v. United States,* 487 U.S. 250, 254–255, 108 S.Ct. 2369, 101 L.Ed.2d 228 (1988).

Unlike a petit jury that requires a unanimous verdict, the government wasn't required to persuade any particular combination of grand jurors to obtain this indictment. The government had to persuade twelve or more grand jurors to indict, out of at least sixteen grand jurors in attendance. That the indictment was returned demonstrates that twelve or more voted to indict; the vote of the excused grand juror wouldn't have affected the outcome. Mr. Simon had no right to a particular composition of the grand jury; as has already been discussed, grand jurors may be excused temporarily, so that the grand jury's composition might differ from session to session. Indeed, one member of the grand jury that indicted Mr. Simon had missed an earlier session, and the prosecutor properly produced a transcript of evidence from that session (which included exculpatory witnesses) for that grand juror to review. *See United States v. Lang,* 644 F.2d 1232 (7th Cir.1981).

If the excusing of the grand juror from the proceedings amounted to misconduct by anyone, that misconduct didn't affect Mr. Simon's substantial rights. Dismissal is not appropriate. *Bank of Nova Scotia v. United States,* 487 U.S. at 254–255.

C

Mr. Simon also had moved for disclosure of grand jury transcripts to allow him to seek any further issues with what was presented to the grand jury or what occurred during the proceedings. Since then, the government provided quite a few transcripts. At the hearing, the court asked Mr. Simon if those transcripts made his motion moot; he responded that if he has all the transcripts the government has, his motion is moot. The government then informed the court that Mr. Simon has all the transcripts it has. The court deems the motion moot and denies it as such.

V

Counts 1 through 4 of the indictment allege that Mr. Simon violated 26 U.S.C. § 7206(1) by filing tax returns for the years 2003 through 2006 because they didn't report certain income for each of those years and because they didn't disclose certain foreign bank accounts. Counts 5 through 8 of the indictment allege that Mr. Simon failed to file Reports of Foreign Bank Accounts—what the parties call "FBARs" for the years 2004 through 2007, and so violated 31 U.S.C. §§ 5314 and 5322. Mr. Simon moves to dismiss these counts because the IRS has extended any requirement for the filing of FBARs or any disclosure of them on tax returns and expressly made the extension retroactive, *see* Administrative Notice 2010–23, March 13, 2010; and Notice 2009–62, (August 31, 2009), and because Mr. Simon filed all FBARs that could have been required before the indictment.

***15** 31 C.F.R. § 24 (reports of foreign financial accounts) provides that:

> Each person subject to the jurisdiction of the United States having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons [Form TD F 90–22.1] ...

Under 31 C.F.R. § 27(c):

> Reports required to be filed by 103.24 shall be filed with the Commissioner of Internal Revenue on or before June 30 of each calendar year with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year.

Mr. Simon argues that the IRS retroactively extended the filing deadline in § 27(c) (and the duty to disclose those accounts on tax returns) for (i) persons with no financial interest in a foreign financial account but with signature or other authority over that account, and (ii) persons with a financial interest in, or authority over, a foreign financial account in which the assets are held in a commingled fund, by Administrative Notice 2010–23 (March 13, 2010) and Administrative Notice 2009–62 (August 31,2009). Such people now have until June 30, 2011 to file FBARs for all calendar years before 2010. Mr. Simon says he filed all of the FBARs that could have been required before his indictment on April 15, 2010 and was in full compliance at the time, and that any earlier failure to file or disclose can't be the basis of any criminal violation of 26 U.S.C. § 7203.

As the government sees it, Mr. Simon doesn't qualify for relief under the IRS notices because he had a financial interest, not just signature authority, in the foreign accounts. Even if he did qualify, the government argues, administrative relief can't change any criminal liability incurred before amendment of the regulation. The government further contends that the notices haven't become final regulations under the Administrative Procedures Act, and that Congress didn't expressly grant retroactive rule-making authority to the Treasury Department under Title 31. Mr. Simon's January 2010 filing of FBARs for 2005–2007, the government says, doesn't absolve him of criminal liability because under the regulations existing at the time the FBARs had to be filed by June 30 of the following year (June 30 of 2006, 2007, and 2008). The government also notes that Mr. Simon never filed an FBAR for 2003 or 2004.

In reply, Mr. Simon argues that he doesn't have a financial interest in Ichua, JS Elekta or Elekta, that 31 C.F.R. § 103.55 gives the Treasury Secretary authority to make exceptions to the reporting requirements, that the exceptions made by the administrative notices were expressly retroactive, and that he wasn't required to file a FBAR for 2004 because the account balance was less than $10,000. No documentation supports his factual assertions.

***16** Whether Mr. Simon had a financial interest in a foreign account is a matter for resolution at trial, not on pretrial motions. The court agrees with the government, though, that if Mr. Simon committed a crime by failing to file an FBAR when the regulations required him to do so, a later regulatory amendment can't absolve him of criminal liability without retroactive modification of the underlying statute. See *United States v. Hark,* 320 U.S. 531, 64 S.Ct. 359, 88 L.Ed. 290 (1944); *United States v. Uni Oil, Inc.,* 710 F.2d 1078, 1086 (5th Cir.1983); *City & County of Denver v. Bergland,* 695 F.2d 465, 480 (10th Cir.1982); *United States v. Resnick,* 455 F.2d 1127, 1134 (5th Cir.1972); *United States v. Masciandaro,* 648 F.Supp.2d 779, 784 (E.D.Va.2009). The statute hasn't been changed.

Mr. Simon argues that the government is mistaken because none of these cases (or the several others the government cites) involved expressly retroactive regulations. Mr. Simon's description of the cited cases is accurate, but the court disagrees with Mr. Simon as to where that distinction leads. To agree with Mr. Simon that a regulation's self-declaration of retroactivity requires a different outcome would be to hold that an agency acquires the power to forgive crimes already committed by simply declaring its intent to exercise that power. The cited cases teach that even if an agency's regulations becomes intertwined in a crime's definition, it is Congress and not the agency that creates the crime, and only Congress can forgive the crime. See also *United States v. U.S. Coin and Currency,* 401 U.S. 715, 737–38, 91 S.Ct. 1041, 28 L.Ed.2d 434 (1971); *Allen v. Grand Central Aircraft Co.,* 347 U.S. 535, 553–555, 74 S.Ct. 745, 98 L.Ed. 933 (1954); *United States v. Curtiss–Wright Export Corp.,* 299 U.S. 304, 332, 57 S.Ct. 216, 81 L.Ed. 255 (1936).

The court denies Mr. Simon's motion to dismiss counts 5 through 8 of the indictment.

VI

For all of these reasons, the court:

1. DENIES the defendant's motion to suppress and motion for *Franks* hearing (Doc. No. 37) in all respects except for the issue of the manner of the warrant's execution and retention of items seized, hearing on which will be scheduled by a separate order;

2. GRANTS the government's oral motion, made at the September 28 hearing, to exclude the presentation, at the hearing concerning the method of execution of the warrant, any expert testimony that the search and/or warrant did or didn't comport with the IRS manual;

3. DENIES the defendant's motion for leave to file affidavit in support of his motion to suppress (Doc. No. 59);

4. DENIES the defendant's motion for bill of particulars (Doc. No. 35);

5. DENIES the defendant's motion to dismiss based on tainted grand jury procedures;

6. DENIES AS MOOT the defendant's motion for disclosure of grand jury transcripts; and

7. DENIES the defendant's motion to dismiss counts 5–8 relating to reports of foreign bank accounts (Doc. No. 36).

SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2010 WL 3980310, 106 A.F.T.R.2d 2010-6739, 2010-2 USTC P 50,680

Footnotes

[1] Actually, one of those categories is "uncategorized." The rest are accounting fees, ATM & cash withdrawals, automobile, bank charges, boat, clothing, "Person One," "Person Two," computer, contributions, education, entertainment, gifts, hair care, household, insurance, interest, legal fees, make-up, medical, miscellaneous, office supplies, photography, postage, rent, service charges, subscriptions, taxes, telephone, and travel.

The "education" category is subdivided into School One, School Two, School Three, lessons, summer camp, and other.

The "household category is subdivided into carpet cleaning, decorating, flowers, furniture, groceries, improvements/repairs, lawn care, mortgage, supplies, utilities, and other.

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2017 WL 1703936
United States District Court,
D. Massachusetts.

UNITED STATES of America, Plaintiff,
v.
Monica TOTH, Defendant.

Civil Action No. 15-cv-13367-ADB
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Signed 05/02/2017

Attorneys and Law Firms

Andrew A. DeMello, United States Department of Justice, Washington, DC, for Plaintiff.

Monica Toth, Weston, MA, pro se.

MEMORANDUM AND ORDER DENYING MOTION TO DISMISS

ALLISON D. BURROUGHS, U.S. DISTRICT JUDGE

***1** The United States of America filed this case to collect a civil penalty assessed against Defendant Monica Toth for her alleged failure to timely report her financial interest in, and/or her signatory or authority over, a foreign bank account for the 2007 calendar year. Currently before the Court is Toth's motion to dismiss [ECF No. 49]. For the reasons explained below, Toth's motion to dismiss is denied.

I. BACKGROUND

At the motion to dismiss stage, the Court accepts as true all well-pleaded facts, analyzes those facts in the light most hospitable to the plaintiff's theory, and draws all reasonable inferences from those facts in favor of the plaintiff. United States ex rel. Hutcheson v. Blackstone Med., Inc., 647 F.3d 377, 383 (1st Cir. 2011). The following facts are taken from the complaint. [ECF No. 1].

In 1999, a bank account was opened in Toth's name at UBS AG in Zurich, Switzerland (the "Account"). The Account has remained open continuously since 1999. At all times since the Account was opened, Toth had a financial interest in the Account and held the authority to control the disposition of the funds in the Account.

This case concerns Toth's tax liability related to the Account for the year 2007. At all times during the 2007 calendar year, Toth was a United States citizen and resident. Toth prepared her own federal income tax return for the year 2007, which she signed under penalty of perjury and filed in a timely manner. Toth failed to report any income or loss from the Account, or otherwise disclose the existence of the Account, in her 2007 return. Toth also failed to file a Financial Bank Account Reports form ("FBAR") prior to June 30, 2008, as required by 31 U.S.C. § 5314 and 31 C.F.R. § 1010.350.

The FBAR is required when a United States citizen has a financial interest in, or signatory or other authority over, any foreign financial accounts that individually or collectively have a maximum value greater than $10,000 during the calendar year. 31 U.S.C. § 5314; 31 C.F.R. § 1010.350. The Government alleges that the Account's balance exceeded $10,000 and that Toth had a financial interest in, and/or signatory or other authority over, the Account at all times during the 2007 calendar year.

Sometime after June 2008, the IRS initiated an audit as to Toth's tax liability for 2007, during which time the IRS investigated matters relating to the Account. As of June 30, 2008, the Account's balance was at least $4,347,407. On September 19, 2013, the Treasury Department assessed a civil penalty (the "FBAR Penalty") against Toth in the amount of $2,173,703, due to Toth's willful failure to disclose the Account to the IRS. Notice of the assessment of the FBAR Penalty and a demand for payment was sent to Toth on or about September 19, 2013. Toth has neglected, refused, or failed to pay the FBAR Penalty.

On September 16, 2015, the United States initiated this action against Toth. [ECF No. 1]. On October 13, 2016, Toth filed a motion to dismiss [ECF No. 49] and memorandum in support [ECF No. 50] arguing that the instant action should be dismissed pursuant to Federal Rules of Civil Procedure 12(b)(2), (4), (5), and (6). The Government filed oppositions on October 27, 2016 [ECF No. 51] and December 14, 2016 [ECF No. 55].

II. LEGAL STANDARDS AND DISCUSSION

a. Toth's motion to dismiss pursuant to Rules 12(b)(4) and (5)

***2** Toth first moves to dismiss this action for insufficient and defective service of process pursuant to Federal Rule of Civil Procedure 12(b)(4) and (5). [ECF No. 49]. She argues that the Government failed to comply with the time limitations of Rule 4(m). [ECF No. 50 at ¶ 20]. "The plaintiff is responsible for having the summons and complaint served" upon the defendant within "120 days after the complaint is filed" unless this time period is extended by the Court following a showing of good cause. Fed. R. Civ. P. 4(c)(1), (m).[1] The complaint was filed on September 16, 2015. [ECF No. 1]. On February 1, 2016, the Government filed its proof of service, indicating that a professional process server had effected service upon Toth pursuant to Massachusetts Rule of Civil Procedure 4(d)(1) on January 11, 2016. [ECF No. 4 at 3]. As Toth was served within "120 days after the complaint [was] filed," the Government complied with the requirements of Federal Rule of Civil procedure 4(m).

Toth also argues that service was insufficient because the Government failed to have her personally served with the summons and complaint. [ECF No. 50 ¶ 19]. "Unless federal law provides otherwise, an individual ... may be served in a judicial district of the United States by ... following state law for serving a summons in an action brought in courts of general jurisdiction in the state where the district court is located or where service is made...." Fed. R. Civ. P. 4(e)(1). Massachusetts Rule of Civil Procedure 4(d)(1) allows for service to be made "by delivering a copy of the summons and of the complaint ... by leaving copies thereof at [the plaintiff's] last and usual place of abode." Mass. R. Civ. P. 4(d)(1). Here, a copy of the summons and complaint were left at Toth's last and usual place of abode, 76 Hallet Hill Road, Weston, Massachusetts.[2] [ECF No. 4 at 3]. Thus, because the Government complied with Massachusetts state law in serving Toth, service was not defective.

b. Toth's motion to dismiss pursuant to Rule 12(b)(2)

Next, Toth moves to dismiss this action for lack of personal jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(2) "because the [Government] failed to reasonably notify [her]." [ECF No. 49]. "A district court faced with a motion to dismiss under Rule 12(b)(2) may choose among several methods for determining whether the plaintiff has met its burden" to prove that the Court has personal jurisdiction over the defendant: "the '*prima facie*' standard, the 'preponderance-of-the-evidence' standard, or the 'likelihood standard.' " Hilsinger Co. v. FBW Invs., 109 F. Supp. 3d 409, 416 (D. Mass. 2015) (citing Daynard v. Ness, Motley, Loadhold, Richardson & Poole, P.A., 290 F.3d 42, 50–51, 51 n.5 (1st Cir. 2002)). "When a district court considers a motion to dismiss for lack of personal jurisdiction without first holding an evidentiary hearing, the *prima facie* standard governs its determination."[3] Id. (citing United States v. Swiss Am. Bank, 274 F.3d 610, 618 (1st Cir. 2001)). "In conducting a *prima facie* analysis, the court is required to take specific facts affirmatively alleged by the plaintiff as true ..., construing them in the light most favorable to the plaintiff...." Id. (citing Ticketmaster-N.Y., Inc. v. Alioto, 26 F.3d 201, 203 (1st Cir. 1994)). "Although the court will construe the facts in the light most favorable to the plaintiff in a motion to dismiss, the plaintiff still has the burden of demonstrating each jurisdictional requirement." Id.

***3** "The *prima facie* showing of personal jurisdiction must be based on evidence of specific facts set forth in the record." Boit v. Gar-Tec Prods., Inc., 967 F.2d 671, 675 (1st Cir. 1992) (citing Kowalski v. Doherty, Wallace, Pillsbury & Murphy, 787 F.2d 7, 9 (1st Cir. 1986)). "The 'plaintiff must go beyond the pleadings and make affirmative proof.' " Id. (quoting Chlebda v. H.E. Fortna & Bro., Inc., 609 F.2d 1022, 1024 (1st Cir. 1979)). Although some circuits "hold that allegations in a complaint, unsupported by any evidence in the record before the court, are sufficient to make a *prima facie* showing of personal jurisdiction so long as the defendant does not present evidence to contradict the allegations[,] ... [i]t has long been the rule of this circuit ... that plaintiffs may not rely on unsupported allegations in their pleadings to make a *prima facie* showing of personal jurisdiction." Id. (internal citations omitted).

"[J]urisdiction based on physical presence alone constitutes due process because it is one of the continuing traditions of our legal system that define the due process standard of 'traditional notions of fair play and substantial justice.' " Burnham v. Super. Ct. of Cal., Cty. of Marin, 495 U.S. 604, 619 (1990). Here, the Government argues that Toth resides within the jurisdiction of this Court. [ECF No. 1 at ¶ 2]. The Government's proof of service of process upon Toth indicates that she was served at 76 Hallet Hill Road, Weston, Massachusetts. [ECF No. 4 at 3]. Toth herself confirms that the process server left "the summons on [her] door." [ECF No. 50 at ¶ 19]. Additionally, all of Toth's pleadings filed in the instant action, including the pending motion to dismiss, identify the Hallet Hill Road address as her primary address. See [ECF Nos. 49 at 2, 50 at 7]. Thus, the Government has gone beyond the pleadings and made affirmative proof that this Court has personal jurisdiction over Toth by way of her physical presence in Massachusetts. Boit, 967 F.2d at 675; Burnham, 495 U.S. at 619.

c. Toth's motion to dismiss pursuant to 12(b)(6)

Finally, Toth moves to dismiss this action for failure to state a claim upon which relief can be granted pursuant to Federal Rule of Civil Procedure 12(b)(6). [ECF No. 49]. To evaluate a Rule 12(b)(6) motion to dismiss for failure to state a claim, the Court must accept as true all well-pleaded facts, analyze those facts in the light most hospitable to the plaintiff's theory, and draw all reasonable inferences from those facts in favor of the plaintiff. United States ex rel. Hutcheson, 647 F.3d at 383. Although detailed factual allegations are not required, a pleading must set forth "more than labels and conclusions." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007). A "formulaic recitation of the elements of a cause of action" is not enough. Id. To avoid dismissal, a complaint must set forth "factual allegations, either direct or inferential, respecting each material element necessary to sustain recovery under some actionable legal theory." Gagliardi v. Sullivan, 513 F.3d 301, 305 (1st Cir. 2008) (internal quotations and citation omitted). Further, the facts alleged, when taken together, must be sufficient to "state a claim to relief that is plausible on its face." A.G. ex rel. Maddox v. Elsevier, Inc., 732 F.3d 77, 80 (1st Cir. 2013) (quoting Twombly, 550 U.S. at 570).

The First Circuit has noted that "[t]he plausibility standard invites a two-step pavane." Id. "At the first step, the court 'must separate the complaint's factual allegations (which must be accepted as true) from its conclusory legal allegations (which need not be credited).' " Id. (quoting Morales-Cruz v. Univ. of P.R., 676 F.3d 220, 224 (1st Cir. 2012)). "At the second step, the court must determine whether the remaining factual content allows a reasonable inference that the defendant is liable for the misconduct alleged." Id. (internal quotations and citation omitted). "The make-or-break standard ... is that the combined allegations, taken as true, must state a plausible, not a merely conceivable, case for relief." Sepulveda-Villarini v. Dep't of Educ. of P.R., 628 F.3d 25, 29 (1st Cir. 2010). "Although evaluating the plausibility of a legal claim requires the reviewing court to draw on its judicial experience and common sense, the court may not disregard properly pled factual allegations, even if it strikes a savvy judge that actual proof of those facts is improbable." Ocasio-Hernandez v. Fortuno-Burset, 640 F.3d 1, 12 (1st Cir. 2011) (internal quotations and citations omitted).

***4** Here, the Government alleges that Toth has violated 31 U.S.C. § 5314 and 31 C.F.R. § 1010.350. 31 U.S.C. § 5314 provides:

> [T]he Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.

31 C.F.R. § 1010.350 provides:

> Each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. [§] 5314 to be filed by such persons. The form prescribed under section 5314 is the Report of Foreign Bank and Financial Accounts (TD-F 90-22.1), or any successor form.

A "United States person" includes both a citizen of the United States and a resident of the United States. 31 C.F.R. § 1010.350(b)(1)–(2). The types of reportable accounts under the regulation include a bank account, securities account, or other financial account.[4] Id. § 1010.350(c). "A foreign country includes all geographical areas located outside of the United States...." Id. § 1010.350(d). "A United States person has a financial interest in each bank, securities or other financial account in a foreign country for which [she] is the owner of record or has legal title." Id. § 1010.350(e)(1). "Signature or other authority means the authority of an individual ... to control the disposition of money, funds or other assets held in a financial account by direct communication ... to the person with whom the financial account is maintained." Id. § 1010.350(f)(1).

Here, the Government has alleged sufficient facts to "allow[ ] a reasonable inference that [Toth] is liable for the misconduct alleged." A.G. ex rel. Maddox, 732 F.3d at 80. The Government has asserted that during the 2007 calendar year, the year in which it alleges that Toth violated the reporting statute, Toth was both a citizen and resident of the United States. [ECF No. 1 ¶ 18]. The Government further alleges that the Account was a "foreign bank account" located in Switzerland, id. at 1–2, ¶ 4, that the Account was held in Toth's name, id. ¶ 4, and that Toth "held the authority ... to control the disposition of the funds in the Account by direct communication ... to UBS AG," id. ¶ 6. The Government also alleges that Toth failed to report "any income or loss from the Account, or otherwise disclose ... the existence of the Account" on her self-prepared 2007 federal income tax return filed with the Internal Revenue Service, id. ¶¶ 13–16, and that Toth failed to file the FBAR by the deadline to file, id. ¶ 17. Thus, the Government has set forth "factual allegations, either direct or inferential, respecting each material element necessary to sustain recovery under" 31 U.S.C. § 5314 and 31 C.F.R. § 1010.350. Gagliardi, 513 F.3d at 305 (internal quotations and citation omitted).

***5** Toth also argues that the fine imposed by the Government violates the Excessive Fines Clause of the Eighth Amendment. "The Secretary of the Treasury may impose a civil money penalty on any person who violates, or causes any violation of, any provision of section 5314." 31 U.S.C. § 5321(5)(A). The penalty may not exceed $10,000 unless the violation is willful. Id. § 5321(5)(B)–(C). Whether Toth, in fact, violated § 5314, and, if so, whether that violation was willful is a question of fact that the Court cannot resolve at this stage. Accordingly, the Court does not address whether the fine to be imposed, if any, violates the Eighth Amendment.

III. CONCLUSION

For the reasons explained above, Toth's motion to dismiss is DENIED.[5]

SO ORDERED.

All Citations

Slip Copy, 2017 WL 1703936, 119 A.F.T.R.2d 2017-1688

Footnotes

[1] All citations to the Federal Rules of Civil Procedure refer to the Rules as they existed on September 16, 2015, the date on which the instant action was commenced. Toth asserts that this case should be dismissed for insufficient and defective service of process because the Government failed to effect service of the summons and complaint within 90 days. [ECF No. 50 at ¶ 20]. Toth refers to the current version of Rule 4(m). On April 29, 2015, the Supreme Court amended the Federal Rules of Civil Procedure, including Rule 4(m). See Order of the Supreme Court of the United States, Apr. 29, 2015, 305 F.R.D. 457 (amending the time for service under Rule 4(m) from 120 days to 90 days). The Supreme Court ordered that the amendments "shall take effect on December 1, 2015, and shall govern all proceedings in civil cases *thereafter* commenced and, insofar as just and practicable, all proceedings then pending." Id. at 460 (emphasis added). Therefore, the current version of Rule 4(m) does not apply in this case, and the United States was entitled to a period of 120 days to complete service.

[2] Toth's own filings in this Court demonstrate that the 76 Hallet Hill Road address is her "last and usual place of abode." See, e.g., [ECF Nos. 49 at 2, 50 at 7].

[3] The heightened standards of "preponderance-of-the-evidence" or "likelihood" govern "[i]n cases that feature conflicting versions of the facts." Hilsinger Co., 109 F. Supp. 3d at 417. Here, the facts related to personal jurisdiction have not been contradicted by Toth.

4 “The term ‘other financial account’ means (i) An account with a person that is in the business of accepting deposits as a financial agency; (ii) An account that is an insurance or annuity policy with a cash value; (iii) An account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association; or (iv) An account with ... [a] mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions....” 31 C.F.R. § 1010.350(c)(3).

5 Toth has included multiple items of correspondence as exhibits to her motion to dismiss. See [ECF No. 50 at 8–10]. Because the Court did not consider these materials in deciding the pending motion to dismiss, the submission of these materials did not convert the motion to dismiss into a motion for summary judgment. See Fed. R. Civ. P. 12(d) (“If, on a motion under Rule 12(b)(6) or 12(c), matters outside the pleadings are presented to and not excluded by the court, the motion must be treated as one for summary judgment under Rule 56.”)

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2016 WL 10647265
United States District Court, C.D. California.

UNITED STATES
v.
Letantia BUSSELL

Case No.: CV 15–02034 SJO (VBKx)
|
Filed 09/15/2016

Attorneys and Law Firms

Indira J. Cameron–Banks, Thomas Derrick Coker, AUSA—Office of US Attorney, Los Angeles, CA, for United States.

Victor Sherman, Law Offices of Victor Sherman, Los Angeles, CA, for Letantia Bussell.

PROCEEDINGS (in chambers): ORDER DENYING DEFENDANT'S MOTION TO REQUIRE THE GOVERNMENT TO ACCEPT DEFENDANT'S TENDERED PAYMENT OF THE FBAR PENALTY [ECF No. 73]

S. JAMES OTERO, UNITED STATES DISTRICT JUDGE

***1** This matter is before the Court on Defendant Letantia Bussell's ("Bussell" or "Defendant") Motion to Require the Government to Accept Defendant's Tendered Payment of the FBAR Penalty ("Motion"), filed on August 3, 2016. The United States ("Government" or "Plaintiff") opposed the Motion ("Opposition") on August 22, 2016. (ECF No. 74.) Bussell filed a reply ("Reply") on August 30, 2016.[1] (ECF No. 75.) The Court found the matter suitable for disposition without oral argument, and vacated the hearing set for September 12, 2016. *See* Fed. R. Civ. P. 78(b). For the following reasons, the Court **DENIES** Defendant's Motion.

I. FACTUAL AND PROCEDURAL BACKGROUND

In 2002, a jury found Bussell guilty of (1) conspiracy in violation of 18 U.S.C. § 371; (2) false statements, false oaths and concealed assets in bankruptcy, and aiding and abetting and causing an act to be done, in violation of 18 U.S.C. § 152(1); and (3) attempt to evade or defeat tax, and aiding and abetting and causing an act to be done, in violation of 26 U.S.C. § 7201. *United States v. Bussell*, Case No. 8:01–cr–00056–AHS ("Criminal Action"), J. & Commitment ("Criminal Judgment" or "Restitution") 1, ECF No. 534.) Pursuant to 18 U.S.C. § 3663, the court imposed a $2,393,527 Criminal Judgment for restitution owing to multiple businesses. (Criminal J. 2–3.) In 2003, the Government recorded notice of this lien in the Los Angeles County Recorder's Office. (Opp'n 2.) The Criminal Judgment was amended in 2005 and 2009, and ultimately Defendant was ordered to pay a special assessment of $300, a fine of $50,000.00, costs of prosecution of $55,626.09, and restitution to non-federal victims totaling $1,200,871.75. (No. 01–cr–56, Amended J. & Commitment, ECF No. 703; Final Order of Restitution Due and Payable by Def. Letantia Bussell, ECF No. 740.) Currently, Defendant makes monthly installment payments of $7,000 towards her Criminal Judgment pursuant to a 2012 order in the Criminal Action. (No. 01–cr–56, Order Increasing Amount Monthly Restitution Payment and Withdrawing Mots., ECF No. 776.) Defendant has made every payment since then. (Decl. of Victor Sherman ("Sherman Decl."), ¶ 9, ECF No. 73.) The outstanding balance of the Criminal Judgment is $411,882.16, of which $294,235.08 is for restitution to non-federal victims and $62,020.99 is for fines and fine interest. (Decl. of Indira J. Cameron–Banks ("Cameron–Banks Decl.") ¶ 1, ECF No. 74–1.)

***2** In 2015, the Government initiated the instant case, seeking to reduce statutory penalties into a civil judgment. After partially granting summary judgment, the Court found that "Pursuant to 31 U.S.C. Section[s] 5321((a)(5)(c) [and 3717(e)(2)], [Bussell was] personally liable and indebted to the United States of America for the Report of Foreign Bank and Financial Accounts ('FBAR') penalty assessment for the year 2006 in the amount of [...] $1,120,513, plus statutory interest accruing from the date of assessment on June 5, 2013, as provided by law, until such obligation is paid in full." (J. Favor of Gov't Against Bussell ("Civil Judgment" or "FBAR Penalty") 1–2, ECF No. 45.) In reaching this conclusion, the Court held that the penalty did not violate Bussell's Due Process rights, yet reduced the fine to comport with the Excessive Fines Prohibition. *See* U.S. CONST. amends. V, VIII. On March 8, 2016, the Government recorded an abstract of this judgment with the Los Angeles County Recorder's

Office. (Opp'n 3.) Currently, the balance on the Civil Judgment is over $1.3 million. (*Id.*)

The real property located at 2285 Worthing Lane, Los Angeles, CA 90077 (“Bussell Home”) is owned by an irrevocable trust (“Trust”) which was settled by Bussell and her husband on December 15, 1992. (Mot. 2). Bussell is a tenant at that property. Karen Tomczyk (“Trustee”) is the current trustee. (Mot. 2.) Since the Trust has authority to pay the debts of its trustor, the Trust seeks to refinance the Bussell Home to pay the Civil Judgment in full. But the Trust is unwilling to pay off the Criminal Judgment. (Sherman Decl. ¶ 9.) The Bussell Home is currently encumbered by the Civil Judgment, preventing refinancing. (Opp'n Ex. C, 1–3 (releasing the Bussell Home from the Criminal Judgment).)

II. DISCUSSION

In the instant Motion, Bussell seeks an Order from the Court compelling the Government to accept her proffered payment of the FBAR penalty adjudicated by the Court on January 11, 2016. (*See generally* Mot.) Bussell moves the Court to allow her to continue paying the Criminal Judgment at the court-ordered $7,000 per month; and to compel the Government to accept tendered payments toward the Civil Judgment. (Mot. 6.) Otherwise, Bussell contends that the Criminal Judgment will dwindle by $7,000 a month while the Civil Judgment grows by $8,000 a month. (Mot. 1.) Bussell asks the Court to order the Government to calculate the total outstanding balance, and to accept full payment within sixty-days. (Proposed Order Compelling Gov't to Accept Def.'s Tendered Payment FBAR Penalty, ECF No. 73–6.)

The Government opposes Bussell's Motion and contends that Bussell must pay the Criminal Judgment in full before payments are applied to the Civil Judgment. (Opp'n 3.) As support for its position, the Government first contends that the statutory scheme favors enforcement of the Criminal Judgment. Second, that because the Criminal Judgment lien is “senior to, and broader than” the Civil Judgment lien, payments should apply to the Criminal Judgment first. (*Id.*) Finally, the Government argues that Bussell has presented insufficient authority for the Court to grant Bussell's requested relief. (Opp'n 5.)

The Court addresses these arguments in turn and ultimately **DENIES** Defendant's Motion.

A. Legal Standard

Title 18 United States Code Section 3612(c) mandates that “[t]he [Government] is responsible for collecting unpaid criminal fines and restitution on behalf of all victims.” 18 U.S.C. § 3612(c). Additionally, the Government may enforce an order of restitution “by all [ ] available and reasonable means.” 18 U.S.C. § 3664(m)(1)(A)(ii). After surveying the statutory scheme, and considering that over $350,000 of the outstanding Criminal Judgment is for fines, fine interest and restitution to non-federal victims, the Court concludes that the Government's position is a reasonable means to ensure enforcement of the Criminal Judgment.

1. Statutory Scheme Favors Enforcement of Criminal Judgments

The Court first addresses Defendant's Motion by examining the statutory scheme regulating the enforcement of civil and criminal judgments. The Government argues that Congress enacted a statutory scheme granting the Government greater authority to collect criminal debts than civil debts. (*See generally* Opp'n 3, n. 1.) For instance, the Civil Judgment “create[s] a lien **on all real property** of [Defendant] on filing a certified copy of the abstract of the judgment in a manner in which a notice of tax lien would be filed ....” 28 U.S.C. § 3201(a) (emphasis added). Whereas, the Criminal Judgment establishes “a lien in favor of the United States **on all property and rights to property** of [Defendant] as if the liability of [Defendant] were a liability for a tax assessed under the Internal Revenue Code of 1986.” 18 U.S.C. § 3613(c) (emphasis added); *see also United States v. Kaczynski*, 551 F.3d 1120, 1125 (9th Cir. 2009) (explaining that a criminal judgment lien arises “automatically upon entry of judgment ... and may be enforced against all property and property rights, regardless of the nature of the property.”). í

***3** Accordingly, it follows that even if the Trust loaned Bussell money to pay off the Civil Judgment, a lien on those funds would automatically arise in favor of the Criminal Judgment. *See* 26 U.S.C. § 6321 (tax lien attaches to “all property and rights to property” of the liable person); *see also Drye v. United States*, 528 U.S. 49, 58–59 (1999) (tax liens attach to insurance proceeds which the taxpayer has a legal right to claim immediately).

In light of this statutory scheme, the Court is satisfied by the reasonableness of the Government's position that any payment above the court-mandated $7,000 monthly payment in the Criminal Judgment must be applied towards the Criminal Judgment before any payments may be applied to the Civil Judgment.

2. The Criminal Judgment Precedes the Civil Judgment

In addition to arguing that the statutory scheme favors the enforcement of criminal liens over civil liens, the Government also contends that Criminal Judgment is also the senior debt. (Opp'n 3.) In the absence of statutory authority to the contrary, the common-law governs the priority of liens under federal law by the rule that "first in time is the first in right." *United States v. Pioneer Am. Ins.*, 374 U.S. 84, 87 (1963); *United States v. McDermott*, 507 U.S. 447, 449 (1993). Since the common-law rule was codified in 28 U.S.C. § 3201(b), the Civil Judgment "has priority over any other lien or encumbrance which is perfected later in time." 28 U.S.C. § 3201(b). Here, however, the Criminal Judgment was perfected in 2003, while the Civil Judgment was not perfected until 2016. Since the Criminal Judgment was entered years before the Civil Judgment, the seniority of the Criminal Judgment also supports a finding of reasonableness.

3. Bussell's Asserted Constitutional Rights Under the Fifth and Eighth Amendments

Without reference to any case law, Bussell also claims that her Fifth and Eighth Amendments compel the granting of her Motion. (Notice of Mot.) Having already concluded that the Government's position is reasonable and appropriate, the Court declines to addresses these arguments.

III. RULING

For the foregoing reasons, the Court **DENIES** Defendant's Motion.

IT IS SO ORDERED.

All Citations

Slip Copy, 2016 WL 10647265, 120 A.F.T.R.2d 2017-6376

Footnotes

[1] Under L.R. 7–10, "[a] moving party may, not later than fourteen (14) days before the date designated for the hearing of the motion, serve and file a reply memorandum, and declarations or other rebuttal evidence." The Court notes that Defendant filed the instant Reply thirteen days before the hearing date, and advises all parties to strictly adhere to any and all future filing deadlines. Despite its untimeliness, the Court considers the arguments contained therein.

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2017 WL 4685252
Only the Westlaw citation is currently available.
United States District Court,
M.D. Florida,
Orlando Division.

UNITED STATES of America, Plaintiff,
v.
Gamal S. BADREG, Defendant.

Case No: 6:17-cv-886-Orl-18TBS
|
Signed 09/28/2017

Attorneys and Law Firms

Joanna L. Barry, US Department of Justice, Washington, DC, for Plaintiff.

ORDER

THOMAS B. SMITH, United States Magistrate Judge

***1** This matter comes before the Court on Plaintiff's Motion for Default Judgment (Doc. 10). Defendant has not opposed the motion and the time within to do so has expired. For the reasons that follow, I respectfully recommend that the motion be **granted**.

I. Background

The government alleges that Defendant, a naturalized United States citizen, operates Vosges of America, Inc. ("Vosges") in Miami, Florida, which sells medical supplies to hospitals in the Middle East (Doc. 1 at ¶ 8). In 2002, Defendant opened (and was the beneficial owner of) a bank account at the Union Bank of Switzerland, now UBS AG (Id. at ¶¶ 10-11). Defendant "made various transfers and check requests for the account ... met with UBS representatives regarding his holdings ... and signed a series of documents requesting that UBS destroy correspondence with him regarding the account" (Id. at ¶¶ 12-13). Most of Vosges' income is derived from Defendant's family's business, Al-Rihan Medical ("Al-Rihan"), which is owned by his sister (Id. at ¶¶ 9, 16). Between 2003 and 2006, an Al-Rihan related entity deposited funds into Defendant's UBS account, and in 2008, Defendant held a high balance of $2,255,890 in the account (Id. at ¶¶ 14-15). The government contends that Defendant transferred the majority of the money to: "(i) another account he held at Emirates Islamic Bank, Dubai; (ii) to Global Vos Tech Int., a company owned by his father (who is now deceased), his mother, and his sister; and (iii) Al-Rihan" (Id. at ¶ 16). In March, 2009, UBS told Defendant that the U.S. Department of Justice was investigating account holders for possible tax evasion and recommended he voluntarily disclose his account information to the government (Id. at ¶ 17). Two months later, Defendant made a final fund transfer to Al-Rihan and closed his UBS account (Id. at ¶ 18).

The government claims that Defendant failed to disclose the UBS account to his accountant until 2011 and failed to include any income from the UBS account on his 2004-2008 year tax returns (Id. at ¶ 20). For example, "[i]n 2008 alone, [Defendant] failed to report [to the Department of Treasury] over $400,000 in income from his UBS account." (Id. at ¶¶ 20-23). "Despite the UBS account having a high balance of more than $2 million in 2008, [Defendant's] late filed [Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts] FBAR for tax year 2008 reported only $903,130.00 and [Defendant] refused to supply any account statements for the UBS account or his account at the Emirates Islamic Bank." (Id. at ¶ 23).

In response to Defendant's refusal to file the mandatory FBAR report for calendar year 2008, the Internal Revenue Service assessed a civil penalty of $100,000.00 against Defendant, pursuant to 31 U.S.C. § 5321(a)(5) (Id. at ¶ 27). Defendant was given notice of the assessment and demand for payment (Id. at ¶ 28). In its complaint, the government acknowledges that since the assessment was levied, Defendant has made several payments to the IRS, however, $68,191.83 (comprised of the penalty and interest) remain unpaid (Id. at ¶¶ 29-30). On May 17, 2017, the government filed this action to reduce the civil penalty to judgment, pursuant to 31 U.S.C. § 5321(a)(5) (Id. at ¶ 30). The government asks the Court to also award accrued interest from December 2, 2016 through the date of payment, as well as court costs and associated fees (Id.).

***2** Defendant failed to respond to the complaint and on June 28, 2017, the government moved for entry of a clerk's default (Doc. 8), which was entered the next day (Doc. 9). Now, the government asks the Court to enter default judgment against Defendant in the amount of $44,191.83 as of July 18, 2017, plus interest accrued through the date of payment (Doc. 10). Defendant has failed to respond to the motion and the time within to do so has expired (Docket).

II. Discussion

A. Entry of Default

As an initial matter, I find that the entry of default by the Clerk was proper. Court clerks are required to enter a defendant's default "[w]hen service of process is properly effected, but the served party fails to respond in a timely manner ..." Kelly v. Florida, 233 Fed.Appx. 883, 885 (11th Cir. 2007) (citing FED. R. CIV. P. 55(a)).

Federal Rule of Civil Procedure 4(e) provides that an individual may be served by giving a copy of the summons and complaint to the individual personally; giving a copy of the summons and complaint to an age-appropriate person who lives at the individual's "dwelling or usual place of abode;" serving a copy on the person's agent "authorized by appointment or by law" to receive process; or by a manner permitted under the laws of the state in which the federal district court is located for an action brought in a court of jurisdiction in that state or in the state wherein service is made. FED. R. CIV. P. 4(e).

The Return of Service on file states that on May 25, 2017, the process server served Saeed Badreg, who is over the age of fifteen, at Defendant's usual place of abode: 9001 Southern Breeze Drive, Orlando, FL 32836. (Doc. 7). Service on this defendant complies with the federal rules (FED. R. CIV. P. 4(e)) and the rules of the State of Florida (FLA. STAT. § 48.031(1)(a)). Pursuant to Federal Rule of Civil Procedure 12, Defendant was required to file a response by June 15, 2017. See FED. R. CIV. P. 12(a)(1)(A)(i). Defendant has not responded to the government's complaint and the time within to do so has expired. Therefore, I find that default was properly entered.

B. Servicemembers Civil Relief Act

The Servicemembers Civil Relief Act ("SCRA") does not bar entry of default judgment against Defendant. The affidavit of the process server confirms that Defendant "is not an active duty member of the U.S. Armed Forces," as defined in 10 U.S.C. § 101(a)(4) (Doc. 7). Defendant's status is further confirmed by the copy of the Department of Defense's "Status Report" and the declaration of Joanna L. Barry, which are both attached to the motion (Doc. 10-2). This is sufficient to satisfy the SCRA's affidavit requirement. See Branch Banking and Trust Co. v. Chalifoux Bus. Park, LLC, Case No. 6:15-cv-2005-Orl-31TBS, 2016 WL 1238746, at *2 (M.D. Fla. Mar. 10, 2016); see also 50 U.S.C. § 3931.

C. Entry of Default Judgment

A district court may enter a default judgment against a properly served defendant who fails to defend or otherwise appear if the factual allegations of the complaint, which are assumed to be true, provide a sufficient legal basis for entry of a default judgment. Nishimatsu Constr. Co. v. Houston Nat'l Bank, 515 F.2d 1200, 1206 (5th Cir. 1975).[1]

A court may enter a default judgment only if the factual allegations of the complaint, which are assumed to be true, provide a sufficient legal basis for entry of a default judgment. Id. In defaulting, a defendant "admits the plaintiff's well-pleaded allegations of fact, is concluded on those facts by the judgment, and is barred from contesting on appeal the facts thus established." Id. "The defendant is not held to admit facts that are not well-pleaded or to admit conclusions of law. In short, despite occasional statements to the contrary, a default is not treated as an absolute confession by the defendant of his liability and of the plaintiff's right to recover." Id. (footnote omitted).

***3** If the facts in the complaint are sufficient to establish liability, then the court must conduct an inquiry to ascertain the amount of damages. See Adolph Coors Co. v. Movement Against Racism & the Klan, 777 F.2d 1538, 1543-44 (11th Cir. 1985). "Damages may be awarded only if the record adequately reflects the basis for the award via a hearing or a demonstration of detailed affidavits establishing the necessary facts." Id. at 1544 (quoting United Artists Corp. v. Freeman, 605 F.2d 854 (5th Cir. 1979) (per curiam)).

1. Well-Pleaded Allegations

United States citizens are required to pay taxes on their gross income, regardless of where it is earned. See

26 U.S.C. § 61(a). To comply with this requirement, individuals must voluntarily report their interests in financial accounts held overseas by completing (a) Schedule B, Part III, Line 7 of the Form 1040 individual tax return and (b) an FBAR, if the balance in the foreign account is greater than $10,000. See 31 C.F.R. § 1010.306(c). The IRS is permitted to assess a civil penalty against any individual who fails to report his interest in a foreign account on an FBAR. See 31 C.F.R. § 1010.810(g). If the individual's failure to pay is deemed to be willful, then the IRS has the discretion to assess a maximum penalty of $100,000 or 50 percent of the balance in the foreign account at the time of the violation, whichever is greater. 31 U.S.C. § 5321(a)(5)(C)-(D).

The well-pleaded allegations of fact in the government's complaint establish that (1) Defendant became a naturalized United States citizen in 2000 and was the owner and operator of a bank account at the Union Bank of Switzerland, now UBS AG; (2) that in 2008, the monthly balance in his account exceeded $2 million; and (3) that he failed to include any of this foreign income on his tax returns or report it on an FBAR, as required by law (Doc. 1 at ¶¶ 7-20). The government further alleges that Defendant willfully attempted to evade the reporting requirement by failing to disclose the foreign account to his income tax preparer, instructing UBS to destroy his correspondence, and by transferring funds and closing the account instead of voluntarily reporting its existence as recommended by UBS (Id. at ¶¶ 13, 18, 20). By virtue of the default, Defendant has admitted the government's well-pled allegations. Nishimatsu, 515 F.2d at 1206. Therefore, I conclude that the government has adequately established its claim that Defendant willfully failed to report the earnings in his Swiss bank account.

2. Damages

The government assessed a civil penalty of $100,000 against Defendant for his willful failure to report; and even though Defendant has made some payments, $44,191.83, of the penalty still remains unpaid (Doc. 10).The amount requested is substantiated by the declarations of IRS revenue agent, Araceli Pardenila and Department of Justice Tax attorney, Joanna L. Barry, as well as the copy of the IRS's certified official record attached to the motion (Doc. 10-1; Doc. 10-2). On this record, I respectfully recommend the Court award the government damages in the amount of $44,191.83, "which represents the penalty plus interest and associated fees." (Doc. 10 at 4; Barry Decl., Doc. 10-2)

D. Costs

In its complaint, the government made a demand for the costs of this action (Doc. 1 at ¶ 30(a)), but no such demand was made in the motion for default judgment. The filing fee was waived (Doc. 1; Docket), and it is unclear what other costs were incurred by the government in the prosecution of this action.

III. Recommendation

***4** Upon consideration of the foregoing, I respectfully recommend that the district judge

(1) **GRANT** the government's motion for default judgment (Doc. 10);

(2) Direct the Clerk to **ENTER** judgment against Defendant in the amount of $44,191.83; and

(3) Give the government fourteen (14) days from the rendition of its order to **SUBMIT** a bill of costs or a notice that it does not seek costs in this action.

IV. Notice to Parties

A party has fourteen days from this date to file written objections to the Report and Recommendation's factual findings and legal conclusions. A party's failure to file written objections waives that party's right to challenge on appeal any unobjected-to factual finding or legal conclusion the district judge adopts from the Report and Recommendation. See 11th Cir. R. 3-1.

RESPECTFULLY RECOMMENDED at Orlando, Florida on September 28, 2017.

All Citations

Slip Copy, 2017 WL 4685252

Footnotes

[1] In Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc), the Eleventh Circuit adopted as binding precedent all decisions of the former Fifth Circuit handed down before October 1, 1981.

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2011 WL 8995
Only the Westlaw citation is currently available.
United States District Court,
N.D. Indiana,
South Bend Division.

UNITED STATES of America
v.
James A. SIMON.

Cause No. 3:10–CR–56(01) RM.
|
Jan. 3, 2011.

Attorneys and Law Firms

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OPINION and ORDER

ROBERT L. MILLER, JR., District Judge.

***1** This matter is before the court on defendant James Simon's renewed motion for judgment of acquittal and alternative motion for new trial [Doc. No. 131]. For the reasons that follow, the court denies his motions.

I. BACKGROUND

A 23–count indictment was handed down in April 2010, charging Mr. Simon with filing false federal income tax returns (Counts 1–4), failing to file foreign bank account reports (FBARs) (Counts 5–8), mail fraud (Counts 9–19), and fraud involving federal financial aid (Counts 20–23). More than seventeen pretrial motions required four hearings, numerous oral rulings [Doc. Nos. 25, 33, 71 and 109], and three detailed written opinions and orders [Doc. Nos. 62, 74 and 100]. Trial began on November 2, 2010. Evidentiary objections were the rule, rather than the exception, during trial, and the court frequently had to restate earlier evidentiary rulings. Mr. Simon seemed to change his theory of defense mid-trial, requiring additional briefing.

On the trial's sixth and final day, the court presented the parties with a proposed set of final jury instructions based on the instructions the court and the parties had tendered before trial, along with an explanation of the sources of those proposed instructions and a set of proposed rulings, and conducted an instruction conference. Pursuant to the court's stated policy, the parties are to tender any proposed jury instructions by the first day of trial. The court, accordingly, denied as untimely the supplemental proposed instructions Mr. Simon tendered at the conference [Doc. No. 122].

Evidence and closing arguments concluded on November 9, final instructions were given, and the jury deliberated for several hours before returning a verdict. The jury found Mr. Simon guilty of Counts 1–4 (filing false tax returns in violation of 26 U.S.C. § 7206(1)), Counts 6–8 (failure to file reports of foreign bank and financial accounts in violation of 31 U.S.C. §§ 5314 and 5322), Counts 9–12, 15, and 17–19 (mail fraud in violation of 18 U.S.C. § 1341) and Counts 20–23 (fraud involving federal financial aid in violation of 20 U.S.C. § 1097). Count 5 was dismissed on the government's motion at the close of its case in chief, and the jury found Mr. Simon not guilty on the mail fraud charges alleged in Counts 13, 14, and 16.

The court denied Mr. Simon's first motion for judgment of acquittal on November 4, at the close of the government's case in chief; and denied his second motion for judgment of acquittal on November 10, at the conclusion of the evidence. [Doc. No. 129]. Mr. Simon now renews his motion for acquittal, asking that the court either vacate the jury's verdict and enter a judgment of acquittal, or alternatively grant him a new trial.

II. STANDARD OF REVIEW

Federal Rule of Criminal Procedure 29(c) governs motions for judgment of acquittal made after a jury verdict. A judgment of acquittal should be entered only "if there is insufficient evidence to sustain the jury's findings." *Unites States v. Murphy,* 406 F.3d 857, 861 (7th Cir.2005)."[A] trial judge should reverse a jury verdict only if, viewing the evidence in the light most favorable to the prosecution, the record contains no evidence on which a rational jury could have returned a guilty verdict." *Id.; see also United States v. O'Hara,* 301 F.3d 563, 569–570 (7th Cir.2002); *United States v. Duprey,* 895 F.2d 303, 310 (7th Cir.1989). Under Federal Rule of Criminal Procedure 29(d)(1), "If the court enters a judgment of acquittal after a guilty verdict, the court must also conditionally determine whether any motion for a new trial should be granted if the judgment of acquittal is later vacated or reversed ... [and] must specify the reasons for that determination."

***2** Federal Rule of Criminal Procedure 33 governs motions for new trial, and provides that: "Upon the defendant's motion, the court may vacate any judgment and grant a new trial if the interest of justice so requires ...." Rule 33 motions are to be granted "sparingly and with caution," and only in "exceptional cases." *United States v. Reed,* 875 F.2d 107, 113 (7th Cir.1989); *see also United States v. DePriest,* 6 F.3d 1201, 1216 (7th Cir.1993); *United States v. Morales,* 902 F.2d 604, 605–606 (7th Cir.1990.

III. DISCUSSION

A. *Renewed Motion for Judgment of Acquittal*

Mr. Simon's renewed motion for judgment of acquittal is premised on arguments previously raised, considered, and rejected. He contends that there was insufficient evidence to prove: (1) that the funds he received from JAS Partners Ltd., Elekta Ltd., JS Elekta Ltd, and Ichua were taxable income that should have been reported; (2) that he acted willfully, knowingly, or intentionally; and (3) that he failed to file timely FBARs. Mr. Simon has presented no new authority or argument that persuades the court that its previous rulings were erroneous.

The government presented sufficient evidence to prove not only that Mr. Simon falsely reported his taxable income on his 2003–2006 returns, but that he falsely reported that he had no financial interest in, or signature or other authority over, financial accounts in foreign countries in those years. The absence of direct evidence of Mr. Simon's state of mind (willfulness, knowledge, or intent) doesn't bar conviction when there is convincing circumstantial evidence supporting the jury's determination, *United States v. Ytem,* 255 F.3d 394, 396 (7th Cir.2001), as there was in this case. The government presented considerable and uncontradicted evidence that the Simons received large sums of money in 2003, 2004, 2005 and 2006 from various business entities that Mr. and/or Mrs. Simon created, owned, and/or controlled; that the funds were transferred from one entity to another before ultimately being deposited in Mrs. Simon's personal checking account; that the Simons used those funds to pay their personal expenses, and that they didn't report any of those funds as income on their 2003–2006 tax returns.

Although Mr. Simon initially argued that the funds were non-taxable loans, he seemed to change course mid-way through trial, arguing instead that the funds were non-taxable distributions of capital. But he provided little evidence to support the loan theory, and no evidence to support a capital distribution theory. The evidence presented at trial was more than sufficient to establish the elements of the offenses charged in the counts of conviction.

The court detailed its reasons for rejecting Mr. Simon's argument with respect to the FBARs in the Opinion and Order issued on October 8, 2010 [Doc. No. 62], and finds no basis for reconsidering that decision now.

B. *Motion for New Trial*

***3** Mr. Simon argues, in the alternative, that he is entitled to a new trial under Federal Rule of Criminal Procedure 33 because the court erred when it: (1) denied his pretrial motions for change of venue, to suppress evidence seized during the search of his home, to dismiss the indictment in its entirety, and to dismiss the counts relating to foreign bank account reports (FBARs) in particular; (2) excluded his proffered evidence and testimony concerning the nature and character of the funds as non-taxable distributions—specifically, the testimony of Howard Richshafer and Herbert Long; and (3) failed to properly or adequately instruct the jury and rejected the defendant's proposed jury instruction with respect to the theory of defense (that the funds were non-taxable distributions) and his proposed instruction on good-faith reliance.

For the reasons stated in open court at the hearing on June 10, 2010, and in the Opinion and Orders issued on October 8 and October 20, 2010 [Doc. Nos. 62 and 74], the court rejects Mr. Simon's argument that it erred in denying his pretrial motions to change venue [Doc. No.

14]; to suppress and for an evidentiary hearing pursuant to *Franks v. Delaware* [Doc. No. 37], to dismiss the indictment based on tainted grand jury proceedings [Doc. No. 41], and to dismiss counts relating to reports of foreign bank accounts [Doc. No. 36].

The court already has considered Mr. Simon's arguments with respect to the admissibility of Mr. Richshafer's and Mr. Long's testimony, and stated its reasons for excluding their testimony on the record in open court on November 1 and November 5, 2010. Mr. Simon presented no authority then or now that warrants reconsideration of the court's earlier rulings. An expert may provide an opinion to help the jury understand the facts, but he may not give testimony stating ultimate legal conclusions based on those facts, or "usurp either the role of the trial judge in instructing the jury as to the applicable law or the role of the jury in applying that law to the facts before it." *United States v. Bilzerian,* 926 F.2d 1285, 1294 (2d Cir.1991); *accord, Good Shepard Manor Found. Inc. v. City of Momence,* 323 F.3d 557, 564 (7th Cir.2003) ("expert tetimony as to legal conclusions that will determine the outcome of the case is inadmissible"); *United States v. Sinclair,* 74 F.3d 753, 757–58 n. 1 (7th Cir.1996) ("Federal Rules of Evidence 702 and 704 prohibit experts from offering opinions about legal issues that will determine the outcome of a case."); *Panter v. Marshall Field & Co.,* 646 F.2d 271, 294 n. 6 (7th Cir.1981) ("It is not for witnesses to instruct the jury as to applicable principles of law, but the judge.").

Mr. Simon's challenges to the adequacy of the jury instructions in this case are similarly without merit. The court requires the parties to tender proposed jury instructions by the first day of trial. When Mr. Simon tendered supplemental instructions [Doc. No. 122] on the last day of trial, the court denied them as untimely. Even had they been submitted in a timely fashion, the instructions must be correct statements of the law that are supported by the evidence. They were not.

***4** The court carefully considered Mr. Simon's arguments, has given detailed reasons for rejecting them, and believes that it properly ruled on each of the issues raised. Mr. Simon hasn't presented any authority or identified any error or circumstance that would warrant reconsideration at this stage of the proceedings or a new trial.

IV. CONCLUSION

For these reasons, the court DENIES Mr. Simon's renewed motion for a judgment of acquittal and alternative motion for new trial [Doc. No. 131].

SO ORDERED.

All Citations

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2016 WL 3597579
United States District Court,
N.D. Indiana, South Bend Division.

United States of America
v.
James A. Simon.

CAUSE NO.:3:14-CV-2025-RLM
|
Signed 07/05/2016

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OPINION AND ORDER

Robert L. Miller, Jr., Judge

***1** In November 2010, a jury found James A. Simon guilty of filing false tax returns, failing to report his interest in foreign bank accounts, mail fraud, and federal financial aid fraud. The court sentenced Mr. Simon to a total of 72 months imprisonment to be followed by three years of supervised release, and the court of appeals affirmed the conviction and sentence. Mr. Simon now moves to vacate, set aside, or correct his sentence under 28 U.S.C. § 2255. For the reasons that follow, the court denies Mr. Simon's motion.

I. BACKGROUND

The factual background underlying Mr. Simon's conviction is set out in detail in the court of appeals' opinion denying Mr. Simon's direct appeal. United States v. Simon, 727 F.3d 682 (7th Cir. 2013). Because Mr. Simon's "business dealings require a flowchart to unravel," id. at 683, the court recites only the facts needed to resolve the specific arguments Mr. Simon raises in his § 2255 motion.

Mr. Simon was a certified accountant, professor of accounting, and entrepreneur with interests in several businesses and entities. One of those ventures was JAS Partners, a domestic limited partnership in which Mr. Simon and his wife each had a one percent partnership stake and the Cook Islands-based Simon Family Trust owned the other 98 percent. Another of Mr. Simon's ventures was Elekta Ltd., a corporation chiefly owned by Mr. Simon's retired sisters but entrusted wholly to Mr. Simon's management. Elekta owned nineteen percent of a third venture that Mr. Simon managed, JS Elekta. JS Elekta in turn owned 75 percent of a fourth business, Ichua Company, also managed by Mr. Simon. Of those four businesses over which Mr. Simon had signature authority, three – Elekta, JS Elekta, and Ichua – were foreign entities possessing foreign bank accounts.

This case is about money that Mr. Simon paid to himself from those four entities and from another domestic venture, William R. Simon Farms. Between 2003 and 2006, Mr. Simon (or his immediate family members) received about $1.8 million combined from the businesses, which Mr. Simon spent on personal and family expenses and recorded as loans in his personal financial records. No promissory notes existed for these purported loans, and Mr. Simon paid no interest to the companies that made them. He repaid a small portion of the principal to JAS Partners after becoming aware of the government's investigation into his finances. He reported none of this money as income on his tax returns. In 2005 Mr. Simon paid less than $400 in taxes, and in each of the other three years between 2003 and 2006 he paid no taxes at all and claimed a refund. None of the tax returns disclosed that Mr. Simon had interests in or control over foreign bank accounts. Mr. Simon prepared and filed these tax returns himself.

During these years, Mr. Simon filled out need-based financial aid applications for the private schools his children attended. On these applications, he reported that he had no or very little income, suffered large debts or losses, spent no money on clubs or vacations, had only a few thousand dollars of assets, was in a precarious financial situation due to business failures and litigation, and had enough money to keep him "afloat but barely." These representations were all false: Mr. Simon had the payments from his businesses, spent lavishly on several expensive club memberships, and could afford vacations to Europe and Disney World in addition to a comfortable lifestyle for himself and his family. Based solely on these applications and the tax forms Mr. Simon submitted, the schools gave the Simon family a total of $120,000 in need-based financial aid. Mr. Simon also filled out federal “FAFSA” financial aid applications for one of his daughters to attend college. As he did on his private financial aid applications, Mr. Simon reported minimal gross income and assets on the FAFSA application.

***2** In November 2007, IRS agents searched Mr. Simon's house pursuant to a warrant. Mr. Simon hired attorneys soon after that and began preparing a defense to possible charges. His attorneys hired a team of investigators and conducted their own investigation into Mr. Simon's finances, including interviewing the people already interviewed by government agents. Mr. Simon's defense team also met with prosecutors to discuss the probable charges, to guide their planning of colorable defenses.

In April 2010, Mr. Simon was charged in a 23-count indictment. Counts 1-4 alleged that Mr. Simon filed false tax returns for the years 2003-2006. The tax returns were allegedly false in that they underreported income, and in that they didn't check the “yes” box of Line 7a on Schedule B to IRS Form 1040. The question associated with Line 7a asked whether Mr. Simon had any interest in or authority over foreign accounts. Counts 5-8 charged Mr. Simon with failing to file forms called Reports of Foreign Bank and Financial Account, or “FBARs,” for the years 2004-2007. FBARs concern foreign financial accounts, and a person is required to file them if he or she has an interest in or signature authority over foreign accounts worth more than $10,000. Counts 9-19 charged Mr. Simon with mail fraud related to the need-based financial aid applications he made to the private schools his children attended. Those counts alleged that Mr. Simon underreported his income on the forms, and that the tax returns he attached were fraudulent for the same reasons as alleged in counts 1-4. Counts 20-23 charged Mr. Simon with federal financial aid fraud based on the FAFSA forms he filled out on his daughter's behalf. The FAFSA application required Mr. Simon to include information from his tax returns; if the tax returns were false (as alleged in counts 1-4), the aid applications were fraudulent as well.

At trial, Mr. Simon's defense to the tax fraud counts was generally that the $1.8 million he received from his business entities wasn't taxable income. He primarily characterized the money as funds loaned to him legitimately by his businesses, and which he intended to pay back. He suggested in the alternative that the payments could be considered nontaxable partnership distributions rather than taxable income. With regard to not checking the “yes” box on the part of Schedule B of his tax returns asking whether he had interest in or control over any foreign bank accounts, Mr. Simon's defense was that he used TurboTax software to automatically fill out his tax forms. Based on how he answered the program's questions, the program didn't ask him anything about foreign accounts. His defense as to the FBAR reporting requirements was that the requirements were confusing, and in any case filing or not filing them had no effect on tax liability so there would be no reason for him to intentionally conceal his control over the foreign accounts. With regard to the mail fraud and financial aid fraud counts, Mr. Simon's defense was that if the jury accepted his explanations on the tax and FBAR issues – that the money wasn't taxable income and he didn't think he had to file the FBARS – then none of the statements on the financial aid applications were false. In addition, for the private financial aid applications, even if his statements about his income and assets were false they weren't materially so; because his children were high-performing academically, the schools wanted them to attend and essentially made price concessions on tuition. He argued that the schools themselves had instructed him to just estimate the information on the forms, because the answers wouldn't really affect the amount of tuition his family would have to pay.

***3** After a six-day trial, the jury mostly rejected these explanations. The jury found Mr. Simon not guilty of three of the mail fraud counts but guilty as to the other twenty counts in the indictment. The court sentenced Mr. Simon to an aggregate term of 72 months imprisonment and an aggregate term of 3 years of supervised release. [1] The court of appeals affirmed the conviction in all respects, and Mr. Simon timely filed this motion to vacate under § 2255.

A federal prisoner can challenge his sentence on the ground that the sentence was “imposed in violation of the Constitution or laws of the United States, or that the court was without jurisdiction to impose such sentence, or that the sentence was in excess of the maximum authorized by law, or is otherwise subject to collateral attack.” 28

U.S.C. § 2255. Mr. Simon is entitled to relief under § 2255 only if he can show a "fundamental defect which inherently results in a complete miscarriage of justice," United States v. Addonizio, 442 U.S. 178, 185 (1979), or "an omission inconsistent with the rudimentary demands of fair procedure," Hill v. United States, 368 U.S. 424, 428 (1962).

Issues not argued and decided on direct appeal can't ordinarily be raised in a § 2255 petition unless the petitioner can show good cause and actual prejudice for the procedural default. Galbraith v. United States, 313 F.3d 1001, 1006 (7th Cir. 2002). Claims of ineffective assistance of counsel are an exception, and can still be argued in a § 2255 petition even if not raised on direct appeal. *See* Massaro v. United States, 538 U.S. 500, 504 (2003) (holding that "an ineffective-assistance-of-counsel claim may be brought in a collateral proceeding under § 2255, whether or not the petitioner could have raised the claim on direct appeal.").

The court in which a § 2255 motion is brought must hold an evidentiary hearing if affidavits or other competent proof establishes a dispute as to a material factual issue. *See* Taylor v. United States, 287 F.3d 658, 660 (7th Cir. 2002). An evidentiary hearing isn't required if "the motion and files and records of the case conclusively show that the petitioner is entitled to no relief," 28 U.S.C. § 2255 (2012), or if the petitioner's factual allegations are purely speculative. *See* Gallo-Vasquez v. United States, 402 F.3d 793, 797 (7th Cir. 2005) ("[A] hearing is not necessary if the petitioner makes conclusory or speculative allegations rather than specific factual allegations.") (alteration in original) (internal quotation marks omitted).

Based on Mr. Simon's § 2255 motion and the record of this case, the court concludes that the factual and legal issues raised can be resolved on the record and no hearing is necessary. *See* Menzer v. United States, 200 F.3d 1000, 1006 (7th Cir. 2000) (holding that a hearing is not required where the record conclusively demonstrates that a petitioner is entitled to no relief on his § 2255 motion). Even accepting all relevant facts as Mr. Simon alleges them, he hasn't shown that he is entitled to relief.

II. DISCUSSION

Mr. Simon brings two general claims, both grounded in the allegation that his trial counsel provided constitutionally ineffective assistance. The Sixth Amendment guarantees criminal defendants the right to constitutionally sufficient representation by an attorney. This right provides for only "a professionally competent defense, not for the best possible defense." Rutledge v. United States, 230 F.3d 1041, 1053 (7th Cir. 2000) (quoting Holman v. Gilmore, 126 F.3d 876, 883 (7th Cir. 1997)). To prevail on an ineffective assistance of counsel claim, Mr. Simon must show both that his attorneys' performance "fell below an objective standard of reasonableness" and that there is a reasonable probability that, but for his attorneys' errors, the result of the proceeding would have been different. Strickland v. Washington, 466 U.S. 668, 688-693 (1984). This is a difficult standard to meet; to prevail, Mr. Simon must show both "that counsel made errors so serious that 'counsel' was not functioning as the counsel guaranteed the defendant by the Sixth Amendment" and "that counsel's errors were so serious as to deprive [Mr. Simon] of a fair trial, a trial whose result is reliable." Strickland v. Washington, 466 U.S. at 687; *see also* Kimmelman v. Morrison, 477 U.S. 365, 374 (1986) ("The essence of an ineffective-assistance claim is that counsel's unprofessional errors so upset the adversarial balance between defense and prosecution that the trial was rendered unfair and the verdict rendered suspect.").

***4** With regard to the performance prong of the Strickland inquiry, there is a strong presumption that counsel performed effectively. *See* Berkey v. United States, 318 F.3d 768, 772 (7th Cir. 2003). "A court's scrutiny of an attorney's performance is 'highly deferential' to eliminate as much as possible the distorting effects of hindsight, and we 'must indulge a strong presumption that counsel's conduct falls within the wide range of reasonable professional assistance.' " Vinyard v. United States, 804 F.3d at 1225 (quoting Strickland v. Washington, 466 U.S. at 687). The reasonableness of counsel's performance must be evaluated "from counsel's perspective at the time of the alleged error and in light of all the circumstances" known to counsel at the time. Kimmelman v. Morrison, 477 U.S. at 381. An attorney's performance is judged holistically, and even a clear mistake doesn't amount to constitutionally ineffective assistance where the attorney's performance was competent on the whole. *See* Dahler v. United States, 143 F.3d 1084, 1086 (7th Cir. 1998) (noting that "it is essential to examine the attorney's entire work product; an isolated slip-up in an otherwise competent representation does not violate the sixth amendment"). Because reviewing courts shouldn't second-guess counsel's strategic choices, the burden of showing that counsel's decisions fell outside the wide range of reasonable strategic choices "rest[s] squarely on the defendant." Burt v. Titlow, 134 S. Ct. 10, 12, 187 L.Ed. 2d 348 (2013). "The question is whether an attorney's representation amounted to incompetence under prevailing professional norms, not whether it deviated from best practices or most common custom." Makiel v. Butler, 782 F.3d 882, 897 (7th Cir. 2015) (internal quotation marks omitted).

"Even if counsel's performance was deficient, a petitioner must also show that 'there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different,' meaning 'a probability sufficient to undermine confidence in the outcome.' " Eckstein v. Kingston, 460 F.3d 844, 848 (7th Cir. 2006) (quoting Strickland, 466 U.S. at 694). While a petitioner must do more than just show that counsel's errors had some conceivable effect on the outcome, he "need not show that counsel's deficient conduct more likely than not altered the outcome in the case." Strickland, 466 U.S. at 693. "In weighing the effect of counsel's errors, the court must consider the totality of the evidence...A verdict or conclusion that is overwhelmingly supported by the record is less likely to have been affected by errors than one that is only weakly supported by the record." Eckstein v. Kingston, 460 F.3d at 848 (quoting Hough v. Anderson, 272 F.3d 878, 891 (7th Cir. 2001)).

Both the performance and prejudice prongs of the Strickland inquiry must be satisfied before a prisoner is entitled to relief, and if a claim fails under either prong the claim fails and the court need not address the remaining prong. *See* United States v. Taylor, 569 F.3d 742, 748 (7th Cir. 2009) ("Courts may deny ineffective assistance of counsel claims for lack of prejudice without ever considering the question of counsel's actual performance."); Milone v. Camp, 22 F.3d 693, 703 (7th Cir. 1994) ("The Court need not address both Strickland prongs if it is clear that [the petitioner] cannot satisfy one of them").

As an initial matter, both Mr. Simon and the government focus heavily on matters that aren't actually material to resolving the claims in the § 2255 motion. The government points extensively to outward indicia of diligence on the part of Mr. Simon's lawyers – the number of attorneys Mr. Simon had, the quantity of investigators and experts they hired, the sheer volume of pretrial, mid-trial and post-trial motions, and the extensive presentation of evidence at trial and sentencing. The government is correct that the constitutional effectiveness of trial counsel should be examined holistically. "Isolated errors do not constitute ineffective assistance if the attorney's work product taken as a whole demonstrates competence." Rutledge v. United States, 230 F.3d 1041, 1053 (7th Cir. 2000).

But sheer activity doesn't equate to constitutional effectiveness. A large, expensive defense team filing a flurry of motions might still be ineffective if their decision making on a critical point falls below an objective standard of reasonableness, just as a single attorney doing nothing other than negotiating a quick plea can be constitutionally effective. *See* Premo v. Moore, 562 U.S. 115, 123-125 (2011). Pointing to all the dust Mr. Simon's attorneys kicked up before and during trial doesn't resolve the question of whether some specific acts or omissions fell below a professional standard of reasonableness such that Mr. Simon was denied the effective assistance of counsel.

***5** At the same time, Mr. Simon makes voluminous factual allegations and arguments about the defense team's pre-trial game plan and whether his attorneys followed it. Mr. Simon insists that his pretrial agreement with his attorneys as to what defense they would pursue is relevant because it shows his counsel knew the agreed-on defense to be the best available one. Even if Mr. Simon is correct that he and counsel agreed on a strategy before trial and that the strategy eventually pursued at trial deviated from that plan, that doesn't show ineffectiveness. For one thing, whether his attorneys provided the "best" available defense isn't the issue in a § 2255 motion, because "[t]he Constitution calls for a professionally competent defense, not for the best possible defense." Rutledge v. United States, 230 F.3d 1041, 1053 (7th Cir. 2000). For another thing, which strategy appears optimal might shift over time. "Trial tactics are a matter of professional judgment" and a reviewing court "will not play 'Monday morning quarterback' when reviewing claims that an attorney rendered constitutionally deficient representation in making decisions on how to best handle a case." United States v. Malone, 484 F.3d 916, 920 & n. 1 (7th Cir. 2007).

There are countless legitimate strategic reasons an attorney might plan out a particular theory of the case before trial yet abandon it once proceedings are underway. A competent criminal defense attorney must adjust as the government's case unfolds and as government witnesses tell their story and experience cross examination. The need to see and experience those developments usually prevents pretrial plans from being set in stone. *See* Blake v. United States, 723 F.3d 870, 879 (7th Cir. 2013) ("Counsel's performance is to be evaluated in light of the discretion properly accorded an attorney to develop appropriate trial strategies according to the attorney's independent judgment, given the facts of the case, at least some of which may not be reflected in the trial record."). Concerns such as these occasionally lead experience criminal defense counsel to waive or defer opening statements.

In short, whether Mr. Simon got the defense he expected isn't at issue – the court asks only whether the defense he actually got passes constitutional muster. For this reason, the "factual disputes" that Mr. Simon believes entitle him to an evidentiary hearing don't. His affidavit and his counsel's affidavit present different stories about how and why various defense decisions were made, but resolving those disputes isn't necessary. In ruling on a § 2255 motion, the court looks at constitutional effectiveness from an "objective standard of reasonableness" – the question is whether there could have been *any* sound strategic reason for a particular act or decision, not what an attorney was actually thinking when making the choice. *See* Cullen v. Pinholster, 563 U.S. 170, 196 (2011) (emphasizing that Strickland mandates a strong presumption of reasonableness, so a court reviewing an ineffectiveness claim is "required not simply to give [the] attorneys the benefit of the doubt, but to affirmatively entertain the range of possible reasons [counsel] *may have had* for proceeding as they did.") (internal quotation marks and citations omitted) (emphasis added); *see also* Harrington v. Richter, 562 U.S. 86, 110 (2011) (holding that Strickland "calls for an inquiry into the objective reasonableness of counsel's performance, not counsel's subjective state of mind.").

Mr. Simon first alleges that his counsel mistakenly thought the defense could call experts to testify as to principles of tax law, and so neglected to prepare jury instructions on the relevant legal principles. The jury therefore never heard a critical part of Mr. Simon's defense, specifically that any mischaracterization of the payments he received wasn't willful because other alternative tax treatments for the payments would have had the same result. His second claim alleges several different alleged errors by trial counsel which cumulatively impeded Mr. Simon's attempt to present his defenses to the jury.

A. Ineffectiveness related to Mr. Simon's proposed willfulness-based defense

***6** As Mr. Simon describes it, his "primary contention is that he received ineffective assistance because trial counsel failed to provide timely and adequate law to the court." In essence, he argues that he wanted to make a good-faith defense to the charge that he underreported his income on his tax returns, but his counsel made a fatal legal error that prevented him from presenting the legal basis for his planned defense to the jury.

According to Mr. Simon, counsel had always planned on a two-pronged defense to the portions of the tax fraud charges in counts 1-4 based on underreported income. First, counsel would argue that there was nothing false about the tax returns because the payments not reported as income were in fact legitimate nontaxable loans from the businesses to Mr. Simon. The argument would be that Mr. Simon honestly considered these legitimate loans, and intended to repay them. Second, counsel would argue that even if Mr. Simon was wrong to consider the payments nontaxable loans, the mistake couldn't have been willful because the payments would have been untaxable no matter how they were characterized. If the money didn't properly qualify as loans, it would have been either partnership distributions or advances on reimbursements for expenses that Mr. Simon paid on behalf of the businesses – and neither of those would have changed the tax treatment, because partnership distributions and reimbursements are both non-taxable. In other words, if the jury rejected his argument that the loans were legitimate, Mr. Simon wanted it to infer that he must not have *intentionally* lied about the payments because there would have been no tax benefit to doing so; at worst his mischaracterization of the money as loans was an honest mistake, because he would have owed no taxes on the payments no matter how they were classified. Mr. Simon emphasizes that he never intended "to present alternative or contradictory" defenses that the money was either loans *or* partnership distributions *or* expense reimbursements. Rather, he believes his attorneys should have presented the following "common sense" question to the jury: "why would [Mr. Simon] willfully mischaracterize the money as loans, which ultimately caused him to owe significant taxes, when he could have characterized the money as a partnership distributions [sic] or even income and owed none?"

For jurors to understand and accept that defense, they'd need to know how the tax laws treat all those different categories of payments. The proper way to educate the jury about tax law principles is by submitting timely and legally correct jury instructions, not by calling expert witnesses; only the court can instruct the jury on the law, and expert witnesses can't generally testify as to what the law is or whether someone's conduct was or wasn't lawful. *See* United States v. Jungles, 903 F.2d 468, 477 (7th Cir. 1990). Mr. Simon's attorneys tried to call tax law professionals as expert witnesses, telling the court that the witnesses would opine on how the tax laws treat various types of payments and whether the payments at issue here were taxable. The court refused to permit such testimony, a holding that was upheld on appeal. *See* United States v. Simon, 727 F.3d 682, 697 (7th Cir. 2013) ("The court was correct to preclude any witness from generally explaining the law to the jury.").

After the witnesses' testimony was excluded, the only available course for Mr. Simon's attorneys was to propose jury instructions supporting his theory of defense. Because his counsel thought they could call experts instead, Mr. Simon says, they were caught off guard when the experts were excluded and didn't have time to formulate adequate jury instructions. Counsel submitted jury instructions on how partnership distributions and expense reimbursements are treated under the tax laws, but didn't do so until the final day of trial. The court refused to give the instructions because they were untimely, and also because they were inadequate; they didn't explain to the jury how to calculate Mr. Simon's basis in JAS Partners, and without knowing Mr. Simon's basis the jury couldn't have determined whether distributions from the partnership were nontaxable. Accordingly, the jury was left without any instruction on how the tax laws applied to partnership distributions and reimbursements or expense advances, and Mr. Simon argues that this left him without a full defense.

***7** "An attorney's ignorance of a point of law that is fundamental to his case combined with his failure to perform basic research on that point is a quintessential example of unreasonable performance under Strickland." Hinton v. Alabama, 134 S. Ct. 1081, 1089 (2014). Mr. Simon believes that his attorneys made such a fundamental misstep, erroneously believing that experts could testify as to what the law is and thus squandering the chance to prevent a meritorious defense. He argues that the attorneys clearly didn't make a strategic choice to jettison the good-faith defense based on alternative characterizations of the payments as partnership distributions or reimbursements, because they *tried* to present this defense and were only prevented from doing so by their own elementary legal mistakes. He insists that his attorneys couldn't have strategically chosen to call experts to testify on the law because such experts would obviously be excluded by the court, and they couldn't have strategically chosen to submit untimely and inadequate jury instructions.

That Mr. Simon's counsel wound up on the wrong side of an evidentiary ruling doesn't mean that they made a fundamental legal error that prevented Mr. Simon from mounting a full and reasonable defense. Counsel doesn't act deficiently simply by pushing the envelope. There is an obvious strategic logic in at least trying to admit favorable but likely inadmissible evidence, or proposing favorable but likely improper jury instructions; if successful such efforts might secure the defendant an unreviewable acquittal, and if unsuccessful there's no real cost to the defendant. Mr. Simon is certainly correct that there is never a valid strategic reason to submit untimely jury instructions as opposed to timely ones, but his argument that this mistake made his trial unfair presupposes that there was *any* legally valid way to present his chosen defense to the jury. In fact, there was not. The court wouldn't have permitted Mr. Simon's preferred good-faith defense to be presented to the jury even if his attorneys had submitted timely and correct jury instructions, because the defense Mr. Simon wanted to raise would have been wholly speculative given the evidence at trial. Even if his attorneys made a mistake by submitting jury instructions too late, this error couldn't possibly have prejudiced Mr. Simon because the instructions would have been rejected even if timely.

"A defendant is entitled to an instruction on his theory of defense only if '(1) the instruction provides a correct statement of the law; (2) the theory of defense is supported by the evidence; (3) the theory of the defense is not part of the government's charge; and (4) the failure to include the instruction would deprive the defendant of a fair trial.' " United States v. Campos, 541 F.3d 735, 744 (7th Cir. 2008) (quoting United States v. Millet, 510 F.3d 668, 675 (7th Cir. 2007)). Mr. Simon's theory doesn't meet the second criterion, because it was wholly speculative. To convict Mr. Simon on counts 1-4, the government was required to prove only that he filed a return that he did not believe was true and correct to "every material matter." United States v. Pansier, 576 F.3d 726, 736 (7th Cir. 2009). Accordingly, the focus is on Mr. Simon's own knowledge and intent; if he characterized the money as loans and the jury found that he knew the loans weren't legitimate, it is no defense that other hypothetical characterizations of the money unknown to Mr. Simon might have been available that could have resulted in no tax liability. Wholly hypothetical or speculative mental state defenses such as the one Mr. Simon now insists his attorneys should have mounted are often raised, but routinely excluded. *See, e.g.*, United States v. Zayyad, 741 F.3d 452, 460 (4th Cir. 2014) ("If the defendant wants to present a theory or belief that might have justified his actions, then he must present evidence that he in fact relied on that theory or belief."); United States v. Curtis, 782 F.2d 593, 599 (6th Cir. 1986) ("Willfulness is personal. It relates to the defendant's state of mind. It does not exist in the abstract. Unless there is a connection between the external facts and the defendant's state of mind, the evidence of the external facts is not relevant.").

***8** In United States v. Kokenis, 662 F.3d 919 (7th Cir. 2011), the defendant controlled a number of corporations and business entities and was charged with filing false tax returns by not reporting various payments as income. Id. at 922-926. The defendant wanted to call tax experts to testify about an obscure "pool of capital" accounting theory under which the payments at issue could have been excluded from taxable income, and wanted to argue that the pool of capital theory "would have provided a layer of credibility to [his] argument that he did not act willfully" in characterizing the money as nontaxable. Id. at 929-930. The district court refused to admit this testimony and declined to give a jury instruction on good faith. The court of appeals affirmed, noting that whether the "pool of capital" theory might have been available to the defendant was irrelevant to whether he willfully filed false returns, because the "mere existence of the theory without evidence of [the defendant's] knowledge of and reliance on the theory is insufficient to support the assertion of good faith." Id. at 928. Because there was "no evidence that he actually relied on the pooling capital theory," the defendant's proffered evidence "would be irrelevant, confusing, and perhaps even misleading." Id.

Mr. Simon's situation is much the same. He wanted to argue that his failure to list the payments as income wasn't willful because several possible characterizations of the payments would have resulted in no tax liability to him. But there was no evidence that Mr. Simon relied on these alternate possible bases for escaping tax liability, and no evidence that he ever considered the possibility of characterizing the payments as partnership distributions or expense reimbursements. A defendant "only needs to demonstrate a foundation in evidence, 'however tenuous,' to support his theory, but a 'mere scintilla of evidence...is not sufficient to warrant a defense instruction.' " United States v. Canady, 578 F.3d 665, 672–73 (7th Cir. 2009) (quoting United States v. Buchmeier, 255 F.3d 415, 427 (7th Cir. 2001)). Not only could Mr. Simon point to nothing suggesting that he relied on the alternative income characterizations when deciding not to report the payments as income, there was affirmative evidence to the contrary. Mr. Simon consistently recorded the payments as loans in his own records, noted them as loans on the tax returns of the businesses making the alleged loans, and characterized them as loans in UCC documents and bankruptcy filings. This evidence that Mr. Simon exclusively categorized the payments as loans negates any possible inference that he might have relied on a good faith belief that the payments were something else. Like the defendant in Kokenis, Mr. Simon "seems to be asserting that just because there may be evidence to show that someone could have had a good-faith belief that he wasn't violating the law, then he should be able to present such evidence to the jury. Not so. Without any connection to his state of mind, such evidence is irrelevant." Kokenis, 662 F.3d at 930; *see also* United States v. Trudeau, 812 F.3d 578, 591 (7th Cir. 2016) ("When a defendant offers nothing but speculation to link a piece of evidence to his state of mind, the evidence is properly excluded unless the defendant offers corroboration that the evidence *in fact* influenced his mental state.") (emphasis in original).

Moreover, there was no prejudice to Mr. Simon. The government points out that there was even less justification for treating the payments as partnership distributions or expense reimbursements than there was for treating them as loans; the loan-based defense truly was the only one with even a shadow of support in the record. It's unlikely the jury would have credited Mr. Simon's willfulness defense had it been presented to them, because the record didn't actually support characterizing the payments as the alternate forms of nontaxable transfers Mr. Simon proposes. It isn't necessary to review the problems with a partnership or reimbursement-based defense here, however, because even if Mr. Simon had presented his willfulness-based defense and the jury had credited it against all odds, he would still have been convicted on the tax fraud counts. Counts 1-4 of the indictment alleged that Simon's tax returns were fraudulent in two ways – underreporting income, and failing to disclose his interests in foreign accounts – and the jury only needed to find one willful, material falsehood to convict him on these counts. The willfulness-based argument that Mr. Simon claims was critical to his defense was only relevant to one of the two falsehoods, and would have provided no defense to the allegation that Mr. Simon's tax returns were false because they didn't disclose his foreign accounts on Schedule B of the returns.

***9** The jury could have convicted on counts 1-4 based solely on the nondisclosure of foreign accounts and would almost certainly have done so, given that it convicted Mr. Simon of failing to file the required FBAR reports disclosing the same foreign accounts. Indeed, by convicting the FBAR counts the jury necessarily found that Mr. Simon had foreign accounts he was required to disclose. The only way the jury could have acquitted on the tax fraud counts, then, would be if jurors believed Mr. Simon's failure to disclose wasn't willful. Counts 5-8 also had a willfulness requirement, so this would have been highly unlikely; the jury would have had to find that Mr. Simon's failure to disclose his foreign accounts in the FBAR reports was willful but that his failure to disclose those accounts on his tax returns was an honest mistake. Both at trial and on appeal, Mr. Simon took the position that the Schedule B accusations and the FBAR accusations stood or fell together. *See* United States v. Simon, 727 F.3d at 698 ("Both Simon and the government treated [the Schedule B issues] as coterminous with the FBAR issue. That is, if Simon prevailed on the FBAR issue, he could prevail on the Schedule B issue. On the other hand, if he lost on the FBAR issue, he also lost on his Schedule B defense."). Because Mr. Simon lost on the FBAR issue, he would have lost on the Schedule B issue and the jury would have convicted him of tax fraud regardless of whether it believed his tax returns also understated his income.

Mr. Simon isn't entitled to relief on his "primary" claim: that his counsel's elementary legal mistakes prevented him from mounting his planned defense that any underreporting of his income wasn't willful, because the payments would still have been nontaxable if considered partnership distributions or expense reimbursements. He wouldn't have been entitled to present his alternative tax law theories or the good-faith defense based on them to the jury regardless of what counsel had done, because there was no evidence Mr. Simon had ever actually considered or relied upon those alternate characterizations of the payments in preparing his returns. The law simply doesn't support the willfulness-based defense Mr. Simon now insists he planned to raise, so counsel's inability to present that defense to the jury couldn't have been constitutionally ineffective performance. Moreover, the jury rejected Mr. Simon's defense to the other alleged falsity on his tax returns – the failure to report foreign accounts in Schedule B. He would therefore have been convicted on the tax fraud counts in any case, and could have suffered no prejudice from his attorneys' inability to present his willfulness-based defense regarding the characterization of the payments.

B. Ineffective assistance related to the mail fraud charges

Mr. Simon also argues that his attorneys provided constitutionally ineffective assistance in defending him against the mail fraud charges in the indictment. Counts 9-19[2] alleged that Mr. Simon committed mail fraud in the course of sending financial aid applications to the private schools his children attended or sought to attend. The indictment alleged that Mr. Simon underreported his income on applications for need-based financial aid in the same way he underreported his income on his tax returns as alleged in counts 1-4. Mr. Simon argues that his counsel failed to adequately investigate potential defenses to these charges. He says his counsel missed two legal infirmities in the indictment that could have formed the basis for meritorious motions to dismiss the mail fraud counts. He also claims that apart from these legal arguments, his attorney neglected to locate and call witnesses that would have been favorable to the defense.

"Money or property"

When a claim of ineffective assistance is based on counsel's failure to present a motion, the court looks to whether the proposed motion would have been meritorious. *See* United States v. Cieslowski, 410 F.3d 353, 360 (7th Cir. 2005); Owens v. United States, 387 F.3d 607, 610 (7th Cir. 2004). The inquiry turns to whether the legal arguments for dismissal that Mr. Simon now makes would have been successful if raised in a pretrial motion to dismiss or a mid-trial motion for judgment of acquittal.

The first legal infirmity that Mr. Simon identifies concerns whether his children's private schools had a property right in the full value of tuition. To convict Mr. Simon of mail fraud, the government needed to prove that he used the mails in furtherance of "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C.A. § 1341. The "money or property" targeted by the scheme need not be physical, tangible property, Carpenter v. United States, 484 U.S. 19 (1987), but the victim must actually have a recognized property right in the object of the scheme at the time the fraud is committed. Cleveland v. United States, 531 U.S. 12, 15 (2000) ("It does not suffice, we clarify, that the object of the fraud may become property in the recipient's hands; for purposes of the mail fraud statute, the thing obtained must be property in the hands of the victim.).

***10** Mr. Simon insists that need-based financial aid doesn't result in the transfer of any money or property from a school to a student's family; the schools use need-based aid awards to reduce the amount of tuition they would otherwise charge, so they have no cognizable "property right" in the full price of tuition. The government responds that the private schools had a property right to the full amount of tuition, and that by fraudulently pleading poverty Mr. Simon induced the schools to offer his family a hefty tuition discount.

Mr. Simon's argument blinks the fact that he isn't constitutionally entitled to a perfect defense; so long as his attorneys mounted a professionally reasonable defense, they were under no obligation to bring every conceivably colorable motion Mr. Simon can identify after the fact. As Mr. Simon himself acknowledges, "what may constitute money or property for the purpose of the [mail fraud statute] has been the subject of numerous appellate court decisions" and "circuit court opinions vary as to when a money or property right is implicated." No controlling court opinion seems to have directly addressed whether underreporting income on financial aid forms satisfies the "money or property" element of the mail fraud statute, so to determine whether the charges against Mr. Simon should be dismissed his attorneys needed to navigate a tangled web of case law and compare his conduct to dozens of not-quite-analogous schemes. Given the imprecise contours of the "property right" requirement and the difficulty of harmonizing the cases, even an attorney who incorrectly concluded that his client's scheme fit the statute might not necessarily fall below the constitutional minimum of effective assistance. Put simply, on such complex and unsettled legal ground a professionally reasonable attorney is entitled to some room for error. That Mr. Simon can now in hindsight point to colorable legal arguments his attorneys didn't raise doesn't mean his constitutional right to counsel was violated.

In any event, Mr. Simon's counsel wasn't ineffective because his proposed legal argument isn't meritorious. He relies on Cleveland v. United States, 531 U.S. 12 (2000), for the proposition that the mail fraud statute only applies when a victim is deprived of property actually in its hands at the time of the fraud. Cleveland concerned a scheme in which the defendants made false statements to the State of Louisiana to obtain video poker licenses. The defendants were convicted of defrauding the state, but the Supreme Court held that the convictions had to be reversed; because the defendants paid the required licensing fees and a share of their revenue to the state, the state hadn't actually been deprived of any "money or property." Id. at 22-23. The Court held that the state had only a regulatory interest in who received the licenses, not a cognizable property right for purposes of the mail fraud statute.

Cleveland differs significantly from Mr. Simon's case. Mr. Simon is right that under Cleveland, gain to the defendant isn't enough to satisfy the mail fraud statutes without a corresponding loss to the victim of something in which the victim has a property right. But unlike in Cleveland, Mr. Simon's false statements about his income deprived the private schools of something of value – the full price of tuition – that they would otherwise have received. The private schools didn't have a mere "regulatory interest" in which students received need-based financial aid, because each award of aid meant an attending student paid less than full tuition; a spot in the class allocated to a student attending for free could otherwise have been occupied by a student paying full price.

***11** Mr. Simon's reliance on United States v. Adler, 186 F.3d 574 (4th Cir. 1999) is misplaced. Adler concerned a situation in which the defendant controlled a business that owed a debt to the victim, and that business received a large settlement payment from an unrelated suit. The defendant told the victim that he could pay the debt once the settlement proceeds came in. Realizing that he would have no money left if he used the settlement money to pay the debt, the defendant instead paid the settlement money to himself as a bonus. When the company's creditor demanded to know where the settlement money was, the defendant provided a fraudulent list of transactions that left out the payment to himself. The Fourth Circuit held that while the creditor had a legitimate right to payment of the debt, it had no property right in the particular money the defendant received from the unrelated settlement because the defendant never promised to pay the debt with those specific proceeds. Id. at 579-580. Mr. Simon misreads Adler as holding that a defendant's promise to pay a debt isn't enough to create a property right in the creditor to whom the promise is made. The Adler court didn't reach that question at all because it explicitly found that no such promise existed. Id. at 578 ("Mr. Adler did undoubtedly tell Printgear that Adler Industries would be able to pay Printgear after it received the settlement ... But such a claim by Mr. Adler is a far cry from a promise to Printgear of that particular money, and the record reveals that no such promise was ever made."). In any event, the relevance of Adler isn't clear; there is no dispute here about whether the schools were entitled to any particular *source* of funds, only whether they were entitled to full tuition from someone who falsely claimed eligibility for a discount.

Mr. Simon insists that nothing entitled the school to the full amount of tuition payment. Because the school offered price discounts to some families, he argues, the school couldn't have had a property interest in the full amount of tuition; it only acquired an entitlement to the amount of tuition actually agreed upon *after* the need-based aid was awarded. The available authority belies that argument: the relevant cases hold that a defendant who uses fraud to avoid paying the full amount due for a good or service deprives the victim of property within the meaning of the mail fraud statute.

In Pasquantino v. United States, 544 U.S. 349 (2005), the Supreme Court held that defendants committed fraud[3] when they devised a scheme to smuggle liquor out of Canada without paying excise taxes. The Court noted that "[t]he right to be paid money has long been thought to be a species of property," so avoiding paying the taxes was no different than stealing money directly from the Canadian treasury. Id. at 355-356 (internal citations and quotation marks omitted). The private schools Mr. Simon's children attended had a right to be paid money – children attending the schools were obligated to pay tuition. Mr. Simon made fraudulent statements to the schools to avoid paying the full amount due, and in so doing he deprived the schools of property in the form of their right to payment for the educational services they provided.

***12** Persuasive authority from other circuits concerning even more closely analogous circumstances uniformly holds that a defendant who lies about his eligibility for a discount deprives his victim of a property right in the full price of the good or service bought. In United State v. Ali, 620 F.3d 1062 (9th Cir. 2010), the Ninth Circuit held that buyers deprived a software seller of property when they lied about their eligibility for a discount. The court held that the seller "had a right to full payment for its software and was deprived of that right when Defendants fraudulently obtained the software for less than full payment." Id. at 1067. Similarly, in United States v. Stewart, 872 F.2d 957 (10th Cir. 1989), the defendants lied about how they intended to distribute drugs to get a discount from the drug wholesaler. The court held that obtaining the fraudulent discount deprived the seller of property, because "the effect of the scheme was to deprive the manufacturers of money which they should have received" on the sale. Id. at 960. Just like the victims in Ali and Stewart, the private schools in this case established particular criteria a customer had to fulfill in order to obtain a price discount. And just like the defendants in those cases, Mr. Simon misrepresented that he met those criteria in order to obtain a price concession to which he wasn't legitimately entitled.

Mr. Simon tries to distinguish Ali by pointing out that in that case, the defendant and the victim had a contract before the fraud that entitled the victim to payment. He emphasizes that he had no similar contract with the private schools, and that the entitlement to money that forms the basis of a protected property right must come from a contract or statute. But the reasoning in Ali made no mention of the prior contract, relying instead on common law entitlements of a seller to payment. Mr. Simon's argument that a contract or statute is necessary to create a property right seeks to import into the case law limitations that don't appear in it. He also tries to distinguish Stewart based on its age, suggesting that its reasoning depended partly on the gain to the defendant and that Cleveland later held that such gain to a defendant alone can't support a mail fraud conviction. Mr. Simon misreads Stewart. Its reasoning doesn't hinge on gain to a defendant alone, but rather on the fact that falsely representing one's eligibility for a discount is intended to "gain money or property at the expense of the victim." United States v. Stewart, 872 F.3d at 960. It is precisely this deprivation of the victim's property that the mail fraud statute punishes. Stewart remains good law, its reasoning is persuasive, and its factual circumstances are so close to Mr. Simon's that it is fatal to his argument that his particular misstatements were outside the scope of the mail fraud statute.

For these reasons, Mr. Simon's misrepresentation of his financial status to his children's private schools deprived the schools of "money or property" under the mail fraud statutes and a motion to dismiss the mail fraud counts on that basis would have failed. Mr. Simon's attorneys weren't constitutionally ineffective in deciding not to bring a meritless motion to dismiss.

Timing of the mailings

The other argument Mr. Simon thinks should have been raised in a pretrial motion directed at some of the mail fraud charges concerns the timing of the mailings at issue. Counts 9-12 of the indictment concerned one particular private school, Canterbury School in Fort Wayne, Indiana. Three of Mr. Simon's children attended Canterbury for the 2004-2005 school year, and Mr. Simon applied for need-based financial aid on behalf of all three. Mr. Simon's financial aid applications were demonstrably false in a number of respects, including reporting that he spent no money on clubs or vacations the prior year when he was actually a dues-paying member of numerous expensive country clubs and had taken a vacation to Disney World. The mailings charged in counts 9-12 weren't the fraudulent financial aid applications, but rather the year-end billing statements confirming financial aid awards for each child that Canterbury mailed to Mr. Simon after the school year ended. Mr. Simon argues that if his attorneys had investigated further, they would have discovered that the statements were mailed at the end of the 2004-2005 school year and so came *after* the alleged fraud was complete and played no role in furthering it.

***13** Mr. Simon isn't really complaining about evidence that could have been located but wasn't; he simply wishes his attorneys had mounted a particular defense that they chose not to. The only thing Mr. Simon says would have been revealed by more "investigation" was the date of the mailings relative to the posting of financial aid awards. No investigation is needed to know that schools award financial aid at the beginning of the school year, and it seems unlikely that Mr. Simon's large team of lawyers and investigators all remained wholly ignorant of the fact that the end-of-year billing statements charged in the indictment were mailed at the end of the year. Mr. Simon's real claim seems to be that his lawyers were constitutionally ineffective in not moving to dismiss the Canterbury charges based on the timing of the mailings.

Again, nothing in the constitution required Mr. Simon's counsel to make every conceivably colorable argument. Counsel reasonably chose to defend the mail fraud charges on materiality grounds, arguing that because the schools wanted Mr. Simon's academically gifted children to enroll, they were willing to make price concessions and told Mr. Simon that the financial information he put down in the applications wouldn't really matter. This wasn't an indefensible choice; that school officials didn't consider themselves defrauded and in fact continue to support the Simon family could certainly have convinced a jury that the government was overreaching with these particular charges. In contrast, moving to dismiss because of the timing of the mailings would risk wasting valuable trial preparation time briefing a complex legal issue – time that could otherwise have been spent working on issues that didn't concern only a tiny fraction of the government's case against Mr. Simon.

Regardless, Mr. Simon's claim – whether viewed as an attack on his lawyers' strategic choices or as a criticism of the scope of their investigation – falls apart for the independent reason that a motion to dismiss the charges based on the timing of the mailings wouldn't have succeeded. The mail fraud statute doesn't punish a scheme to defraud per se, but rather punishes use of the mails "for the purpose of executing such scheme or artifice or attempting so to do." 18 U.S.C.A. § 1341. Even an innocent, routine mailing by a third party containing no false statements itself can satisfy the statutory mailing element, provided that the mailing was part of the scheme as contemplated by the schemer. *See* Carpenter v. United States, 484 U.S. 19, 28 (1987); Parr v. United States, 363 U.S. 370, 390 (1960). The mailing at issue need not itself be an essential element of the scheme, but must be at least "incident to an essential part of the scheme," Pereira v. United States, 347 U.S. 1, 8 (1954), or "a step in [the] plot," Badders v. United States, 240 U.S. 391, 394, (1916). Even a mailing that occurs after the money or property targeted by the scheme has been received can fall within the scope of the statute, if it helps to conceal the fraud from detection or facilitates an ongoing scheme. *See* Schmuck v. United States, 489 U.S. 705, 711-712 (1989).

Mr. Simon emphasizes that the billing statements came in June 2005, after the 2004-2005 school year had ended and financial aid had already been awarded. He insists that the statements did nothing to conceal the scheme or make a later step in the scheme possible; they simply confirmed that no money was due on the accounts of Mr. Simon's children. While Mr. Simon is correct that financial aid had already been fully paid out for the 2004-2005 year by the time these mailings occurred, he takes too narrow a view of the fraudulent scheme. As the government notes, Mr. Simon's children continued to attend Canterbury for years after the 2004-2005 academic year. [4] Getting confirmation from the school that he owed no money at the end of the academic year proved to Mr. Simon that he had gotten away with it; a full year after the financial aid applications, Canterbury remained unsuspecting of his true financial status. "The relevant question at all times is whether the mailing is part of the execution of the scheme as conceived by the perpetrator at the time," even if the mailing later proves to be documentation of the fraud that comes back to bite the schemer. Schmuck v. United States, 489 U.S. 705, 715 (1989). The billing statements reassured Mr. Simon that he remained in the school's good graces, and because he hoped to continue sending his kids there (and would fill out further financial aid applications to do so), a rational jury could have found that the mailings were part of the scheme as conceived by Mr. Simon. Mr. Simon's attorneys were accordingly not ineffective in declining to bring a motion to dismiss based on the timing of the mailings in counts 9-12.

Mr. Turnbull's testimony

***14** Mr. Simon's final claim about his mail fraud counts is that had his attorneys more thoroughly investigated the charges against him, they would have identified and called Michael Turnbull as a witness. Mr. Turnbull was the director of admissions at Culver Academies, another private school Mr. Simon's children attended, and oversaw the school's financial aid committee during the years in question. Mr. Simon presents an affidavit from Mr. Turnbull, in which Mr. Turnbull says he doesn't recall Mr. Simon's investigators or attorneys contacting him and was never asked to testify as a witness at trial. Mr. Turnbull also states that Culver exercises discretion in awarding financial aid and uses it as a tool to offer price concessions, that when asked by parents about how to fill out spending information on the applications Mr. Turnbull would tell them to give their best guess, and that he sometimes encouraged parents to write "0" on the part of the forms asking how much the family could pay or to leave that question blank. Mr. Simon argues that had his attorneys interviewed Mr. Turnbull, Mr. Turnbull would have corroborated certain elements of Mr. Simon's general defense that (1) his answers on the financial aid application weren't materially false because the school doesn't care much about those answers, and (2) he filled out the forms exactly as the school directed him to.

An attorney representing a criminal defendant has a duty to make "some investigation into the prosecution's case and into various defense strategies" or to "make a reasonable decision that makes particular investigations unnecessary." Brown v. Sternes, 304 F.3d 677, 691 (7th Cir. 2002) (quoting Kimmelman v. Morrison, 477 U.S. 365, 384 (1986)). Accordingly, whether an attorney's decision not to investigate a particular witness constitutes ineffective assistance depends on factors such as "counsel's overall diligence, the likely relevance of the witness's testimony, whether alternative ways of proving the point exist, and the strength of the government's case." United States v. Best, 426 F.3d 937, 945 (7th Cir. 2005). As Mr. Simon's own affidavit shows, his counsel conducted an extensive investigation that included interviewing the many people who had been interviewed by government agents. Critically, his attorneys interviewed Scott Joyner, Culver's director of financial aid, four times before trial. Because Mr. Joyner sat on Culver's financial aid committee and was familiar with Mr. Simon's specific case, Mr. Simon's attorneys could very reasonably have determined that a fishing expedition for other Culver employees who might have relevant testimony wasn't an efficient use of their time. Even if Mr. Simon's attorneys had missed a more favorable Culver witness, that doesn't mean that the decision not to interview other Culver employees was unreasonable.

***15** Moreover, even if the limited investigation of Culver employees constituted deficient performance, Mr. Simon hasn't met his burden of proving prejudice. A defendant raising an ineffective assistance of counsel claim regarding the failure to call a witness is only entitled to relief on such a claim if he makes a specific, affirmative showing as to what the missing evidence would have been, United States ex rel. McCall v. O'Grady, 908 F.2d 170, 173 (7th Cir. 1990), and proves that the witness's testimony would have produced a different result, United States ex rel. Cross v. DeRobertis, 811 F.2d 1008, 1014 (7th Cir. 1987). Mr. Turnbull's testimony, as reflected in his affidavit, falls far short of that showing. Mr. Turnbull says he can't recall anything about what he did or didn't discuss with Mr. Simon, and offers only general testimony about what he sometimes told other parents. He doesn't say that he gave Mr. Simon specifically any instructions at all on how to fill out the aid applications. Mr. Simon complains that if interviewed at the time of trial Mr. Turnbull's memory might have been clearer, but it is Mr. Simon's burden of showing that testimony favorable to him wasn't presented. A petitioner who claims his attorney's failure to investigate violated his Sixth Amendment rights must "provide the court sufficiently precise information, that is, a comprehensive showing as to what the investigation would have produced." Richardson v. United States, 379 F.3d 485, 488 (7th Cir. 2003). Mr. Simon's speculation that an uncalled witness might have been able to corroborate his story isn't enough to meet the exacting standards for habeas relief.

In addition, even if Mr. Turnbull testified at trial and recalled giving Mr. Simon instructions on how to fill out the aid forms, that testimony wouldn't have materially changed the outcome on the mail fraud counts. Even if Mr. Turnbull had told Mr. Simon to give a "best guess" as to his spending and encouraged him to write "0" for the amount of tuition he could pay, that wouldn't excuse Mr. Simon from making specific false statements about his financial situation (such as complaining of phantom "major business failures"). The jury heard a wealth of evidence from which it could conclude that Mr. Simon's financial aid form responses were not his "best guess" as to the previous year's spending, given the wholesale disconnect between his actual lifestyle and his answers on the application. To the extent that Mr. Simon wanted to call Mr. Turnbull to testify that Culver wanted his children to attend and was willing to make concessions to ensure that, the jury already heard such evidence from other witnesses.

Mr. Simon can't show either that his counsel's decision not to interview Mr. Turnbull was unreasonable nor that it prejudiced his defense.

C. Ineffective assistance related to the Schedule B filing requirements

Next, Mr. Simon claims that his attorneys were ineffective in failing to investigate the filing requirements related to reporting foreign accounts on a tax return. Counts 1-4 of the indictment alleged that Mr. Simon filed false tax returns for the years 2003-2006. One of the ways the government argued Mr. Simon's returns were false was that Mr. Simon hadn't checked the "yes" box on Line 7a of IRS form 1040 Schedule B, which asks whether the filer has control over foreign financial accounts. Mr. Simon argues that his counsel was unaware that Line 7a doesn't simply ask if the filer has control over any foreign account; rather, it asks whether the filer has control over one or more accounts with a combined value exceeding $10,000. Had his attorneys adequately investigated this requirement, Mr. Simon argues, they would have requested jury instructions concerning the $10,000 limit. The jury instructions actually given at trial didn't inform the jury that they had to find Mr. Simon's accounts totaled over $10,000 to find that his not checking "yes" on the Schedule B forms was a falsehood. Alternately, Mr. Simon argues that if his attorneys were aware of the filing requirement they could have moved to dismiss based on a lack of proof that the accounts held over $10,000.

Given that Mr. Simon's responses on the Schedule B forms wouldn't have been false if his accounts totaled under $10,000, it was professionally unreasonable not to ensure that the jury was instructed on that point. But Mr. Simon isn't entitled to relief because he can't show prejudice from counsel's error. For three of the four years at issue, the government proved at trial that Mr. Simon's accounts *did* exceed $10,000 – no rational jury could have found otherwise, and a motion to dismiss those counts would have been dead in the water. Notably, the jury instructions for counts 5-8 (concerning Mr. Simon's failure to file FBAR reports for the foreign accounts) did include the $10,000 requirement, so in convicting Mr. Simon on those counts the jury necessarily found that his accounts met the minimum balance. And while the jury instructions didn't mention the $10,000 limit specifically, the jury was still well aware of that limit; the government offered as an exhibit the IRS instructions for Schedule B, which clearly state that a taxpayer can check "no" on Line 7a if the combined value of the foreign accounts is under $10,000. The government's closing argument explicitly directed the jury to consult these instructions during deliberations.

***16** For 2004, the situation is different. The government concedes that there was no evidence that Mr. Simon's accounts met the minimum balance in that year – in fact, the government agreed to dismiss the 2004 FBAR count on that basis. Once the government made that admission, there was no excuse for Mr. Simon's attorneys not moving to dismiss count 2 (the 2004 Schedule B count) on the same basis; as both sides maintained throughout trial, the Schedule B and FBAR issues for each year stood or fell together. Still, the court agrees with the government that this error was a minor one in the context of the entire trial. No attorney is perfect, and the Sixth Amendment doesn't entitle Mr. Simon to a flawless defense. His attorneys vigorously put the government to its burden of proof on every charge, and mounted colorable defenses on every issue. That they missed a clear winning argument on an issue relating to one part of a single count in a complex 23-count trial doesn't mean they fell so far below professional standards of reasonableness that they weren't functioning as counsel within the meaning of the Sixth Amendment.

More importantly, Mr. Simon ignores that count 2 alleged two falsehoods on the tax return: checking "no" on Schedule B and underreporting income. Even had his attorneys noticed the $10,000 issue as to the 2004 Schedule B and successfully moved to dismiss, it wouldn't have resulted in dismissal of count 2 entirely because the allegations about income underreporting would survive. Mr. Simon could still be convicted on count 2 if the jury found that he underreported his income on his 2004 tax return. Mr. Simon's defense to the income underreporting for 2004 was exactly the same as his defense to the alleged underreporting in every other year: he argued that the money he received constituted loans and didn't need to be reported. The government's evidence was strong that the money Mr. Simon considered loans actually wasn't. And the jury convicted Mr. Simon on every other count that depended on his misrepresenting his financial status, so it would be somewhat bizarre for the jurors to decide the payments from the 2004 returns were legitimate untaxable loans but all the other purported loans in the case were fraudulent.

There simply isn't a reasonable probability that the jury would have acquitted Mr. Simon on count 2 even if his attorneys had succeeded in getting the Schedule B allegations to that count dismissed, because the jury would have found that Mr. Simon's 2004 tax return was false in underreporting his taxable income. Even if his attorneys provided ineffective assistance by not investigating the filing requirements of Schedule B, Mr. Simon hasn't carried his burden of showing that such a deficiency prejudiced him.

D. Ineffective assistance related to the TurboTax program

Mr. Simon next claims that his attorneys conducted an inadequate investigation of the workings of the TurboTax software that Mr. Simon used to prepare his tax returns. As already discussed, counts 1-4 alleged that Mr. Simon didn't disclose his control of foreign financial accounts totaling over $10,000 on Line 7a of Schedule B to the tax forms. Mr. Simon had such accounts, and for three of the four years charged his accounts met the $10,000 threshold requiring disclosure. Accordingly, his only available defense concerned his mental state: he didn't realize he needed to disclose the accounts, and failed to check "yes" on Line 7a purely by mistake.

According to Mr. Simon, he used a computer program called TurboTax to prepare his tax returns for the years in question. He says he told his attorneys before trial that he didn't think TurboTax asked him about foreign accounts and so didn't prepare a Schedule B form for him. His attorneys subpoenaed a TurboTax representative to talk about what the version of the program Mr. Simon used would and wouldn't have asked a user when automatically filling in Form 1040, but apparently TurboTax never responded and no representative testified at trial. Mr. Simon insists that had his attorneys diligently followed up, a TurboTax representative could have testified in support of Mr. Simon's defense that the program didn't automatically prepare a Schedule B form because he never reported over $1,500 in interest income. Alternatively, his attorneys could simply have asked an expert witness to recreate Mr. Simon's 2003-2006 tax returns using the versions of TurboTax from those years. He believes his attorneys provided ineffective assistance when they didn't diligently pursue and develop his TurboTax-based defense.

***17** The decision by Mr. Simon's counsel not to go into greater depth on the TurboTax program was very reasonable. The evidence Mr. Simon says should have been presented actually might have been fatal to his willfulness defense. The expert affidavit he attaches to his § 2255 motion makes absolutely clear that had he answered the programs' questions truthfully, it would have prepared a Schedule B form and asked him about foreign accounts. This is so because there are two independent things that prompted TurboTax to print a Schedule B form: a user reporting over $1,500 in interest income *or* the user answering "yes" to questions about whether the user "[had] an interest in a foreign account" (in the 2003-2005 version of TurboTax) or "owned or signed on a foreign bank or broker or other financial account" (in the 2006 version). The evidence at trial clearly established that Mr. Simon had interests or signature authority over such foreign accounts; even now he doesn't claim that he could have truthfully answered "no" to those questions. Had he answered those questions truthfully, TurboTax would have prepared a Schedule B form asking about the accounts regardless of the amount of interest income Mr. Simon reported. [5] His attorneys reasonably decided not to press the issue and stopped investigating the workings of TurboTax. When an attorney begins investigating an issue and correctly surmises that it won't come out in his client's favor, that attorney's decision to cease the investigation is itself a strategic choice entitled to deference.

Even if Mr. Simon's lawyers could be said to have been professionally unreasonable in not following up on the subpoena to the TurboTax representative or having an expert recreate the returns, the error didn't prejudice Mr. Simon. First and foremost, the jury *heard* this defense. Evidence was presented that Mr. Simon used TurboTax, and one of Mr. Simon's expert witnesses testified that if an individual doesn't report $1,500 of interest income in a particular year, "TurboTax doesn't even print out the Schedule B." The jury had Mr. Simon's tax returns for the years in question, and could readily see that he didn't report over $1,500 in interest income for any of the years between 2003 and 2006. While Mr. Simon's attorneys didn't emphasize the defense by asking an expert to actually recreate Mr. Simon's tax returns with the program, they nonetheless presented every necessary piece of the defense to the jury; the government even made clear in its closing argument that Mr. Simon's defense to the Schedule B issue was that TurboTax didn't print out Schedule B's for him. Mr. Simon complains that his attorneys didn't emphasize this defense enough, but doesn't identify any specific part of the defense that wasn't actually presented.

The aborted investigation into a possible TurboTax-based defense didn't constitute ineffective assistance of counsel, and even if it did there was no conceivable prejudice to Mr. Simon. Mr. Simon insists he is entitled to an evidentiary hearing on this issue, but doesn't identify any factual disputes whatsoever on this point so no hearing is necessary.

E. Ineffective assistance related to Mr. Simon's testimony

Lastly, Mr. Simon complains about the decision that he wouldn't testify at trial. Mr. Simon suggests several pieces of evidence that he claims could only have come in through his own testimony, and several pieces of evidence admitted at trial that he claims could only have been rebutted by his testimony. Through an affidavit attached to his motion, Mr. Simon relates in detail his recollection of how he and his attorneys discussed the prospect of Mr. Simon testifying. He identifies two errors that he believes constituted ineffective assistance: (1) his attorneys didn't adequately prepare him and didn't call him as a witness, and (2) they never explicitly informed him that the decision whether to testify was his alone.

Anthony LaSpada, Mr. Simon's lead defense counsel, submitted his own affidavit disputing essentially all the allegations in Mr. Simon's affidavit about how the defense team approached the possibility of Mr. Simon testifying. One expert and one investigator who were both part of Mr. Simon's defense team also submitted affidavits that generally corroborate Mr. LaSpada's story and refute Mr. Simon's. Mr. Simon believes these factual disputes necessitate an evidentiary hearing.

***18** Mr. Simon isn't entitled to a hearing, for two reasons. The first is that a habeas petitioner can't ensure himself an evidentiary hearing simply by providing an affidavit saying that his lawyer stopped him from testifying. “[T]his barebones assertion by a defendant, albeit made under oath, is insufficient to require a hearing or other action on his claim that his right to testify in his own defense was denied him. It just is too facile a tactic to be allowed to succeed.” Underwood v. Clark, 939 F.2d 473, 476 (7th Cir. 1991). Because of the ease of making such a claim and the waste of judicial resources that would occur if every defendant were entitled to a hearing by saying the magic words “my lawyer kept me off the stand,” pragmatic considerations require that someone other than the defendant back up his story. *See* id. (holding that “some substantiation is necessary, such as an affidavit from the lawyer who allegedly forbade his client to testify” in order to “give the claim sufficient credibility to warrant a further investment of judicial resources in determining the truth of the claim.”).

Second, even taking his version of events as true, he isn't entitled to relief. With regard to Mr. Simon's argument that his counsel was constitutionally ineffective for not preparing him to testify and not calling him as a witness, Mr. Simon asserts that: (1) he and his attorneys initially planned for him to take the stand; (2) his attorneys spent no time preparing him to testify; and (3) on the morning of the last day of trial, his attorneys told him they didn't want to call him to testify and gave reasons. The decision about whether Mr. Simon would testify was his alone; his attorneys couldn't have prevented him from testifying and couldn't have forced him to testify against his will. To the extent that Mr. Simon is challenging not the decision to avoid calling him but rather the extent to which his attorneys prepared him for his testimony, whether they prepared him was irrelevant because he chose not to testify. Mr. Simon doesn't assert in his affidavit or his § 2255 motion that the alleged inadequacy of the preparation influenced his decision not to take the stand, so whether his attorneys spent enough time going over his testimony with him is a moot point.

Mr. Simon admits in his affidavit that his attorneys discussed the prospect of Mr. Simon testifying, and explained that having him testify would be a bad idea. He recalls them giving him two reasons for that recommendation: that the trial judge “did not like” him and that if he testified he risked an obstruction of justice enhancement at sentencing. Accurate or not, those are exactly the kind of strategic considerations Strickland insulates from hindsight review. And there were many other excellent reasons his attorneys may have had for advising Mr. Simon not to take the stand. Chief among these was that a federal judge in a separate bankruptcy proceeding had made several formal findings that Mr. Simon's testimony wasn't credible. The trial court might have allowed the government to cross-examine Mr. Simon about those findings. *See* United States v. Dawson, 434 F.3d 956, 959 (7th Cir. 2006). Reasonable counsel could certainly have concluded that Mr. Simon's testimony wasn't worth the risk that the jury would hear about a federal judge essentially calling Mr. Simon a liar.

The second facet of Mr. Simon's claim – that he is entitled to relief because his attorneys never let him know that the decision to testify was his alone –fares no better. For one thing, it is belied by Mr. Simon's own affidavit. He admits that his attorneys told him he had the right to testify. While he insists that he misinterpreted this statement (believing it meant that the government couldn't prevent him from testifying, but his own lawyer still could), he doesn't allege that his attorneys actually said anything that could be fairly construed as suggesting that interpretation. Mr. Simon's attorneys can't be blamed for assuming a client as educated and worldly as Mr. Simon would understand a clear statement in plain English that he had the right to testify. Mr. Simon also admits that on the last day of trial, his attorney asked him whether he would testify. Even if Mr. Simon wrongly believed that he had no choice before that, the question alone should have sufficed to correct his thinking. Mr. Simon tries to explain why he didn't infer from this question that the choice was his to make, but his explanations are too weak to warrant discussion. Even taking his affidavit as true, Mr. Simon's attorneys said enough to put him on notice that it was up to him whether to testify in his own defense.

***19** Finally, failing to inform an client of the right to decide whether to testify doesn't fall below an objective standard of reasonableness. Mr. Simon concedes in his motion that “[t]he Seventh Circuit has indicated that the failure to inform a defendant that the right to testify is his alone is not ineffective assistance of counsel.” He is correct. *See* Taylor v. United States, 287 F.3d 658, 661 (7th Cir. 2002) (“There may be a factual dispute about whether counsel told [the defendant] in so many words that the accused alone makes the decision whether to testify, but this dispute is not material.”). Mr. Simon argues that other courts of appeal have held otherwise, and suggests that they take the better position. But the law of this circuit governs decisions by this court, and this court lacks the power to overrule opinions by the court of appeals.

Accordingly, Mr. Simon's attorneys didn't provide ineffective assistance regarding Mr. Simon's decision whether to testify. Because Mr. Simon hasn't identified any material factual dispute, he isn't entitled to an evidentiary hearing.

III. CONCLUSION

For these reasons, the court DENIES Mr. Simon's § 2255 motion to vacate his sentence (Doc. No. 194). Moreover, because Mr. Simon hasn't made a substantial showing of the denial of a constitutional right, the court declines to issue a certificate of appealability. *See* 28 U.S.C. § 2253(c).

SO ORDERED.

All Citations

Not Reported in F.Supp.3d, 2016 WL 3597579, 118 A.F.T.R.2d 2016-5065

Footnotes

[1] Mr. Simon notified the court that he anticipated being released to home confinement on June 1, 2016 and so may no longer be in custody. Nonetheless, he has notified the court that he intends to pursue relief under § 2255 despite his release, and he is entitled to do so because he was in custody when he filed his petition. *See* Virsnieks v. Smith, 521 F.3d 707, 717-718 (7th Cir. 2008).

[2] The jury convicted Mr. Simon of most of the mail fraud counts, but acquitted him with regard to the three specific mailings involved in counts 13, 14, and 16.

[3] Technically wire fraud, but the wire and mail fraud statutes use identical language (aside from the jurisdictional element) and decisions based on one are commonly consulted in interpreting the other. *See* United States v. Turner, 551 F.3d 657, 666 n.4 (7th Cir. 2008) (“Cases construing the mail-fraud statute are equally applicable to cases involving violations of the wire-fraud statute.”).

[4] Mr. Simon initially argued that his children never returned to Canterbury after 2004-2005, so there was no ongoing scheme for the mailings to further after he received the 2004-2005 financial aid. He abandons this argument in his reply brief, admitting that his children continued to attend Canterbury.

[5] Mr. Simon's only response on this point is that “any questions regarding an interest in a foreign account, distribution from a foreign trust, or owning or signing on a foreign account are asked at a different time in a catchall list of questions that are unrelated to interest income.” That is of course irrelevant; whenever the program asked the questions, Mr. Simon had an obligation to answer them truthfully.

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206 F.Supp.3d 1
United States District Court,
District of Columbia.

Eva MAZE, et al., Plaintiffs
v.
INTERNAL REVENUE SERVICE, et al., Defendants.
Marie M. Green, et al., Plaintiff
v.
Internal Revenue Service, et al., Defendants.

Civil Action Nos. 15-1806 (CKK), 16-1085 (CKK)
|
Signed 07/25/2016

Synopsis
Background: Taxpayers who had failed to report funds held in foreign bank accounts and who had entered in the Offshore Voluntary Disclosure Program (OVDP), a voluntary disclosure program established by the Internal Revenue Service (IRS) brought action against IRS, alleging violation of the Administrative Procedure Act based on IRS's failure to provide direct method of entry into Streamlined Filing Compliance Procedures (SFCP), a subsequently established disclosure program, which imposed on taxpayers greater offshore penalties, exposure to additional civil penalties, increased filing burdens, disparate standard of review, and longer case-review time as compared to other similarly situated applicants, and seeking declaratory and injunctive relief. IRS moved to dismiss.

Holdings: The District Court, Colleen Kollar-Kotelly, J., held that:

[1] requested relief was restraint of assessment and collection of accuracy-related penalties and failure-to-file penalties;

[2] requested relief to switch programs was restraint on assessment and collection of unpaid taxes;

[3] requested relief to directly enter into SFCP would have shifted burden of proof for finding of willfulness, and therefore restrained assessment and collection of unpaid taxes; and

[4] taxpayers possessed adequate alternative remedies.

Motion granted.

Attorneys and Law Firms

***3** Joseph Brant Judkins, George M. Clarke, III, Baker & McKenzie, LLP, Washington, DC, for Plaintiffs.

***4** Geoffrey John Klimas, Joseph E. Hunsader, Richard Jeremy Hagerman, U.S. Department of Justice, Washington, DC, for Defendants.

MEMORANDUM OPINION

COLLEEN KOLLAR-KOTELLY, United States District Judge

Plaintiffs are individuals who failed to report offshore income in foreign accounts, to file required documentation regarding these funds, and to pay the requisite amount of taxes associated with those funds. After they were made to see the error of their ways, each began to participate in a voluntary program of the Internal Revenue Service ("IRS") to begin to unwind these errors. The program in which they began to participate is now one among a family of such programs designed to encourage delinquent taxpayers to correct their previous errors. Each of these programs encourages participation by providing benefits to would-be taxpayers, as well as replenishing the public fisc. Plaintiffs now seek injunctive and declaratory relief against the IRS and associated defendants in connection with these programs, including a declaration that certain rules regarding transitions between two of these programs are unlawful; an injunction against the enforcement of those rules; and a judgment that Plaintiffs can withdraw from one program and enter another, contrary to the existing rules governing those programs.

Before the Court is Defendants' [9] Motion to Dismiss filed in the case captioned *Maze v. Internal Revenue Service* (15-cv-1806).[1] Defendants first argue that this Court is deprived of subject matter jurisdiction over this case as a result of the Anti-Injunction Act and the tax exception to the Declaratory Judgment Act. They next argue that the United States has not waived its sovereign immunity over the claims in this case because the claims pertain to enforcement decisions that are committed to agency discretion by law. *See* 5 U.S.C. § 701(a)(2) (Administrative Procedure Act inapplicable when "(2) agency action is committed to agency discretion by law"). Upon consideration of the pleadings, [2] the relevant legal authorities, and the record for purposes of this motion, the Court GRANTS Defendants' [9] Motion to Dismiss. As explained further below, the Court concludes that it has no jurisdiction over this action in light of the Anti-Injunction Act and the tax exception to the Declaratory Judgment Act. Therefore, the Court does not reach Defendants' argument that this case must be dismissed because enforcement activities are committed to the agency's discretion by law. This case is dismissed in its entirety for want of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1).

*5 I. BACKGROUND

The Court limits its presentation of the background to the key facts that are necessary for the Court's resolution of the fundamental issue presented in the pending motion: whether the Court is deprived of jurisdiction over this action in light of the jurisdiction-stripping provision of the Anti-Injunction Act and in light of the tax exception to the Declaratory Judgment Act.

A. Statutory and Regulatory Context

[1] **[2]** **[3]** The United States tax system has a broad reach. Notably, "[t]he United States income tax system reaches all U.S. citizens' income no matter where in the world it is earned, 'unless it is expressly excepted by another provision in the Tax Code.' " *Rogers v. Comm'r of I.R.S.*, 783 F.3d 320, 322 (D.C. Cir.), *cert. denied* ––– U.S. ––––, 136 S.Ct. 369, 193 L.Ed.2d 291 (2015) (citations omitted). In order to implement this system, as the Supreme Court has noted, "our tax structure is based on a system of self-reporting." *United States v. Bisceglia*, 420 U.S. 141, 145, 95 S.Ct. 915, 43 L.Ed.2d 88 (1975); *see also Florida Bankers Ass'n v. U.S. Dep't of the Treasury*, 799 F.3d 1065, 1073 (D.C.Cir.2015) (Henderson, J., dissenting), *cert. denied* ––– U.S. ––––, 136 S.Ct. 2429, 195 L.Ed.2d 780 (2016). Those reporting requirements are both detailed and complex, and they extend to certain foreign assets, accounts, and income. *See, e.g.*, 26 U.S.C. § 6048(c) (reporting required by United States beneficiaries of foreign trusts). As the Supreme Court has further noted, "basically the Government depends upon the good faith and integrity of each potential taxpayer to disclose honestly all information relevant to tax liability." *Bisceglia*, 420 U.S. at 145, 95 S.Ct. 915. In addition to depending on the honesty of each taxpayer, the system includes an array of civil and criminal penalties, including, but not limited to, accuracy-related penalties for the underpayment of taxes and penalties for failing to file certain required documentation. *See, e.g.*, 26 U.S.C. §§ 6046, 6046A, 6048, 6677, 6679 (failure to file penalties); *id.* § 6662 (accuracy-related penalties). This scheme includes criminal penalties for willful failures to comply with tax obligations. *See, e.g., id.* § 7201 ("Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ..., or imprisoned not more than 5 years, or both, together with the costs of prosecution."); *id.* § 7206 (criminal penalties for willful false statements in tax materials submitted).

The IRS engages in affirmative investigations of taxpayers suspected of non-compliance. However, in light of the limited resources available for such investigations, the IRS uses a variety of voluntary disclosure programs to encourage non-compliant taxpayers to come into compliance with the applicable law. Common to all such programs is that the IRS provides certain benefits for taxpayers in exchange for voluntary disclosure pursuant to the applicable guidelines. Providing some *benefit* for voluntary disclosure—even belated—encourages voluntary participation in those programs. [3] It is several such programs, all ***6** with respect to foreign assets, accounts, and income, that are central to this case.

Two basic types of programs are at issue in this case: Offshore Voluntary Disclosure Programs ("OVDPs") and Streamlined Filing Compliance Procedures ("SFCP" or "Streamlined Procedures"). To participate in the 2012 OVDP, [4] which Plaintiffs entered, a taxpayer is required to comply with the following requirements, among others:

- file *eight* years of tax returns and Reports of Foreign Bank and Financial Accounts ("FBARs");
- pay tax and interest for *eight* years; and
- pay accuracy-related penalties for *eight* years.

Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014 ("Revised 2012 OVDP FAQs"), https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised (last visited July 18, 2016). [5]

In return for full compliance with the applicable requirements, the IRS offers participants the following three primary benefits. *First*, with the exception of the accuracy-related penalties under section 6662(a) of the Internal Revenue Code, a compromise of all penalties for which a taxpayer may be liable by paying 27.5% of the aggregate value of the taxpayer's foreign assets. *Id.* This compromise encompasses "FBAR and offshore-related information return penalties and tax liabilities for years prior to the voluntary disclosure period." *Id.* The compromise penalty, which consists of 27.5% of the value of a taxpayer's foreign assets, is referred to as the miscellaneous Title 26 offshore penalty. *Id. Second*, the IRS will not recommend to the Department of Justice criminal prosecution for any matter relating to tax noncompliance or failure to file a Report of Foreign Bank and Financial Accounts. [6] *Id.* As explained by the IRS, participation in an OVDP "generally eliminate [s] the risk of criminal prosecution for all issues relating to tax noncompliance and failing to file FBARs" for past tax years. AR 170, FAQ No. 4. *Third*, the IRS and the taxpayer sign a closing agreement, which constitutes a final settlement of all matters relating to the disclosure period and to years prior to the disclosure period. *Id.* Altogether these actions bar the IRS from taking action based on any tax delinquency in the ***7** years before the eight-year disclosure period.

In 2014, the IRS introduced the 2014 Streamlined Procedures. The IRS explained that "[t]he expanded streamlined procedures are intended for U.S. taxpayers whose failure to disclose their offshore assets was non-willful." AR 146. To participate in the 2014 Streamlined Procedures, a taxpayer is required to comply with the following requirements, among others:

- file *three* years of tax returns and *six* years of FBARs;
- pay tax and interest for *three* years; and
- pay a miscellaneous Title 26 offshore penalty equivalent to 5% of the value of the taxpayer's foreign assets.

Streamlined Filing Compliance Procedures, https://www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-in-the-united-states (last visited July 18, 2016) ("2014 Streamlined Procedures (U.S.)"). A compromise miscellaneous offshore penalty payment is not required for non-U.S. residents. *See* U.S. Taxpayers Residing Outside the United States, https://www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-outside-the-united-states (last visited July 18, 2016) ("2014 Streamlined Procedures (Outside)"). In return, these filings and payments serve as a compromise for all penalties not involving willfulness for the three years covered by the program. *See id.*; 2014 Streamlined Procedures (U.S.). However, the IRS can pursue the taxpayer for fraud-related penalties for all years and for willful FBAR penalties for all years, as well as other penalties from the years *prior* to the three years subject to this program. *See id.* The Streamlined Procedures do not involve any assurance regarding a decision not to refer the matter for criminal prosecution—as the OVDP does—nor do they involve a final settlement agreement resolving tax issues pertaining to prior years. *See id.*

The relationship between these two programs is at the core of this case. A "taxpayer who submits an OVDP voluntary disclosure letter pursuant to OVDP FAQ 24 on or after July 1, 2014, is not eligible to participate in the streamlined procedures." AR 151; *see also* Streamlined Filing Compliance Procedures, https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures (last visited July 18, 2016) ("Streamlined Procedures Overview"). "A taxpayer eligible for treatment under the streamlined procedures who submits, or has submitted, a voluntary disclosure letter under the OVDP (or any predecessor offshore voluntary disclosure program) prior to July 1, 2014, but who does not yet have a fully executed OVDP closing agreement, may request treatment under the *applicable penalty terms* available under the streamlined procedures." AR 151 (emphasis added). "A taxpayer seeking such treatment does not need to opt out of OVDP, but will be required to certify, in accordance with the instructions set forth below, that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct." AR 151-52. Finally, the IRS would consider a request for such treatment "in light of all the facts and circumstances of the taxpayer's case and will determine whether or not to incorporate the streamlined penalty terms in the OVDP closing agreement." AR 152.

In short, a taxpayer that enters an OVDP after July 1, 2014—shortly after the 2014 Streamlined Procedures were introduced—is categorically barred from the Streamlined Procedures. A taxpayer that had *already* entered an OVDP before that deadline, such as Plaintiffs in this case, *may* be able to receive the favorable penalty ***8** terms of the Streamlined Procedures, but must remain in the OVDP in order to do so. The Court will refer to this option, as do Defendants, as the "Transition Treatment." An applicant is not automatically afforded the benefits of Transition Treatment. *See* Transition Rules: Frequently Asked Questions (FAQs), https://www.irs.gov/individuals/international-taxpayers/transition-rules-frequently-asked-questions-faqs (last visited on July 18, 2016) ("Transition FAQs"). Among other requirements for qualifying for this treatment, the IRS "must agree that the available information is consistent with the taxpayer's certification of non-willful conduct." *Id.* A taxpayer afforded the Transition Treatment will only be required to pay the miscellaneous Title 26 offshore penalty required under the Streamlined Procedures rather than the penalty required under the OVDP. *Id.* That is, for a domestic taxpayer, only a 5% penalty will be required as opposed to the 27.5% penalty mandated under the 2012 OVDP, as explained above. There is no alternative path for a taxpayer participating in an OVDP to leave such a program and enter the Streamlined Procedures on the terms applicable to new participants in that program.

Lastly, the treatment of participants in these several programs differs with respect to the availability of criminal non-prosecution letters. As noted above, under the OVDP, participants can receive a criminal non-prosecution letter, which provides assurance that the IRS will not refer related tax matters to the Department of Justice for criminal prosecution. Def.'s Mot. at 7. This benefit is not available under the 2014 Streamlined Procedures. *See generally* 2014 Streamlined Procedures (U.S.). By contrast, the benefit of non-prosecution letters remains available under the Transition Treatment because the participants never exit the OVDP itself; instead, they remain bound by the rules of that program, except that they are eligible to receive beneficial treatment regarding certain penalties, as detailed above. *See generally* Transition FAQs.

B. Plaintiffs' Claims and Relief Sought

Each plaintiff's claims emerges from a similar factual background: after a number of years of failing to report funds held in foreign bank accounts, each plaintiff entered the IRS's 2011 or 2012 Offshore Voluntary Disclosure Program.[7] Compl. ¶¶ 82 (Eva Maze); 90 (Suzanne Batra); 97 (Margot Lichtenstein). Each subsequently sought to "directly enter" the 2014 Streamlined Procedures, and each was told that doing so was not possible. *Id.* ¶¶ 83-84 (Maze); 91-92 (Batra); 98-99 (Lichtenstein). Having received this response, they joined together to bring this action. The parties have not suggested any material differences ***9** among the experiences of the several plaintiffs.

Based on these underlying allegations, Plaintiffs further allege that the "IRS blocked the Plaintiffs from withdrawing from the 2012 OVDP and entering the 2014 SFCP through any route other than the Transition Rules." *Id.* ¶ 103. Plaintiffs then claim that they were harmed by the IRS's "decision to deny Plaintiffs entry into the 2014 [Streamlined Procedures] through any route other than the Transition Rules." *Id.* ¶ 104. Plaintiffs further claim that "the IRS's failure to provide a direct method of entry into the 2014 SFCP imposed upon the Plaintiffs a greater offshore penalty, exposure to additional civil penalties, increased filing burdens, a disparate standard of review, and a longer case-review time (and thus attorneys' fees) as compared to other similarly situated applicants." *Id.*

On the basis of this claim of injury, Plaintiffs claim that Defendants actions violated two provisions of the Administrative Procedure Act. First, they claim that "Defendants actions in promulgating the Transition Rules were arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Id.* ¶ 106 (citing 5 U.S.C. § 706(2)(A)). Second, they claim that the "Transition Rules" were procedurally defective because they "were contrary to the notice-and-comment rulemaking requirements" of the Administrative Procedure Act and were "without observance of procedure required by law." *Id.* ¶ 107 (citing 5 U.S.C. §§ 553, 706(2)(D)).

The Court presents *in full* the relief requested by Plaintiffs through the Complaint, as it pertains directly to the legal question before the Court. Plaintiffs request:

> A. A holding by the Court setting aside the Transition Rules as unlawful under 5 U.S.C. § 706(2);
>
> B. A judgment by the Court that, under 5 U.S.C. § 706(2)(A), the Transition Rules are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law, and are therefore invalid;
>
> C. A judgment by the Court that the Transition Rules did not comply with the notice-and-comment rulemaking requirements of 5 U.S.C. § 553, were without observance of procedure required by law under 5 U.S.C. § 706(2)(D), and are therefore invalid;
>
> D. A judgment that Plaintiffs may withdraw from the 2012 OVDP [Offshore Voluntary Disclosure Program] and directly enter the 2014 SFCP [Streamlined Procedures] where the IRS must treat them the same as any other 2014 SFCP applicants;
>
> E. An injunction prohibiting Defendants or their agents from enforcing the Transition Rules;
>
> F. An award of attorneys' fees, costs, and expenses in this action; and
>
> G. Any other legal or equitable relief to which the Plaintiffs may show themselves to be justly entitled.

Compl., Request for Relief. To summarize, Plaintiffs request (1) judgments that the "Transition Rules" were unlawful under the Administrative Procedure Act, (2) an injunction allowing Plaintiffs to transfer from one IRS voluntary program to another, contrary to the IRS's existing rules prohibiting such a transfer; and (3) an injunction prohibiting the enforcement of the "Transition Rules." Moreover, it appears that Plaintiffs seek to retain benefits that are available only under the OVDP, specifically assurances from the IRS regarding the referral of matters for criminal prosecution for past tax years. *Compare* Defs.' Mot. at 13 (noting receipt of non-prosecution letters by Plaintiffs) *and* ***10** Defs.' Reply at 3 (detailing benefits of non-prosecution letters) *with* Pls.' Opp'n at 20, 31 (failing to relinquish of benefits of non-prosecution letter). Finally, Plaintiffs never claim that they have paid all of the taxes and penalties they owe with respect to *all eight* tax years relevant to the voluntary programs considered in this case; they only claim that they have now paid taxes for the three years covered by the Streamlined Procedures.

II. LEGAL STANDARD

[4] [5] [6] [7] [8] [9] "Federal courts are courts of limited jurisdiction" and can adjudicate only those cases entrusted to them by the Constitution or an Act of Congress. *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377, 114 S.Ct. 1673, 128 L.Ed.2d 391 (1994). The Court begins with the presumption that it does not have subject matter jurisdiction over a case. *Id.* To survive a motion to dismiss pursuant to Rule 12(b)(1), a plaintiff bears the burden of establishing that the Court has subject matter jurisdiction over its claim. *Moms Against Mercury v. FDA*, 483 F.3d 824, 828 (D.C.Cir.2007). In determining whether there is jurisdiction, the Court may "consider the complaint supplemented by undisputed facts evidenced in the record, or the complaint supplemented by undisputed facts plus the court's resolution of disputed facts." *Coal. for Underground Expansion v. Mineta*, 333 F.3d 193, 198 (D.C.Cir.2003) (citations omitted). "At the motion to dismiss stage, counseled complaints, as well as *pro se* complaints, are to be construed with sufficient liberality to afford all possible inferences favorable to the pleader on allegations of fact." *Settles v. U.S. Parole Comm'n,* 429 F.3d 1098, 1106 (D.C.Cir.2005). "Although a court must accept as true all factual allegations contained in the complaint when reviewing a motion to dismiss pursuant to Rule 12(b)(1)," the factual allegations in the complaint "will bear closer scrutiny in resolving a 12(b)(1) motion than in resolving a 12(b)(6) motion for failure to state a claim." *Wright v. Foreign Serv. Grievance Bd.,* 503 F.Supp.2d 163, 170 (D.D.C.2007) (citations omitted).

III. DISCUSSION

Defendants argue that this Court has no jurisdiction over the claims in this case because of the jurisdiction-stripping provision of the Anti-Injunction Act and because of the analogous tax exception to the Declaratory Judgment Act. As explained below, the Court agrees with Defendants that this Court is deprived of jurisdiction over this action in its entirety by those statutes. Therefore, the Court does not reach Defendants' alternative argument that Plaintiffs may not bring these claims under the Administrative

Procedure Act because the underlying enforcement regime is a matter committed to the IRS's discretion as a matter of law.

Under the Anti-Injunction Act, except as explicitly provided by the statute, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."[8] 26 U.S.C. § 7421(a). "The Declaratory Judgment Act likewise prohibits most declaratory suits 'with respect to Federal taxes.' " *Florida Bankers Ass'n v. U.S. Dep't of Treasury*, 799 F.3d 1065, 1067 (D.C.Cir.2015) *cert. denied* ––– U.S. ––––, 136 S.Ct. 2429, 195 L.Ed.2d 780 (2016) (quoting 28 U.S.C. § 2201(a)). Two acts are "coterminous." *Id.* (citing *Cohen v. United States*, 650 F.3d 717, 730–31 (D.C.Cir.2011) (en banc)). Practically that means that the scope of the Anti-Injunction Act governs ***11** the outcome of this case, and there is no need to refer to the tax exception under the Declaratory Judgment Act further. *See id.* at 1068 ("For simplicity, we will refer only to the Anti–Injunction Act."); *Cohen*, 650 F.3d at 730–31 ("In this light, the case is greatly simplified. The DJA [Declaratory Judgment Act] falls out of the picture because the scope of relief available under the DJA is subsumed by the broader injunctive relief available under the AIA [Anti-Injunction Act].").

[10] **[11]** **[12]** **[13]** "The manifest purpose of § 7421(a) is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund." *Enochs v. Williams Packing & Nav. Co.*, 370 U.S. 1, 7, 82 S.Ct. 1125, 8 L.Ed.2d 292 (1962). "As the Supreme Court explained, the provision reflected 'appropriate concern about the ... danger that a multitude of spurious suits, or even suits with possible merit, would so interrupt the free flow of revenues as to jeopardize the Nation's fiscal stability.' " *Cohen v. United States*, 650 F.3d at 724 (quoting *Alexander v. "Americans United" Inc.*, 416 U.S. 752, 769, 94 S.Ct. 2053, 40 L.Ed.2d 518 (1974) (Blackmun, J., dissenting)). While the Anti-Injunction Act does not bar all legal claims pertaining to taxation, it does bar "those suits seeking to restrain the assessment or collection of taxes." *Id.* (quoting *Bob Jones Univ. v. Simon*, 416 U.S. 725, 737, 94 S.Ct. 2038, 40 L.Ed.2d 496 (1974)). Applying the Act "requires a careful inquiry into the remedy sought, the statutory basis for that remedy, and any implication the remedy may have on assessment and collection." *Id.* at 727; *see also Z Street v. Koskinen*, 791 F.3d 24, 30 (D.C.Cir.2015) (same). Upon careful consideration of the remedies sought by Plaintiffs, the basis for those remedies, and the implications for the assessment and collection of *unpaid* taxes, the Court concludes that it has no jurisdiction over this case and dismisses it accordingly.

Defendants present three ways in which this suit seeks to restrain the assessment and collection of *unpaid* taxes. *First*, Defendants argue that, if Plaintiffs were permitted to directly participate in the 2014 Streamlined Procedures, as they request, it would directly interfere with the ability of the IRS to assess and collect accuracy-related penalties and failure-to-file penalties, which are treated as taxes under the Anti-Injunction Act. *Second*, Defendants argue that, if Plaintiffs were permitted to directly participate in the 2014 Streamlined Procedures, it would result in the IRS being forced to compromise Plaintiffs' outstanding tax liability without receiving eight years of tax returns and payments—as required under the 2011 and 2012 OVDPs. *Third*, Defendants argue that, under the relief requested by Plaintiffs, if the IRS chose to investigate whether Plaintiffs actually qualified for the 2014 Streamlined Procedures, the IRS would be required to prove fraud before assessing additional taxes and penalties. Defendants also emphasize that Plaintiffs seek to retain the benefit of the non-prosecution letters that are issued under the OVDP, while also enjoying the benefits of the 2014 Streamlined Procedures. In addition to presenting these three pathways through which the requested relief would restrain the assessment and collection of unpaid taxes, Defendants argue that Plaintiffs have not suffered a harm for which no alternative remedy exists and that, therefore, the attendant exception to the Anti-Injunction Act's jurisdictional bar is inapplicable.

With respect to each of these purported effects on tax assessment and collection, Plaintiffs respond that none of them constitutes ***12** a restraint on the IRS's ability to assess or collect taxes. Plaintiffs present several additional arguments in response. First, they argue that, because they claim they have paid the three-years of taxes required under the streamlined procedures, there is nothing to "assess or collect." (They do not argue that they have paid taxes for the five earlier years encompassed by the OVDPs.) Second, they characterize the "Transition Rules" as a procedural rule and argue that the Anti-Injunction Act does not bar a challenge to such a procedural rule. Third, Plaintiffs argue that the requested relief would not restrain the assessment or collection of taxes because it would not bar the IRS from seeking tax payments for certain years that would not be covered by the 2014 Streamlined Procedures, including the five earlier years that are covered by the OVDPs. Finally, Plaintiffs argue that Anti-Injunction Act is inapplicable because Plaintiffs have no adequate alternative remedy to the current litigation.

The Court first considers whether this action seeks to restrain the assessment or collection of unpaid taxes in the first instance. The Court agrees with Defendants that it does. Then, the Court turns to the question of whether Plaintiffs lack an alternative remedy such that this case falls into that exception to the Anti-Injunction Act's jurisdictional bar. The Court once again agrees with Defendants that adequate alternative remedies are available. Therefore, the Court is deprived of jurisdiction over this action.

A. Restraint of Collection or Assessment of Unpaid Taxes

As noted above, Defendants argue that three facets of the relief sought by Plaintiffs constitute a restraint on the assessment or collection of unpaid taxes. The Court evaluates each of those facets, together with Plaintiffs' arguments that none of these facets constitutes a restraint on the assessment or collection of taxes. The Court then turns to Plaintiffs' additional arguments as to why this case does not entail the restraint of the assessment or collection of taxes.

1. Penalties Treated as Taxes

[14] **[15]** Certain penalties are treated as taxes for the purposes of the Anti-Injunction Act and of the Declaratory Judgment Act. *Florida Bankers Ass'n*, 799 F.3d at 1067 ("Because of its location in the U.S. Code, that penalty is treated as a tax for purposes of the Anti–Injunction Act."). Defendants argue that this case seeks to restrain the assessment and collection of taxes —specifically taxes that are owed but as of yet unpaid— because the relief it seeks would directly restrain the IRS's ability to collect certain penalties that are treated as taxes. The Court addresses the impact of the requested relief on various types of penalties in turn.

Under section 6662(a), an accuracy-related penalty of 20% is applicable to any "underpayment of tax required to be shown on a return." 26 U.S.C. § 6662(a). A provision in Chapter 68 of the Internal Revenue Code provides that the penalties in that chapter, which include the accuracy-related penalties, are considered taxes: "Any reference in this title to 'tax' imposed by this title [that is, the Internal Revenue Code] shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter." *Id.* § 6665(a)(2). In *Florida Bankers Association*, the D.C. Circuit concluded that identical language in Chapter 68, Subchapter B, results in penalties in *that* subchapter being considered taxes under the Anti-Injunction Act. *See Florida Bankers Ass'n*, 799 F.3d at 1068. Because there is no basis to distinguish between the language analyzed ***13** by the D.C. Circuit in *Florida Bankers Association* and the language in section 6665(a)(2), it is necessarily true that the accuracy-related penalties in Chapter 68 are similarly considered taxes for the purposes of the Anti-Injunction Act.

As explained above, participants in the 2012 OVDP must pay eight years of accuracy-related penalties (insofar as they are applicable to individual tax returns). The miscellaneous Title 26 offshore penalty *does not* serve as a compromise for these accuracy-related penalties. These requirements remain applicable to OVDP participants who receive the benefit of the Transition Treatment. *See* Transition FAQs, FAQ No. 9. By contrast, participants in the Streamlined Procedures are not required to pay accuracy-related penalties; instead, the 5% miscellaneous Title 26 offshore penalty serves as a compromise for all non-willful penalties for the three years in question, including the accuracy-related penalties. As a result, Plaintiffs' requested relief would bar the IRS from collecting accuracy-related penalties for the three years covered by the Streamlined Procedures. Because the accuracy-related penalties are considered taxes, the inability of the IRS to collect these penalties constitutes a restraint on the assessment and collection of unpaid taxes and penalties. Moreover, with respect to the five years covered by the OVDP but not covered by the Streamlined Procedures, the requested relief would substantially increase the difficulty in collecting the unpaid taxes and penalties. Specifically, while the IRS would not be barred from collecting accuracy-related penalties, it would not benefit from the automatic submission of tax returns required under the OVDP. The Court concludes that the substantial increase in the difficulty in the collection of those penalties constitutes a restraint on the assessment and collection of unpaid taxes, as well. That is, for both of these reasons, the requested relief constitutes a restraint on the assessment and collection of unpaid taxes.

In addition to the impact of the requested relief on the assessment and collection of accuracy-related penalties, Defendants identify other penalties that would be affected by the requested relief. As described above, participants in the 2012 OVDP are required to pay 27.5% of foreign assets as a compromise for all penalties other than accuracy-related penalties that may be owed by the taxpayers. These penalties include failure-to-file penalties under section 6677 in the following circumstances: for failure to file a return reporting a transaction *with* a foreign trust, *see* 26 U.S.C. § 6048(a); for failure to file a return to report *ownership in* a foreign trust, *see id.* § 6048(b); for failure to file a return for a foreign corporation, *see id.* § 6046; and for failure to file a return for a foreign partnership, *see id.* § 6046 A. As explained above, under the Streamlined Procedures, domestic taxpayers are required to pay only a miscellaneous Title 26 offshore penalty of 5% as a compromise for *all* penalties, including these failure-to-file penalties. In short, under the Streamlined Procedures, taxpayers compromise their penalties for a significantly lower payment than under the OVDP. [9]

The remaining question is whether the reduced-value compromise of these several penalties constitutes a restraint on the assessment or collection of taxes. All of the ***14** failure-to-file penalties listed above are found in Subchapter B of Chapter 68 of the Internal Revenue Code. Therefore, they are considered taxes for the purposes of the Anti-Injunction Act. *Florida Bankers Ass'n*, 799 F.3d at 1068 (considering penalties in Subchapter B of Chapter 68). Accordingly, the Court concludes that the substantial reduction in the *amount* of the miscellaneous offshore penalty—from 27.5% of assets under the 2012 OVDP to 5% of assets—in order to compromise the failure-to-file penalties, among others, constitutes a restraint on the assessment and collection of unpaid taxes. [10]

In response, Plaintiffs focus on the FBAR penalty, arguing that it does not constitute a tax under the Anti-Injunction Act. *See* Pls.' Opp'n at 12-15. But Defendants never argue that the FBAR penalty in fact constitutes a tax. The impact of the requested relief on the IRS's ability to collect the FBAR penalty does not serve as one of the bases for Defendants' argument that this Court is deprived of jurisdiction over this action. Instead, there are other penalties—specifically the accuracy-related and failure-to-file penalties discussed above—that serve as the basis for Defendants' argument. Plaintiffs never discuss those specific penalties, let alone argue that they cannot serve as a basis for depriving this Court of jurisdiction under the Anti-Injunction Act. Plaintiffs also focus on the miscellaneous Title 26 offshore penalty, which they argue that the IRS "made up." But they are mistaking the nature of the miscellaneous penalty. It is not a new penalty that the IRS invented; it is a label that the IRS developed to refer to standard payments required of taxpayers in order to compromise other statutorily-created penalties, including the accuracy and failure-to-file penalties. In effect, it is a substitute for those other penalties. Because those penalties are considered taxes under the Anti-Injunction Act for the reasons explained above, so too is the substitute miscellaneous Title 26 offshore penalty. Finally, Plaintiffs emphasize that the IRS collects a miscellaneous penalty under any of programs involved. But that statement ignores the fact that the miscellaneous penalty is substantially reduced in size under the Streamlined Procedures—5% of foreign assets—compared to 27.5% under the 2012 OVDP. [11] That reduction itself constitutes a restraint on the collection and assessment of unpaid taxes.

For these reasons, the Court concludes that the impacts of the requested relief on the ability of the IRS to collect the accuracy and failure-to-file penalties discussed here constitute a restraint on the assessment and collection of unpaid taxes, depriving the Court of jurisdiction over this suit.

2. Submission of Tax Returns and Payments

[16] Defendants next argue that allowing Plaintiffs to switch from the 2012 OVDP to the 2014 Streamlined Procedures would restrain the assessment and collection ***15** of unpaid taxes because the IRS would only receive tax returns for *three* years, rather than *eight* years under the 2012 OVDP. The Court agrees.

As explained above, participants in the 2012 OVDP, including the Transition Treatment under the OVDP, are required to file *eight* years of tax returns and to pay the associated taxes. By contrast, participants in the 2014 Streamlined Procedures are only required to file *three* years of tax returns and to pay the associated taxes. Under the Streamlined Procedures, Plaintiffs are correct that the IRS is not barred from seeking the tax returns for the previous five years. However, the burden on the IRS of taking affirmative action to ensure that those returns are filed and that the associated taxes are paid is higher than the burden under the 2012 OVDP, under which the filing of eight years of tax returns and the submission of tax payments for all of those years is a condition of participation. As noted above, Plaintiffs have never claimed that they have paid all of the taxes, interest, and penalties associated with the five years under the OVDP that are not covered by the Streamlined Procedures. Nor are they willing to undergo IRS examination with respect to those five years—which is required as a condition for exiting the OVDP. *See* Revised 2012 OVDP FAQs, No. 51. Accordingly, Plaintiffs' requested relief would shift the burden to the IRS to collect the unpaid taxes, as well as any associated penalties and interest, that are due for the five years that are not covered by the Streamlined Procedures. Accordingly, the Court has little trouble concluding that relief allowing Plaintiffs to switch from a program under which *eight* years of returns are filed to one under which only *three* years of returns are filed constitutes a restraint on the assessment and collection of unpaid taxes.

3. Shifting Burden of Proof Regarding Willfulness

[17] Taxpayers that qualify for the Transition Treatment within the OVDP or directly enter the 2014 Streamlined Procedures must certify, under the penalty of perjury, that they acted non-willfully with respect to the related tax activities. *See* Streamlined Procedures (Overview); Transition FAQs, FAQ No. 6 ("[Y]ou must provide to the IRS ... a written statement in the appropriate certification form that would be required under the Streamlined Filing Compliance Procedures signed under penalty of perjury certifying their non-willfulness with respect to all foreign activities/assets, specifically describing the reasons for the failure to report all income"). Even though the requirement that taxpayers certify non-willfulness is common to the Transition Treatment and to direct participation in the 2014 Streamlined Procedures, the IRS's treatment of this information is materially different. Applications do not automatically qualify for the Transition Treatment. Rather, "[b]efore transitional treatment is given, the IRS must agree that the taxpayer is eligible for transitional treatment and must agree that the available information is consistent with the taxpayer's certification of non-willful conduct." *Id.,* FAQ No. 7. In making the determination about whether to allow Transitional Treatment for a particular taxpayer, the IRS assesses this information along with other information submitted. *Id.,* FAQ No. 8. In short, before OVDP participants can receive the benefits of the Transition Treatment, the participants must convince the IRS that their activity was not willful. By contrast, to enter the Streamlined Procedures directly, the taxpayer must simply certify non-willfulness. *See* Streamlined Procedures (U.S.). The returns filed are then subject to auditing under the standard IRS procedures, ***16** which necessarily places the burden on the IRS for showing willfulness. *See* Streamlined Procedures (Overview) ("Returns submitted under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures will not be subject to IRS audit automatically, but they may be selected for audit under the existing audit selection processes applicable to any U. S. tax return and may also be subject to verification procedures in that the accuracy and completeness of submissions may be checked against information received from banks, financial advisors, and other sources."). Accordingly, the relief that Plaintiffs request—directly entering the 2014 Streamlined Procedures rather than being subject to the Transition Treatment—would shift the burden to the IRS for finding willfulness before it could levy associated taxes, penalties, and interest.

Moreover, Defendants emphasize that Plaintiffs are receiving the benefits of assurances that the IRS will not refer them for criminal prosecution, which are only available under the OVDP but not under the Streamlined Procedures. *See* Defs.' Mot. at 13. Yet, Plaintiffs have not agreed to relinquish these benefits, even though they seek "direct" entry to the Streamlined Procedures, which do not offer the benefit of criminal non-prosecution letters. *See* Pls.' Opp'n at 20, 31.

Plaintiffs argue that the burden of proof for willfulness is established by statute and cannot be modified by agency practice. But the statute sets the burden of proof for willfulness in the litigation context. No litigation as to willfulness is involved here. Instead, what is involved is two different voluntary disclosure schemes set up by the IRS. For direct entry into the Streamlined Procedures, the IRS has set up the scheme such that taxpayers can participate upon certification of non-willfulness; they need not convince the IRS of their non-willfulness before receiving the benefits of this program. Instead, the IRS must establish willfulness before assessing additional taxes, penalties, and interest that may not otherwise be due under the Streamlined Procedures. By contrast for OVDP participants to receive the Transition Treatment, *they* must convince the IRS, through the documentation they submit, of the non-willfulness of their conduct. This difference is significant because the additional effort to show non-willfulness could easily hamper the IRS in its tax collection efforts, and because the additional burden on the IRS of proving willfulness—a precondition to certain additional taxes and penalties—restrains the assessment and collection of those unpaid taxes.

Plaintiffs are right that the two programs are established by the IRS. But that fact is immaterial. Plaintiffs are seeking a legal judgment allowing them to switch from one of those programs to the other contrary to the rules established for those programs. Because a greater burden is placed on the IRS under the Streamlined Procedures as compared to the Transition Treatment, a judgment allowing Plaintiffs to be considered directly under the 2014 Streamlined Procedures necessarily restrains the assessment and collection of unpaid taxes. Therefore, the Court concludes that the impact of the requested relief on the burden regarding willfulness is yet another reason that this Court is deprived of jurisdiction over this suit under the Anti-Injunction Act.

4. Plaintiffs' Additional Responses

In addition to Plaintiffs' arguments addressing the three specific bases for Defendants' claim that Plaintiffs seek to restrain the assessment and collection of taxes through this suit, Plaintiffs present several additional arguments as to why ***17** there is no restraint on the assessment or collection of taxes in this case and, therefore, why this case is not barred by the Anti-Injunction Act. The Court concludes that none of those arguments have merit.

First, Plaintiffs claim that they have paid the three years of tax, interest, and penalties required under the Streamlined Procedures. (They never argue that they have paid all of the taxes, interest, and penalties due for the eight years encompassed by the OVDP.) On this basis, they argue that there is nothing left for the IRS to collect and, as a result, the Anti-Injunction Act is applicable. For this argument, they rely on *Cohen v. United States*, in which the D.C. Circuit sitting en banc concluded that the claims in that case did not "seek to restrain the assessment or collection of any tax" because, in part, "the IRS previously assessed and collected the excise tax at issue." 650 F.3d at 725. The facts in that case bear no resemblance to those in the case before this Court. In that case, "the money [was] in the U.S. treasury," and the "legal right to it has been previously determined." *Id.* Not so here. In support of this argument, Plaintiffs only state that they have paid the tax, interest, and penalties that would be due under the *Streamlined Procedures*—that is, for three years. But they never state that they have paid the taxes, penalties, and interest for the previous five years, which are required to be paid under the 2012 OVDP. Plaintiffs are not simply seeking entry into the Streamlined Procedures, as if writing on a blank slate; rather, they are seeking to transition from the OVDP into the Streamlined Procedures. Therefore, the entire eight years that are relevant under the OVDP are also relevant to the question of whether this suit seeks to restrain the assessment or collection of unpaid taxes. Because Plaintiffs have *never* claimed, let alone shown, that the "the money is in the U.S. treasury," *id.* at 725, with respect to *all* eight years at issue, this argument fails.

Second, Plaintiffs argue that the Anti-Injunction Act does not apply to this challenge to the Transition Treatment because it is a challenge to a procedural rules for sorting between two IRS programs. Once again, the cases on which Plaintiffs rely bear no resemblance to the case at hand. In *Seven–Sky v. Holder*, the D.C. Circuit considered a challenge to the individual mandate of the Affordable Care Act. 661 F.3d 1, 9 (D.C.Cir.2011) *abrogated by Nat'l Fed'n v. Sebelius*, 567 U.S. 519, 132 S.Ct. 2566, 183 L.Ed.2d 450 (2012). The court held that the challenge was not barred by the Anti-Injunction Act because the "shared responsibility payment" was separate and distinct from the individual mandate and because the suit was aimed at the mandate, rather than at the payment. *Id.* In this case, the relief Plaintiffs seek would directly restrain the assessment and collection of unpaid taxes, as amply demonstrated above. It cannot be characterized as a challenge to "regulatory requirements that bear no relationship to tax revenues or enforcement." *Id.* Indeed, the *Seven–Sky* court noted that the Anti-Injunction Act "bars suits that interfere with ancillary functions to tax collection." *Id.* at 10. While "[m]andating the purchase of health insurance is plainly not such a function," the voluntary disclosure programs subject to this suit are far *more* than ancillary to tax collection. *Id.* Therefore, they are encompassed within the jurisdictional bar of the Anti-Injunction Act—unlike the challenge to the individual mandate in *Seven–Sky*. So, too, Plaintiffs' reliance on

Foodservice and Lodging Institute, Inc. v. Regan, 809 F.2d 842 (D.C.Cir.1987), is wholly unavailing. In *Foodservice*, the D.C. Circuit concluded that a challenge to a regulation imposing certain requirements on submission of ***18** data to assess compliance with tip requirements was not barred by the Anti-Injunction Act. *Id.* at 846. The court reasoned that "[o]n its face, the regulation does not relate to the assessment or collection of taxes, but to IRS efforts to determine the extent of tip compliance in the food and beverage industry." *Id.* This case could not be more dissimilar. On their face, the rules challenged here pertain wholly to the assessment and collection of unpaid taxes, not to any unrelated regulatory goals. For all of these reasons, Plaintiffs' argument that this case is a challenge to a regulatory command untouched by the Anti-Injunction Act is wholly unsuccessful.

Third, Plaintiffs argue that that relief requested in this case does not restrain the assessment or collection of taxes because the IRS is not prohibited from seeking tax returns and payments from all eight years that would be covered by the 2012 OVDP. Once again, notably, Plaintiffs *never* claim that they have actually paid taxes and associated penalties for all eight of those years. The Court explained above why releasing Plaintiffs from the obligation to file tax returns and pay taxes on the first five of those eight years—and only requiring returns and payments for the last three years—constitutes a restraint on the assessment and collection of unpaid taxes. Plaintiffs offer three additional arguments why that is not the case. To the extent the Court has not addressed these arguments above, the Court explains here why none of Plaintiffs' arguments are persuasive.

Plaintiffs present a cursory argument, with no legal support whatsoever, that Defendants have somehow waived reliance on the Anti-Injunction Act because they created the multiple voluntary disclosure programs that are subject to dispute in this case. There is no basis for this argument. Defendants created multiple disclosure programs, with distinct eligibility rules for each, as well as rules for the hybrid Transition Treatment. By doing so, they in no way waived their ability to rely on the Anti-Injunction Act to fend off this challenge, which is targeted at the very gatekeeping rules that establish who may participate in each program.

Next, Plaintiffs argue that the D.C. Circuit and the Supreme Court have foreclosed the theory that the entire tax system should be consider a "single mechanism" for the purposes of applying the Anti-Injunction Act. *Cohen*, 650 F.3d at 726 (citing *Hibbs v. Winn*, 542 U.S. 88, 102, 104, 124 S.Ct. 2276, 159 L.Ed.2d 172 (2004)). This entire argument is inapplicable because the Defendants have not pressed an argument based on a "single mechanism" theory. Instead, they argue that there is no jurisdiction over this case because it directly seeks to restrain the assessment and collection of unpaid taxes. As explained above, the Court agrees with Defendants that the relief requested in this case would restrain the assessment and collection of unpaid taxes, and therefore, Plaintiffs' argument regarding a single mechanism theory is inapposite.

Lastly, Plaintiffs rely on the Supreme Court's recent interpretation of the Tax Injunction Act in *Direct Marketing Association v. Brohl*, ––– U.S. ––––, 135 S.Ct. 1124, 191 L.Ed.2d 97 (2015), to argue for a narrower meaning of the word "restrains," as used in the Anti-Injunction Act. This argument is unavailing because the law in the two cases is different and because the facts are distinguishable.

With respect to the law, in *Direct Marketing*, the Supreme Court was interpreting the Tax Injunction Act, "which provides that federal district courts 'shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law.' " *Id.* (quoting 28 U.S.C. § 1341). That case did not concern either the Anti-Injunction ***19** Act or the Declaratory Judgment Act. Indeed, although the Supreme Court explained that it looks to federal law for the interpretation of the Tax Injunction Act, *id.* at 1129, its analysis focused on the specific language of the Tax Injunction Act, *id.* at 1132–33, which differs in material respects from the language of the Anti-Injunction Act. Specifically, while the Tax Injunction Act forbids "enjoin[ing], suspend[ing] or restrain[ing] the assessment, levy or collection of any tax," the Anti-Injunction simply forbids suits "restraining the assessment or collection of any tax." 26 U.S.C. § 7421(a). For the Supreme Court, it was important that the word "restrain" kept company with "suspend" and "enjoin" in the Tax Injunction Act. 135 S.Ct. at 1132. The Supreme Court explained that the words "suspend" and "enjoin" "refer to different equitable remedies that restrict or stop official action to varying degrees, strongly suggesting that 'restrain' does the same." *Id.* Under the Anti-Injunction Act, the word "restrain" keeps no such company and, therefore, no such inference would be either possible or proper.

With respect to the facts, *Direct Marketing* concerned a Colorado state law that imposed notice and reporting obligations regarding sales taxes on certain retailers. *Id.* at 1128. The Supreme Court concluded that the notice and reporting requirements were separate and distinct from the enumerated actions of "the [1] assessment, [2] levy or [3] collection of any tax" and therefore not subject to the Tax Injunction Act's jurisdictional bar that applies to such activities. *Id.* at 1131 (alterations added). The Supreme Court concluded that the notice and reporting requirements merely inhibited, but did not "restrain" the "assessment, levy or collection of any tax." *Id.* at 1133. Once again, notwithstanding Plaintiffs' contentions to the contrary, this case could not be more different. As demonstrated thoroughly above, Plaintiffs seek relief that would directly restrain the assessment and collection of unpaid taxes by presenting a challenge to the eligibility rules for the IRS's voluntary disclosure program, which set out different schemes for collecting unpaid taxes and associated penalties, and by seeking a judgment allowing them entry to a program from which they would otherwise be barred. *Direct Marking* is wholly distinguishable and, accordingly, provides no basis to disturb the conclusion that this Court is deprived of jurisdiction over this case by the Anti-Injunction Act.

* * *

In sum, the Court concludes that, for all of the reasons discussed above, this case constitutes a suit "for the purpose of restraining the assessment or collection of any tax." 26 U.S.C. § 7421(a). Therefore, if no exception to that rule is applicable, this Court is deprived of jurisdiction over this action. The Court now turns to Plaintiffs' argument that just such an exception applies in this case.

B. No Alternative Remedy Available

[18] **[19]** The Anti-Injunction Act "does not apply at all where the plaintiff has no other remedy for its alleged injury." *Z Street*, 791 F.3d at 31. As the Supreme Court explained in *South Carolina v. Regan*, the "Act's purpose and the circumstances of its enactment indicate that Congress did not intend the Act to apply to actions brought by aggrieved parties for whom it has not provided an alternative remedy." 465 U.S. 367, 378, 104 S.Ct. 1107, 79 L.Ed.2d 372 (1984). "Put another way, 'the Act was intended to apply only when Congress has provided an alternative avenue for an aggrieved party to litigate its claims.' " *Z Street*, 791 F.3d at 29 (quoting *South Carolina*, 465 U.S. at 381, 104 S.Ct. 1107).

[20] ***20** Defendants identify two alternative remedies that Plaintiffs can pursue: specifically, to pursue a settlement with the IRS independent of the established voluntary disclosure programs and, if those settlement talks fail, to pay the full assessed liabilities and seek a refund through a refund suit. That is, it is not necessary to participate in one of the programs established by the IRS to pursue a settlement with the IRS. Although Plaintiffs seek the specific relief regarding taxes and penalties that would be afforded them if they were allowed to directly enter the 2014 Streamlined Procedures, they are not barred from seeking such benefits through separate negotiations with the IRS outside the OVDPs in which they are currently enrolled. *See* Defs.' Reply at 12. In short, as an alternative to the remedies sought through this action, Plaintiffs may negotiate directly with the IRS.

If those negotiations do not yield the results they seek, Plaintiffs may avail themselves of a second alternative opportunity to pursue these results. They can opt-out of the OVDP, allow the IRS to determine their liabilities by examination, pay the assessed liabilities, and file an administrative claim for a refund for the difference between the liability determined and the amount that would be due under the Streamlined Procedures; if that administrative refund claim is denied, they may then file a refund suit in federal court. *See* Revised 2012 OVDP FAQs, No. 51 (explaining opt-out process); 26 U.S.C. § 7422(a) (setting out conditions for federal suit for refund).

Because Plaintiffs are equipped with these alternative remedies, they do not face circumstances like those faced by the State of South Carolina in *South Carolina.* 465 U.S. at 380, 104 S.Ct. 1107. As the D.C. Circuit has explained, "because South Carolina paid no taxes, it was 'unable to utilize any statutory procedure to contest the constitutionality of [the tax].' " *Z Street*, 791 F.3d at 29 (quoting *South Carolina*, 465 U.S. at 380, 104 S.Ct. 1107) (alteration in original). In other words, the State of South Carolina had *no* alternatives whatsoever. Here, by contrast, the taxpayers themselves may engage in settlement negotiations with the IRS in order to pursue the relief that is substantively equivalent to the relief they seek through this suit. And, if any such attempts fail, they may follow the procedure outlined above to pay the assessed liabilities and file a suit in federal court for a refund.

Plaintiffs emphasize that they may not *now* file a suit in federal court (1) because they have not been issued a notice of deficiency and (2) because they claim that they are not *actually* seeking the refund of any taxes they have already paid—as they claim they have paid the amount that would be required under the Streamlined Procedures. But once again they ignore the *five* years prior to those covered by the Streamlined Procedures that are within the eight-year framework of the OVDP. Plaintiffs have never claimed that they have paid all liabilities that would be due on a full examination of all of those years—either during the years in which the respective taxes were owed or in the process of rectifying their prior errors. Upon examination and payment of liabilities for *all* of those years, they could seek any refund compared to the amounts that would be due under the Streamlined Procedures—or as compared to whatever amount they claim they should be due under the applicable law. The Court concludes that these remedies are both available and adequate with respect to the relief Plaintiffs seek in this court. *See Cohen*, 650 F.3d at 733 (requiring an alternative remedy to be "adequate").

***21** Because Plaintiffs possess adequate alternative remedies to the current suit, the Court concludes that this suit remains within the ambit of the jurisdiction-stripping provision of the Anti-Injunction Act and, concomitantly, within the tax exception to the Declaratory Judgment Act). Therefore, the Court need not consider Defendants' argument that Plaintiffs have no legal right to settlement terms offered to other taxpayers.

* * *

The details of the schemes at issue in this case are complex, but it is useful to close by returning to the core of this case. Plaintiffs claim that they have been harmed because "the IRS's failure to provide a direct method of entry into the 2014 SFCP imposed upon the Plaintiffs a *greater offshore penalty, exposure to additional civil penalties, increased filing burdens, a disparate standard of review, and a longer case-review time (and thus attorneys' fees*) as compared to other similarly situated applicants." Compl. ¶ 107 (emphasis added). And Plaintiffs seek, through this case, a judgment allowing them to participate in the 2014 Streamlined Procedures under the same terms as an applicant who had not previously participated in another related IRS voluntary disclosure program. *See id.* Request for Relief, ¶ D. That is, they seek to undo the alleged harm they claim was caused by their inability to enter the 2014 Streamlined Procedures directly: "greater offshore penalty, exposure to additional civil penalties, increased filing burdens, a disparate standard of review, and a longer case-review time (and thus attorneys' fees) as compared to other similarly situated applicants." *Id.* ¶ 107. Notably, Plaintiffs *never* claim that they have paid all of the taxes and associated penalties owed under all of the tax years covered by the programs at issue in this case. Notwithstanding Plaintiffs' attempts to minimize the effect that this lawsuit would have on their bottom line and on the public fisc, they are not simply bringing this lawsuit because they are philosophically dismayed by what they claim was the unlawful promulgation of the "Transition Rules." It is not simply that they seek to have that putative legal wrong remedied in the abstract. They are seeking for that wrong to be remedied as it applies to them, with all of the attendant effects on the taxes, penalties, and other payments that they must make to the United States Treasury via the IRS.

With that background, the question before the Court is whether the unwinding of the impacts alleged by Plaintiffs' through the specific relief they request would restrain the assessment or collection of unpaid taxes. Because the Court answers that question in the affirmative, and because Plaintiffs are not seeking relief for which they would have no adequate alternative remedy, this Court is deprived of subject matter jurisdiction over this case by the Anti-Injunction Act and by the tax exception to the Declaratory Judgment Act. Accordingly, the Court dismisses this case for lack of subject matter jurisdiction. [12]

IV. CONCLUSION

For the foregoing reasons, the Court GRANTS Defendants' [9] Motion to Dismiss. The Court dismisses this case for want of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1). This case is dismissed in its entirety.

***22** An appropriate Order accompanies this Memorandum Opinion.

All Citations

206 F.Supp.3d 1, 118 A.F.T.R.2d 2016-5226, 2016-2 USTC P 50,359

Footnotes

[1] The Court granted the parties' joint motion to consolidate Case No. 15–cv–1806 (*Maze v. Internal Revenue Service*) and Case No. 16–cv–1085 (*Green v. Internal Revenue Service*). Pursuant to the parties' stipulation and the Court's order granting the motion to consolidate, the resolution of the motion to dismiss filed in *Maze* will bind all parties to this consolidated action. For the remainder of this Memorandum Opinion, however, the Court only refers to the parties in *Maze* and to the briefing that they filed for the sake of clarity.

[2] The Court's consideration has focused on the following documents:

- Defs.' Mot. to Dismiss (“Defs.' Mot.”), ECF No. 9;
- Pls.' Opp'n to Defs.' Mot. to Dismiss (“Pl.'s Opp'n”), ECF No. 13; and
- Defs.' Reply in Supp. of Mot. to Dismiss (“Defs.' Reply”), ECF No. 14.

In an exercise of its discretion, the Court finds that holding oral argument in this action would not be of assistance in rendering a decision. *See* LCvR 7(f).

[3] Taxpayers who are undergoing a civil examination or a criminal investigation are not eligible for participation in such programs. *See, e.g.*, Streamlined Filing Compliance Procedures, https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures (last visited July 18, 2016); Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014, https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised (last visited July 18, 2016).

[4] Those provisions were revised when the IRS announced the 2014 Streamlined Procedures. When discussing the 2012 OVDP, the Court refers to the OVDP as revised, given that the revised program is now at issue.

[5] Defendants note that taxpayers under the 2012 OVDP must pay any applicable failure-to-file penalties under section 6651(a)(1) and failure-to-pay penalties under 6651(a)(2)-(3) for eight years. Defs.' Mot. at 8 n.3; *see also* Revised 2012 OVDP FAQs, FAQ No. 7. But Defendants also note that it is unlikely that such penalties would be applicable to Plaintiffs. Defs.' Mot. at 8 n.3. Accordingly, like Defendants, the Court does not discuss those penalties further.

[6] Defendants state that, upon the completion of the requirements of the program, a taxpayer will receive a non-prosecution letter from the IRS, which they describe as essentially assurance from the Commission of the Internal Revenue that the IRS will not refer the matter to the Department of Justice for prosecution. Defs.' Mot. at 7. But Defendants do not point to any material in the record or any legal authority that shows that such letters are automatically issued. In any event, this distinction is immaterial to the resolution of this case.

[7] As Defendants have noted, Plaintiffs include contradictory allegations about whether Plaintiff Batra entered the 2011 Program or the 2012 Program. *Compare* Compl. ¶ 1 (all plaintiffs participated in the 2012 program) *with id.* ¶ 90 (describing participation of Batra in 2011 program). It appears that all references to Batra individually refer to participation in the 2011 Program. *See id.* ¶ 90; Pls.' Opp'n at 4 (citing Decl. of William Sweeney at ¶ 7, Ex. A); *id.* at 5–6. It may be that Plaintiffs' references to all of them participating in the 2012 program and seeking to exit *that* program are simplifications or misstatements. *See, e.g.*, Compl. ¶¶ 101-103, Request for Relief ¶ D. In any event, these discrepancies are immaterial for the purposes for the pending motion because the programs are substantially similar. See Defs.' Mot. at 13 n.5. The one difference that the parties all note is that the 2011 OVDP required a payment of 25% of foreign assets, while the 2012 OVDP required a payment of 27.5% of foreign assets. *See id.*; Pls.' Mot. at 13. But that difference has no effect on the result in this case.

[8] Plaintiffs do not claim that this action falls under one of the statutorily enumerated exceptions to the jurisdiction-stripping provision.

[9] Other than the several failure-to-file penalties listed above, Defendants have not identified any specific penalties affected by the requested relief. Nor have they provided any basis for the Court to conclude that those unidentified penalties should be treated as taxes under the Anti-Injunction Act. With that in mind, the Court finds no basis to treat these unidentified penalties as taxes.

[10] It is immaterial that, under the Transition Treatment, participants are able to compromise the outstanding penalties for a miscellaneous offshore penalty of only 5% of their foreign assets. It is yet unclear whether Plaintiffs would even qualify for the Transition Treatment. Yet, they seek a judgment allowing them to exit the 2012 OVDP and to participate “directly” in

the Streamlined Procedures. Compl., Relief Requested ¶ D. Therefore, the relevant comparison on this issue is between the 2012 OVDP, outside of the Transition Treatment, and the Streamlined Procedures.

[11] The penalty is 25% under the 2011 ODVP. The reduction of that amount to 5% is also a substantial reduction and constitutes a restraint on the assessment and collection of unpaid taxes.

[12] As a result, the Court does not reach Defendants' alternative argument that Plaintiffs may not bring this case under the Administrative Procedure Act because the challenge addresses matters that are committed to the IRS's discretion as a matter of law.

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2014 WL 4979735
NOT FOR PUBLICATION
United States District Court, D. New Jersey.

UNITED STATES of America, Petitioner,
v.
Eli CHABOT and Renee Chabot, Respondents.

Civ. No. 14–3055 (FLW).
|
Signed Oct. 3, 2014.

Attorneys and Law Firms

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OPINION

WOLFSON, District Judge.

***1** Before the Court is United States of America's ("Government") petition to enforce an Internal Revenue Service ("IRS") summons compelling Eli and Renee Chabot ("the Chabots" or "Respondent") to produce all documents concerning any foreign bank accounts that were required to be maintained by the Bank Secrecy Act of 1970 ("BSA") and regulations under that Act. For the following reasons, the Government's petition is GRANTED.

I. Background

On or around April 6, 2010, the IRS received information from the French competent authority pursuant to the United States–France income tax treaty that provided "information concerning U.S. Persons maintaining undisclosed bank accounts at HSBC bank." Danilack Declaration, at ¶¶ 3, 5–6. The IRS claims it has information regarding Pelsa Business Inc. ("Pelsa") accounts at HSBC for the years 2005–2007 and that according to the information provided, Eli Chabot is the beneficial owner of Pelsa. *Id.* at ¶¶ 7–8. On March 12, 2012, the IRS issued an administrative summons requesting that the Chabots appear to testify. On May 12, 2012, the Chabots appeared and, on the advice of counsel, asserted their Fifth Amendment privilege and refused to answer any IRS questions about foreign bank accounts. Gratsy Declaration, at ¶ 5.

On June 20, 2012, the IRS issued another summons to Eli Chabot and one to Renee Chabot. The summons requested both parties to appear on July 13, 2012 to give testimony and produce extensive documents about foreign bank accounts for the period January 1, 2006 to December 31, 2009. *Id.* at ¶¶ 7, 10; *see also* Eli Chabot Summons, Renee Chabot Summons. On July 13, 2012, the Chabots' counsel advised the IRS that the Chabots would not appear, were asserting their Fifth Amendment privilege, and declined to produce the requested documents. *Id.* at ¶ 12, Ex. 3. On November 16, 2012, the IRS amended its summons, narrowing the scope of the information sought to request only those documents required to be maintained by 31 C.F.R. § 1010.420 ("Section 1010.420"). *Id.* at ¶ 13; Pet. To Enforce Summons, at ¶ 8. The Chabots continued to assert their privilege.

On May 14, 2014, the IRS filed a petition to enforce the November 16th summons. *See* Pet. To Enforce Summons. On May 19, 2014, this Court entered an Order to Show Cause, which was adjourned by consent until September 22, 2014. The Order to Show Cause directed Respondents to present any defense or opposition to the petition to enforce the summons.

In their written response, Respondents assert the Fifth Amendment Act of Production Privilege and claim that the Required Records Doctrine, which precludes assertion of the Fifth Amendment privilege, does not apply. The Government replied and urges this Court to adopt the reasoning of six federal courts of appeal in finding that foreign bank account information requested under the Bank Secrecy Act, including under 31 C.F.R. § 1010.420, falls within the Required Records Doctrine. The Third Circuit has not yet ruled on this issue.

***2** On September 22, 2014, this Court held a hearing on its Order to Show Cause and reserved its decision. This Opinion follows.

II. Standard of Review

The Fifth Amendment of the United States Constitution states that "[n]o person ... shall be compelled in any criminal case to be a witness against himself. U.S. Const. Amend. 5. The Supreme Court has clarified that the privilege extends to the act of producing potentially incriminating documents. *Fisher v. United States,* 425 U.S. 391, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976) ("The act of producing evidence in response to a subpoena ... has communicative aspects of its own, wholly aside from the contents of the papers produced."); *see also United States v. Hubbell,* 530 U.S. 27, 120 S.Ct. 2037, 147 L.Ed.2d 24 (2000).

The Required Records Doctrine was first articulated in *Shapiro v. United States,* 335 U.S. 1, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948). Viewed by some courts as an exception to the Fifth Amendment privilege and by others as a "threshold inquiry to determine whether the privilege attaches in the first place," *see In re Special February 11–1 Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d 903 (7th Cir.2012) ("Special February Grand Jury Subpoena"),[1] the doctrine prevents individuals, who possess records the Government requires them to maintain as a result of voluntary participation in certain regulated activities, from asserting their Fifth Amendment privilege. *Shapiro,* 335 U.S. at 33.[2] In a subsequent decision, the Court specified three "premises," or factors, in determining whether the Required Records Doctrine applies: "first, the purposes of the United States' inquiry must be essentially regulatory; second, information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept; and third, the records themselves must have assumed 'public aspects' which render them at least analogous to public documents." *Grosso v. United States,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968).[3]

The Bank Secrecy Act of 1970 ("BSA") regulates offshore banking, and identifies as its purpose "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." 31 U.S.C. § 5311. Under Section 241(a) of the Act, which requires U.S. citizens to "keep records and file reports" of their foreign financial transactions and relationships, the Treasury Department promulgated regulations requiring U.S. citizens with foreign bank accounts to disclose their foreign bank accounts in the form of what is called a foreign bank account report ("FBAR"). 31 C.F.R. § 1010.350. If the citizen possesses, otherwise has a financial interest in, or has signatory authority over such accounts, she must retain the records of such accounts for at least five years, to be kept "available for inspection as authorized by law." *Id.* 1010.420. Failure to file an FBAR is a felony under 31 U.S.C. § 5322.

III. Analysis

Respondents argue that, under the three-pronged test articulated in *Grosso,* (1) Section 1010.420 does not literally require that records be kept, only that information be "retained" and, to the extent it does require records, it is essentially criminal, not regulatory; (2) the information sought is not "customarily kept" by foreign account holders and beneficiaries, especially those in "secrecy" jurisdictions; and (3) the bank records in question, to the extent they exist, are private, informally recorded, and cannot reasonably be said to have a "public aspect." Further, Respondents contend that the required records doctrine should not be extended to a situation such as the present one, in which "the nexus between the recordkeeping requirement and the potential crime is so connected."[4] Resp. Brief at 26.

***3** The Third Circuit has not yet decided whether the documents sought in a summons for foreign bank account information under Section 1010.420 fall within the Required Records Doctrine. However, the Second, Fourth, Fifth, Seventh, Ninth, and Eleventh Circuits have all reached the issue and found that the Required Records Doctrine applies. *See In re Grand Jury Subpoena Dated February 2, 2012,* 741 F.3d 339 (2d Cir.2013); *U.S. v. Under Seal,* 737 F.3d 330 (4th Cir.2013); *In re Grand Jury Proceedings,* 707 F.3d 1262 (11th Cir.2013); *In re Grand Jury Subpoena,* 696 F.3d 428 (5th Cir.2012); *Special February Grand Jury Subpoena,* 691 F.3d 903 (7th Cir.2012); *In re M.H.,* 648 F.3d 1067 (9th Cir.2011), cert. denied sub. nom. *M.H. v. U.S.,* ––U.S. ––, 133 S.Ct. 26, 183 L.Ed.2d 676 (2012). The Government contends that the arguments found persuasive by these other circuit courts should convince this Court, as well. In contrast, Respondents assert that these decisions (1) do not control this Court, (1) are incorrectly decided, and (3) are distinguishable on the facts.

A. *Three-pronged Test*

1. *"Essentially Regulatory"*

The Supreme Court has noted that in those cases where the Fifth Amendment privilege was found to protect against statutory disclosures, "the disclosures condemned were only those extracted from a highly selective group inherently suspect of criminal activities and the privilege was applied only in an area permeated with criminal statutes—not in an essentially noncriminal and regulatory area of inquiry." *California v. Byers,* 402 U.S. 424, 430, 91 S.Ct. 1535, 29 L.Ed.2d 9 (1971).

Respondents argue that Section 1010.420 only requires that five items of information "shall be retained" and "be kept at all times available for inspection," which, when read literally, does not necessarily require the keeping of records. However, Respondents cite no textual support for this proposition. The Government points to Section 1010.420's text to belie Respondent's argument. Section 1010.420 states:

> *Records* of accounts required by § 1010.350 to be reported to the Commissioner of Internal Revenue shall be retained by each person having a financial interest in or signature or other authority over any such account. Such *records* shall contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period. Such *records* shall be retained for a period of 5 years and shall be kept at all times available for inspection as authorized by law.

31 C.F.R. § 1010.420 (emphasis added).[5]

Respondents further argue that Section 1010.420's requirements, when read in isolation from the rest of the BSA, are essentially criminal because Section 1010.420(1) requires records to be retained for five years, which parallels the five-year statute of limitations for federal non-capital crimes, and (2) is administered by a self-proclaimed criminal enforcement agency, the Financial Crimes Enforcement Network ("FinCEN").[6] Respondents cite to *Marchetti, Grosso, Leary,* and *Haynes,* all cases in which the Supreme Court found the Fifth Amendment privilege to apply because the statutes in question targeted inherently illegal activity.[7]

***4** However, all six circuit courts have found that the BSA is essentially regulatory, not criminal, in nature, and does not exceed constitutional limits it its regulation. For one, the statute targets a group of individuals not necessarily engaging in illegal activity, distinguishing these facts from those in *Marchetti, Grosso, Leary,* and *Haynes. In re M.H.,* 648 F.3d at 1074 ("There is nothing inherently illegal about having or being a beneficiary of an offshore foreign bank account."); *see also Grand Jury Subpoena Dated February 2, 2012,* 741 F.3d at 348. Second, the information sought under the statute is used for a variety of purposes, not just for criminal prosecution. *Id.* ("[T]his multifaceted statute clearly contributes to civil and intelligence efforts wholly unrelated to any criminal purpose."); *California Bankers Ass'n v. Shultz,* 416 U.S. 21, 76–77, 94 S.Ct. 1494, 39 L.Ed.2d 812 (1974) (In the BSA, "Congress seems to have been equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported."); *Grand Jury Proceedings,* 707 F.3d at 1271 ("[T]he Treasury Department shares the information it collects pursuant to the Act's requirements with other agencies ... none of which are empowered to bring criminal prosecutions."); *see also* 31 U.S.C. § 5311.

Further, the Government argues—and this Court agrees —that Section 1010.420 in particular has both criminal and civil purposes.[8] First, the disclosure requirements assist the IRS in gathering evidence of undetected civil liability. Second, the regulation at its core seeks basic information about the plausibly innocuous activity of maintaining a foreign bank account. Other district courts have held similarly. *See, e.g., In re Grand Jury Subpoena Dated February 2, 2012,* 908 F.Supp.2d 348, 355 (E.D.N.Y.2012) *aff'd,* 741 F.3d 339 (2d Cir.2013) ("Because the record-keeping requirements of 31 C.F.R. § 1010.420 do not target inherently illegal activity, the provision is essentially regulatory in nature."). Third, as the Second Circuit aptly notes, the fact that FinCEN uses Section 1010.420, a "multi-purposed statute" for criminal enforcement purposes "is neither surprising nor persuasive," and does not change the conclusion that the regulation is essentially regulatory.

Respondents next argue that the other circuits that have considered this issue have ruled incorrectly because they failed to focus on the close connection between the disclosure under Section 1010.420 and the potential crime at issue (i.e., willful failure to file an FBAR under Section 1010.350 of the same statute). Respondents argue that because responding to the IRS's summons may essentially result in admitting to a FBAR violation, they would be potentially forced to admit an element of the crime. Respondents cite to extra-circuit cases involving the attorney-client privilege. *See Baird v. Koerner,* 279 F.2d 623, 633 (9th Cir.1960) (finding that privilege applied when the disclosure of the client's name would implicate the client in a crime); *Tillotson v. Boughner,* 350 F.2d 663 (7th Cir.1965) (finding that privilege applies when "disclosure of the identity of the client ... would lead ultimately to disclosure of the taxpayer's motive for seeking legal advice").

***5** Respondents' arguments do not hold sway here. First, in order to establish that Respondents have violated the BSA, the Government would have to prove that Respondents acted *willfully.* "That fact distinguishes this case from *Marchetti* and *Grosso,* where the activity being regulated—gambling—was almost universally illegal, so that paying a tax on gambling wagers necessarily implicated a person in criminal activity. Admitting to having a foreign bank account carries no such risk. "That the information contained in the required record may ultimately lead to criminal charges does not convert an essentially regulatory regulation into a criminal one." *In re M.H.,* 648 F.3d at 1074–75; *see also Grand Jury Subpoena dated February 2, 2012,* 741 F.3d at 352 ("[A]n account owner who was truly unaware of the recordkeeping requirement would not incur related criminal sanctions by acknowledging in response to a production order his negligent failure to maintain the required record.").

At the September 22nd hearing, Respondents also attempted to distinguish the facts of this case from the six appellate courts which have considered the applicability of the Required Records Doctrine to records requested under Section 1010.420. Respondents argue that here, while they are subjects of a civil investigation, they have nonetheless been brought in for formal interrogation by the IRS, which can also open a parallel criminal investigation—whereas the appellate courts that have ruled on this issue dealt with individuals who were the targets of grand jury investigations. *See, e.g., M.H.,* 648 F.3d at 1070. Respondents also request the Court to take judicial notice of (1) deferred prosecution agreements between the government and UBS and HSBC that resulted in UBS turning over the account information for "certain United States customers of UBS's cross-border business"[9] as well as (2) transcripts from the May 2, 2012 meeting between Respondents and the IRS submitted on the eve of the September 22nd hearing. At the hearing, Respondents argued that the interrogations evidenced from the transcripts, taken together with the deferred prosecution agreements and the totality of the circumstances, created an essentially criminal atmosphere for Respondents that meaningfully differed from the atmosphere encountered by the individuals targeted by grand jury investigations in the six appellate cases.

However, Respondents' attempts to distinguish their case from the six appellate cases that have reached this issue are unconvincing. First, at least one district court has addressed the validity of an IRS administrative summons requesting information under Section 1010 .420, and found no reason to distinguish the Fifth Amendment jurisprudence examined by the appellate courts. *See U.S. v. Chen,* 952 F.Supp.2d 321, 330–31 (D.Mass.2013). Second, even if the IRS began civilly investigating Respondents due to information the IRS received from the deferred prosecution agreements, it does not follow that such a fact transforms Section 1010.420, or even the IRS's use of the regulation in this case, into an "essentially criminal" regulation. As has been represented by the IRS here, there is currently no ongoing criminal investigation or one currently contemplated,[10] which, if anything, makes the application of the Required Records Doctrine here *more* compelling than in the six appellate cases, where the prospect of criminal charges loomed larger because the relevant individuals had been issued grand jury subpoenas and were identified as targets of grand jury investigations.[11] Respondents also fail to cite any case law that requires, or even sanctions, case-by-case speculation under the Required Records Doctrine about the subjective, long term intention behind each records request issued pursuant to a valid regulatory scheme.[12]

***6** Finally, at the September 22nd hearing, Respondents contended that expanding the Required Records Doctrine to Section 1010.420 and depriving them of the Fifth Amendment protection has the effect of allowing the IRS to administratively summon individuals, question them about whether they have foreign bank accounts, and, if they refuse to answer, make an end run around the

Fifth Amendment by asking for records under Section 1010.420. Once the individuals respond with the requested information, the IRS can commence criminal proceedings. Respondents apparently argue against viewing offshore bankers as having "waived" their Fifth Amendment rights by quoting the following dicta in *Marchetti:*

> The constitutional privilege was intended to shield the guilty and imprudent as well as the innocent and foresighted; if such an inference of antecedent choice were alone enough to abrogate the privilege's protection, it would be excluded from the situations in which it has historically been guaranteed, and withheld from those who most require it. Such inferences, bottomed on what must ordinarily be a fiction, have precisely the infirmities which the Court has found in other circumstances in which implied or uninformed waivers of the privilege have been said to have occurred. To give credence to such 'waivers' without the most deliberate examination of the circumstances surrounding them would ultimately license widespread erosion of the privilege through ingeniously drawn legislation.

390 U.S. at 51–52. I find Respondents' reliance on *Marchetti* in this case unpersuasive because this Court has examined the surrounding circumstances and determined that the BSA, including Section 1010.420, does not target a group engaged in inherently criminal activity as was present in *Marchetti;* in *Marchetti,* the underlying statute targeted "wagerers," or gamblers, whose activities were "very widely prohibited under both federal and state law." *Marchetti,* 390 U.S. at 44. *Compare In re Special February 11–1 Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d at 309 ("The voluntary choice to engage in an activity that imposes record-keeping requirements under a valid civil regulatory scheme carries consequences, perhaps the most significant of which, is the possibility that those records might have be turned over upon demand, notwithstanding any Fifth Amendment privilege."). And, again, construing the Required Records Doctrine in this manner does not amount to criminalizing offshore banking. Moreover, it bears emphasizing that compliance with the record keeping requirements of the Act is not incriminating on its face. Compare *Grosso,* 390 U.S. at 66–67, 88, with *Byers,* 402 U.S. at 430–31. "This is not a situation, as petitioners insist, where Congress can completely avoid the Fifth Amendment self-incrimination privilege by simply passing a law that requires a person to keep documents of *illegal* activities and if such records of *illegal* activities are not kept that the same be designated as a crime." Keeping an offshore bank account, like "buying and selling automobiles, is not, in and of itself, an illegal activity." *In re Grand Jury Subpoena Duces Tecum Served Upon Underhill,* 781 F.2d at 69. Therefore, under the *Grosso* test, the BSA—including Section 1010.420—is essentially regulatory.

2. *"Customarily Kept"*

***7** Next, I consider whether the disclosures sought are of information customarily kept. *Grosso,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 19 L.Ed.2d 906. Here, Respondents contend that (1) the information sought under Section 1010.420 do not constitute "records";[13] (2) Section 1010.420 applies to individuals who may not even know of the existence of the bank account(s) in question, and therefore would not keep any records to such account(s); and (3) the inherent nature of foreign banking is so secretive that individuals regulated by Section 1010.420 may not ever possess, much less maintain, records required under the regulation.

However, the appellate courts that have already considered this issue have all rejected Respondents' second and third arguments and found that records requested under Section 1010.420 are customarily kept. "The information that § 1010.420 requires to be kept is basic account information that bank customers would customarily keep, in part because they must report it to the IRS every year as part of the IRS's regulation of offshore banking, and in part because they need the information to access their foreign bank accounts." *In re M.H.,* 648 F.3d at 1076. Regarding the argument that foreign banking can be inherently secretive, "even if those who possess foreign bank accounts for the purposes of avoiding some specific U.S. tax or criminal laws may be less likely to maintain these records, the BSA covers the entire group of foreign bank account holders. We decline to look at the custom of only the miscreants among the larger group of foreign bank account holders." *Grand Jury Subpoena Dated February 2, 2012,* 741 F.3d at 350–51. The Court agrees with the existing case law on this issue and finds such basic and easily-accessible account information to be "customarily kept" under *Grosso* and its progeny.

3. *"Publicly Kept"*

The third prong of analysis invites this Court to examine whether the records sought possess a public aspect. *Grosso,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 19 L.Ed.2d 906. Here, Respondents argue again that the requested information (1) does not constitute a record,[14] because such information can be comprised of hastily scrawled numbers on a napkin and (2) is private, analogous to general taxpayer records. *See Smith v. Reichert,* 35 F.3d 300 (7th Cir.1994).

First, Respondents' argument that records do not include information such as bank account numbers or amounts held in a bank account is not well-taken. Section 1010.420 states that "records of reports required [to be reported] under Section 1010.350 shall be retained for a period of five years and shall be kept at all times available for inspection as required by law." *In re M.H.,* 648 F.3d at 1077; *see also* 31 C.F.R. § 1010.420. Further, Merriam–Webster defines the verb "record" as "to write (something) down so that it can be used or seen again in the future."[15] Information that is required by law to be annually reported, retained, and kept available for inspection indeed constitutes records—regardless of whether the information can fit on a napkin.

***8** Second, the information sought under Section 1010.420 cannot be considered private under the Required Records Doctrine. *Smith,* which concerned taxpayer records such as W–2s and 1099s, is distinguishable. In fact, *Smith* states, "[t]he hypothetical case in which every individual is required to maintain a record of everything he does that interests the government is remote from the case of the individual who enters upon a regulated activity knowing that the maintenance of extensive records available for inspection by the regulatory agencies is one of the conditions of engaging in that activity."). *See also In re Special February 11–1 Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d 300, 309 (7th Cir.2012) ("The voluntary choice to engage in an activity that imposes record-keeping requirements under a valid civil regulatory scheme carries consequences, perhaps the most significant of which, is the possibility that those records might have be turned over upon demand, notwithstanding any Fifth Amendment privilege.").

The Court agrees with the six appellate courts in concluding that because "the personal information is compelled in furtherance of a valid regulatory scheme, as is the case here, that information assumes a public aspect." This is especially true because the Treasury Department typically shares the information it collects under BSA regulations such as Section 1010.420 with other agencies, serving "important public purposes sufficient to imbue otherwise private foreign bank account records with public aspects." *In re Grand Jury Proceedings, No. 4–10,* 707 F.3d at 1273.

Because the *Grosso* test's premises are met, the Required Records Doctrine applies and Respondents may not claim the Fifth Amendment privilege to refuse responding to the IRS's summons.

IV. CONCLUSION

For the reasons stated above, the Court grants the Government's petition to enforce the IRS summons served on Respondents. An appropriate order shall follow.

All Citations

Not Reported in F.Supp.3d, 2014 WL 4979735, 114 A.F.T.R.2d 2014-6235, 2014-2 USTC P 50,466

Footnotes

[1] The Third Circuit has not explicitly ruled on whether the Required Records Doctrine is an exception to the Fifth Amendment privilege. Nonetheless, the circuit has recognized that the doctrine places certain records and filings "outside the prohibition against compulsory self-incrimination." *U.S. v. Buck,* 730 F.2d 129, 132 (3d Cir.1984).

[2] *Shapiro* cautions "that there are limits which the government cannot constitutionally exceed in requiring the keeping of records which may be ... used in prosecuting statutory violations committed by the record-keeper himself." 335 U.S. at 32. However, Respondents do not argue that the Bank Secrecy Act exceeds those limits. Further, the Constitution explicitly allows Congress to "regulate Commerce with Foreign Nations, a category into which offshore banking falls." U.S. Const. art. I, § 8, cl. 3.

[3] Some circuit courts view the three "premises" as requirements. *See Special February Grand Jury Subpoena,* 691 F.3d at 906. Other courts view the test articulated in *Grosso* as more flexible. *See In Re Grand Jury Subpoena,* 696 F.3d 428, 433 (5th Cir.2012) ("Although the Fifth Circuit has applied the first and third prongs of the Required Records Doctrine, it has not applied the second prong ...."). The Third Circuit has not yet taken a position on this issue.

[4] For purposes of these proceedings, Respondents do not contest that the Government has met its burden of proof under *U.S. v. Powell,* 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964) to establish a *prima facie* case for issuing a summons in good faith—by showing that (1) "the investigation will be conducted pursuant to a legitimate purpose," (2) "the inquiry may be relevant to the purpose," (3) "the information sought is not already within the IRS's possession," and (4) "the administrative steps required by the Internal Revenue Code have been followed." *U.S. v. Clarke,* ––– U.S. ––––, 134 S.Ct. 2361, 189 L.Ed.2d 330 (2014) (quoting *Powell,* 379 U.S. at 57–58); *see also* Gratsky Decl. at ¶¶ 9–12.

[5] Additional arguments regarding whether the information sought constitutes "records" are analyzed in the second prong of the *Grosso* test. *See infra* at 11.

[6] Additionally, Respondents cursorily argue that "[a]ny averment by the IRS that the information collected from FBARs and/or collected pursuant to 1010.420 is used for essentially regulatory purposes should be the subject of a hearing pursuant to the teaching of *United States v. Clarke."* ––– U.S. ––––, 134 S.Ct. 2361, 189 L.Ed.2d 330 (2014). Basically, Respondents attach a bad faith motive to the IRS for taking the position that Section 1010.420 is "essentially regulatory" to support the IRS summons here. However, Respondents offer no specific facts that would support an inference of bad faith on the part of the IRS. *Clarke,* 134 S.Ct. at 2365 (The taxpayer only "has a right to question IRS officials about their reasons for issuing a summons .... when he points to specific facts or circumstances plausibly raising an inference of bad faith."). Further, Respondents conceded at the hearing that it did not intend to pursue an evidentiary hearing.

[7] The statutes at issue in these four cases imposed the following requirements: (1) in *Marchetti* and *Grosso,* a tax on wagering, which was virtually banned at the time; (2) in *Haynes,* the registration of illegal firearms; and (3) in *Leary,* registering marijuana traffickers. *Marchetti v. United States,* 390 U.S. 39, 47, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968); *Grosso,* 390 U.S. at 64; *Haynes v. United States,* 390 U.S. 85, 96, 88 S.Ct. 722, 19 L.Ed.2d 923 (1968); and *Leary v. United States,* 395 U.S. 6, 16, 18, 89 S.Ct. 1532, 23 L.Ed.2d 57 (1969).

[8] It is not even clearly necessary to read Section 1010.420 apart from the BSA to determine whether the law at issue is essentially criminal or regulatory. Other circuits have only generally analyzed the underlying statute. *See, e.g., In re Grand Jury Subpoena To Custodian of Records,* 497 F.2d 218, 220 (6th Cir.1974), *cert. denied,* 419 U.S. 1009, 95 S.Ct. 328, 42 L.Ed.2d 283 (statute should be read "as a whole" to determine whether regulatory in nature); *see also In re Grand Jury Subpoena Duces Tecum Served Upon Underhill,* 781 F.2d 64, 67 (6th Cir.1986) ("Although the specific provisions of the Act and the regulations ... may have criminal application, these provisions serve the overall purpose of enforcement of an essentially regulatory program."). The Third Circuit has not yet addressed this issue.

[9] On September 30, 2014, Respondents filed a post-hearing submission elaborating on the significance of the deferred prosecution agreements. Respondents argue that the "certain customers" whose accounts UBS turned over "were inherently those who were suspected of criminal conduct—failure to file an FBAR as required by 31 CFR 1010.350, and made criminal by 31 U.S.C. § 5322." *See* Sept. 30 letter, at 2. Respondents also cite to a DOJ press release publicizing the deferred prosecution agreement in which the DOJ noted it had "successfully prosecuted six U.S. customers of UBS whose information was provided pursuant to the Deferred Prosecution Agreement, and is conducting investigations of dozens of other UBS customers." *Id.*

[10] However, to be clear, the IRS has not represented that a criminal investigation could never develop from the current civil investigation.

[11] To reiterate, "[t]hat the information contained in the required record may ultimately lead to criminal charges does not convert an essentially regulatory regulation into a criminal one." *In re M.H.,* 648 F.3d at 1074–75.

[12] *See, e.g., In re Grand Jury Subpoena Duces Tecum Served Upon Underhill,* 781 F.2d at 67.

[13] The Government does not respond to the first part of Respondents' argument on this issue, presumably because it already addressed whether information requested under Section 1010.420 constitutes a record.

[14] Again, the Government does not explicitly address Respondents' arguments that that information under Section 1010.420 are not records.

[15] *Record,* MERRIAM–WEBSTER, http://www.merriam-webster.com/dictionary/record (last visited Oct. 2, 2014).

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United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
Stephen M. KERR, et al., Defendants.

No. CR–11–02385–002–PHX–JAT.
|
Signed May 16, 2014.

ORDER

JAMES A. TEILBORG, Senior District Judge.

***1** Pending before the Court is Defendant Quiel's Motion to Supplement the Record (Doc. 394), Defendant Kerr's Notice of Joinder to Defendant Quiel's Motion to Supplement the Record (Doc. 395), Defendant Quiel's Motion to Supplement the Record (Doc. 396), and Defendant Kerr's Notice of Joinder to Defendant Quiel's Second Motion to Supplement the Record (Doc. 397). The Court now rules on the motions.

I. Background

The Court has previously recounted the facts of this case:

> In the Indictment (Doc. 3), Kerr was charged with Conspiracy to Defraud the United States (Count 1), Willful Subscription to False Individual Tax Returns for 2007 and 2008 (Counts 2 and 3), and Failure to File Foreign Bank and Financial Accounts (FBARs) for 2007 and 2008 (Counts 6 and 7). Count 1 charged Kerr, Quiel, and Christopher Rusch ("Rusch"), their former attorney, with conspiring to establish companies and bank accounts in Switzerland to move money out of the United States and defraud the IRS. Counts 2 and 3 charged Kerr with intentionally omitting income from the foreign accounts on his 2007 and 2008 tax returns and intentionally failing to mark the box in Schedule B indicating an interest in a foreign bank account. Counts 6 and 7 charged Kerr with willfully failing to file FBARs to report his interest in the foreign accounts. On April 11, 2013, a jury acquitted Kerr of Count 1, and convicted him of Counts 2, 3, 6, and 7 ....
>
> Quiel was charged with Conspiracy to Defraud the United States (Count 1), Willful Subscription to False Individual Tax Returns for 2007 and 2008 (Counts 4 and 5), and Failure to File FBARs for 2007 and 2008 (Counts 8 and 9). Count 1 charged Kerr, Quiel, and Rusch with conspiring to establish companies and bank accounts in Switzerland to move money out of the United States and defraud the IRS. Counts 4 and 5 charged Quiel with intentionally omitting income from the foreign accounts on his 2007 and 2008 tax returns and intentionally failing to mark the box in Schedule B indicating an interest in a foreign bank account. Counts 8 and 9 charged Quiel with willfully failing to file FBARs to report his interest in the foreign accounts. On April 11, 2013, a jury acquitted Quiel of Count 1, and convicted him of Counts 4 and 5.

(Doc. 346 at 1–2). On September 24, 2013, Quiel and Kerr ("Defendants") appealed their convictions to the Ninth Circuit Court of Appeals ("Court of Appeals") (Doc. 372; Doc. 375). Quiel filed his first motion to supplement the record on October 18, 2013, and his second motion on October 22, 2013. (Doc. 394; Doc. 396). Kerr has joined in both motions. (Doc. 395; Doc. 397).

II. Motions to Supplement the Record

Quiel and Kerr ask this Court to supplement the record with documents that they allege tend to show that the third defendant in the case, Christopher Rusch, entered into secret agreements with the government by which Rusch could continue to provide international tax advice. (Doc. 394 at 2–4; Doc. 396 at 1–5). The legal basis for their request is the Court's inherent authority to supplement a record, or alternatively Federal Rule of Appellate Procedure ("FRAP") 10(e). (Doc. 394 at 4; Doc. 396 at 5).

***2** Contrary to Defendants' contention, the Court has no inherent authority to supplement the record after the filing of a notice of appeal. "As a general rule, the filing of a notice of appeal divests a district court of jurisdiction over those aspects of the case involved in the appeal." *Stein v. Wood,* 127 F.3d 1187, 1189 (9th Cir.1997). There are a limited number of exceptions to this general rule, namely to correct clerical errors or clarify a judgment pursuant to Federal Rule of Civil Procedure 60, supervising the status quo during the pendency of an appeal, or when specified by statute. *Id.* No such exception applies in this case. Defendants' filings of notices of appeal on September

24, 2013 divested the Court of jurisdiction with respect to "those aspects of the case involved in the appeal." *See Stein,* 127 F.3d at 1189. Courts' inherent powers "are those which 'are necessary to the exercise of all others.' " *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 764, 100 S.Ct. 2455, 65 L.Ed.2d 488 (1980) (quoting *United States v. Hudson,* 11 U.S. (7 Cranch) 32, 34, 3 L.Ed. 259 (1812)). Because the Court has no jurisdiction over this case, it has no inherent powers to supplement the record.

Defendants' alternative reliance upon FRAP 10(e) is unpersuasive. The rule provides two narrow methods by which a district court may correct the record transmitted to the Court of Appeals:

> (1) If any difference arises about whether the record truly discloses what occurred in the district court, the difference must be submitted to and settled by that court and the record conformed accordingly.
>
> (2) If anything material to either party, is omitted from or misstated in the record by error or accident, the omission or misstatement may be corrected and a supplemental record may be certified and forwarded: ... (B) by the district court before or after the record has been forwarded; ....

Fed. R.App. P. 10(e). "All other questions as to the form and content of the record must be presented to the court of appeals." *Id.* 10(e)(3).

"It is a basic tenet of appellate jurisprudence ... that parties may not unilaterally supplement the record on appeal with evidence not reviewed by the court below." *Lowry v. Barnhart,* 329 F.3d 1019, 1024–25 (9th Cir.2003). As FRAP 10(e) clearly states, only the Court of Appeals has the authority to consider a request to supplement the record with evidence not presented to the district court. *See Nat'l Ass'n for Advancement of Multijurisdiction Practice v. Ariz. Supreme Court,* 2013 WL 5718962, at *2 (D.Ariz.2013) (holding that a request to supplement the record with materials not reviewed by the court "should be directed to the Ninth Circuit Court of Appeals"). Defendants have not shown that their proposed evidence was "omitted from or misstated in the record by error or accident." *See* Fed. R.App. P. 10(e)(2). Indeed, Defendants' stated purpose in seeking to add this evidence to the record is precisely because it was not before the Court at the time of trial or sentencing. *See* (Doc. 394 at 3). This request is appropriately directed to the Court of Appeals, and this Court lacks jurisdiction to consider it. [1]

III. Conclusion

***3** For the foregoing reasons,

IT IS ORDERED that Defendant Quiel's Motion to Supplement the Record (Doc. 394) and Defendant Quiel's Motion to Supplement the Record (Doc. 396) are denied. [2]

All Citations

Not Reported in F.Supp.3d, 2014 WL 2009004

Footnotes

[1] Defendants cite several cases in support of their contention that this Court has authority to supplement the record. (Doc. 394 at 4; Doc. 396 at 5). Each of these cases are distinguishable. *See Cruz v. Astrue,* 2012 WL 3011491, at *1 (D.Ariz. July 23, 2012) (remarking that 42 U.S.C. § 405(g) provided the court with the authority to order the Commission of Social Security to supplement the record); *LimoStars, Inc. v. N.J. Car & Limo, Inc.,* 2011 WL 3471092, at *3 n. 5 (D.Ariz. Aug.8, 2011) (noting that a district court may order the record supplemented for the purpose of obtaining accurate information when ruling on pending motions); *Mangini v. United States,* 314 F.3d 1158, 1160–61 (9th Cir.) (noting that the Court of Appeals had in a separate order granted a motion to supplement the record on appeal "to correct a material misstatement in the record"), *amended by* 319 F.3d 1079 (9th Cir.2003).

[2] Because Kerr joined in these motions, they are denied with respect to Kerr as well.

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2017 WL 5433201
United States District Court,
E.D. Virginia.

UNITED STATES of America, Plaintiff,
v.
George FORBES, Defendant.

Case No. 1:17–cv–00530 (LMB/IDD)
|
Signed 08/24/2017

Attorneys and Law Firms

Kieran O'Neill Carter, US Department of Justice—Tax Division, Washington, DC, Gerard J. Mene, United States Attorney's Office, Alexandria, VA, for Plaintiff.

REPORT AND RECOMMENDATION

Ivan D. Davis, United States Magistrate Judge

***1** This matter is before the Court on Plaintiff's Motion for Default Judgment against Defendant George Forbes ("Defendant") pursuant to Federal Rule of Civil Procedure 55(b)(2). (Dkt. No. 12.) After neither Defendant nor a licensed attorney for Defendant appeared at the hearing on August 18, 2017, the undersigned Magistrate Judge took this matter under advisement to issue this Report and Recommendation. Upon consideration of the Complaint, the Motion for Entry of Default Judgment, and the supporting documents, the undersigned Magistrate Judge makes the following findings and recommends that Plaintiff's Motion be **GRANTED.**

I. INTRODUCTION

Plaintiff, United States of America ("Plaintiff"), filed the Complaint on May 5, 2017 to collect unpaid federal income taxes assessed against Defendant for the years 2008, 2009, and 2010 (Compl. at 1.) Plaintiff has moved for default judgment against Defendant and seeks damages in the amount of $1,657,812.23 as of May 3, 2017, plus statutory additions to tax accruing until paid. (Compl. ¶ A.)

A. Jurisdiction and Venue

Rule 55 of the Federal Rules of Civil Procedure provides for the entry of default judgment when "a party against whom a judgment for affirmative relief is sought has failed to plead or otherwise defend." FED. R. CIV. P. 55(a). The court must have both subject matter and personal jurisdiction over a defaulting party before it can render a default judgment.

This Court has original jurisdiction over all civil actions arising under the Constitution, any civil action expressly authorized by Act of Congress, as well as any civil action arising under any Act of Congress providing for internal revenue. 28 U.S.C. §§ 1331, 1345, and 1355(a). Therefore, this Court has subject matter jurisdiction. This Court has personal jurisdiction over Defendant because he resides in Virginia and was personally served in Virginia. *See Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316–17 (1945). Venue is proper in this Court pursuant to 28 U.S.C. § 1396.

B. Service of Process

For a court to have personal jurisdiction over a defendant for the purpose of entering default judgment, the plaintiff must properly serve the defendant under federal or state law. *Miss. Publ'g Corp. v. Murphree*, 326 U.S. 438, 444–45 (1946) (stating that "service of summons is the procedure by which a court having venue and jurisdiction of the subject matter of the suit asserts jurisdiction over the person of the party served"); *Cent. Operating Co. v. Util. Workers of Am.*, 491 F.2d 245, 249–51 (4th Cir. 1974) (reversing the district court's entry of default judgment because the court lacked personal jurisdiction where the plaintiff failed to effectively serve the defendant with summons and complaint). The Federal Rules of Civil Procedure provide the manner in which service must occur.

Federal Rule of Civil Procedure 4(e) governs service upon an individual and allows service by "delivering a copy of the summons and of the complaint to the individual personally [or] leaving a copy of each at the individual's dwelling or usual place of abode with someone of suitable age and discretion who resides there." FED. R. CIV. P. 4(e)(2)(A)–(B). On May 23, 2017, a certified process server served Defendant by personally serving him with the Summons and Complaint. (Dkt. No. 6.) Therefore, Plaintiff properly served Defendant pursuant to Rule 4(e).

C. Grounds for Default

***2** On May 5, 2017, Plaintiff filed its Complaint against Defendant seeking unpaid federal income taxes and statutory additions to tax accruing and continuing until paid. (Dkt. No. 1.) A certified process server served Defendant on May 23, 2017. (Dkt. No. 6.) On June 28, 2017, after Defendant failed to respond, the Clerk of Court entered default against Defendant. (Dkt. No. 9.) On July 21, 2017, Plaintiff filed the pending Motion for Default Judgment. (Dkt. No. 12.) This Court held a hearing on the Motion on August 18, 2017. (Dkt. No. 16.) After Defendant failed to appear at the August 18, 2017 hearing, the undersigned Magistrate Judge took this matter under advisement to issue this Report and Recommendation.

II. EVALUATION OF PLAINTIFF'S COMPLAINT

Rule 55 of the Federal Rules of Civil Procedure provides for the entry of default judgment when "a party against whom a judgment for affirmative relief is sought has failed to plead or otherwise defend." FED. R. CIV. P. 55(a). A defendant in default concedes the factual allegations of the complaint. *See, e.g., DIRECTV, Inc. v. Rawlins*, 523 F.3d 318, 322 n.2 (4th Cir. 2008); *Partington v. Am. Int'l Specialty Lines Ins. Co.*, 443 F.3d 334, 341 (4th Cir. 2006); *Ryan v. Homecomings Fin. Network*, 253 F.3d 778, 780 (4th Cir. 2001). Default does not, however, constitute an admission of the adversary's conclusions of law, and is not to be "treated as an absolute confession by the defendant of his liability and of the plaintiff's right to recover." *Ryan*, 253 F.3d at 780 (quoting *Nishimatsu Constr. Co., Ltd. v. Hous. Nat'l Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975)). Instead, the Court must "determine whether the well-pleaded allegations in [the plaintiff's] complaint support the relief sought in [the] action." *Id.*

Thus, in issuing this Report and Recommendation, the undersigned Magistrate Judge must evaluate Plaintiff's claims against the standards of Rule 12(b)(6) of the Federal Rules of Civil Procedure to ensure that the Complaint contains plausible claims upon which relief may be granted. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (explaining the analysis for examining a plaintiff's claims under a 12(b)(6) motion to dismiss). To meet this standard, a complaint must set forth "sufficient factual matter, accepted as true, to state a claim for relief that is plausible on its face." *Id.* (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). In determining whether allegations are plausible, the reviewing court may draw on context, judicial experience, and common sense. *Francis v. Giacomelli*, 588 F.3d 186, 193 (4th Cir. 2009) (citing *Iqbal*, 556 U.S. at 679).

III. FINDINGS OF FACT

Upon a full review of the pleadings, the undersigned Magistrate Judge finds that Plaintiff has established the following facts. Plaintiff is the United States of America. (Compl. ¶ 3.) Defendant is a resident of Virginia who failed to file Form TDF 90–22.1, Report of Foreign Bank and Financial Accounts ("FBAR"), for the years of 2008, 2009, and 2010. (Compl. ¶¶ 5, 11.) Defendant, a United States Citizen, lived and worked in Qatar from 2004 to 2011. (Compl. ¶ 9.) During 2008, 2009, and 2010, Defendant owned or had an interest exceeding $10,000.00 in each of his financial accounts at the Commercial Bank of Qatar, UBS, Bank Julius Baer, Barclays Wealth (Monaco), and Ashton Funds Management. (Compl. ¶ 10.) Defendant was aware of his obligation to file FBARs with respect to his interest in his foreign financial accounts because Defendant previously filed FBARs for the calendar years of 2004 through 2007. (Compl. ¶ 12.) Defendant did not report any underreported income for the calendar years of 2008, 2009, and 2010. (Compl. ¶ 24(b).) Defendant used fictitious names and numbered bank accounts in an attempt to conceal his ownership of, or interest in, the foreign financial accounts at issue. (*Id.* at ¶ 24(c).) Defendant has been sent notice and demand for payment for the penalties assessed against him for his willful failure to file FBARs for 2008, 2009, and 2010. (Compl. ¶ 25.)

***3** A delegate of the Secretary of the Treasury of the United States assessed civil penalties under 31 U.S.C. § 5321 against Defendant for his willful failure to report his interests in foreign bank accounts for the calendar years of 2008, 2009 and 2010, as follows:

(Dkt. No. 13 ¶ 7.) As of May 3, 2017, Plaintiff seeks $1,657,812.23 for federal civil penalties, plus interest that has accrued and will continue to accrus by statute until paid. (Dkt. No. 13 at ¶ 9; *see also* 28 U.S.C. §§ 3717(a), 3717(e)(2), 1961(a).)

The undersigned finds that Plaintiff has set forth sufficient factual matter to state a claim for relief that is plausible on its face and that Plaintiff has established Defendant's liability for unpaid federal income taxes with reasonable certainty.

IV. RECOMMENDATION

For the reasons set forth above, the undersigned Magistrate Judge recommends the entry of default judgment in favor of Plaintiff, United States of America, against Defendant, George Forbes. Plaintiff is entitled to $1,657,812.23 as of May 3, 2017, for federal civil penalties, plus statutory interest that has since accrued pursuant to 28 U.S.C. §§ 3717(a), 3717(e)(2), and interest that will continue hereafter pursuant to 28 U.S.C. § 1961(a), until paid.

V. NOTICE

By mailing copies of this Report and Recommendation, the parties are notified as follows. Objections to this Report and Recommendation, pursuant to 28 U.S.C. § 636 and Rule 72(b) of the Federal Rules of Civil Procedure, must be filed within fourteen (14) days of service on you of this Report and Recommendation. A failure to file timely objections to this Report and Recommendation waives appellate review of the substance of the Report and Recommendation and waives appellate review of a judgment based on this Report and Recommendation.

The Clerk is directed to send a copy of this Report and Recommendation to all counsel of record and to the Registrant at the following address:

All Citations

Slip Copy, 2017 WL 5433201, 120 A.F.T.R.2d 2017-6018

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2017 WL 4803823
United States District Court, D. Arizona.

Michael QUIEL, Petitioner,
v.
USA, Respondent.

No. CV-16-01535-PHX-JAT (MHB)
|
CR-11-02385-PHX-JAT
|
Signed 10/24/2017
|
Filed 10/25/2017

Attorneys and Law Firms

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Gregory Bernstein, Timothy J. Stockwell, US Dept. of Justice, Washington, DC, Monica B. Edelstein, US Attorneys Office, Phoenix, AZ, for Respondent.

ORDER

James A. Teilborg, Senior United States District Judge

***1** Pending before the Court is Movant's amended Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside or Correct a Sentence by a Person in Federal Custody (Doc. 7.) The Government has answered, (Doc. 11), and Movant has replied, (Doc. 14.) Magistrate Judge Michelle H. Burns has issued a Report and Recommendation ("R&R") recommending that Movant's claims be denied and dismissed with prejudice, that a Certificate of Appealability be denied, and that leave to proceed *in forma pauperis* on appeal be denied. (Doc. 17.) Movant objects to the R&R. (Doc. 18.)

Relatedly, pending before the Court is Movant's Motion to Compel Government to Produce Documents. (Doc. 19.) The Government opposes this request. (Doc. 20.)

I. Background

Movant does not dispute the procedural background provided by the Magistrate Judge. Therefore, this Court adopts that background, except regarding Movant's subsequently decided appeal:

> On December 8, 2011, a grand jury indicted Movant Michael Quiel with one count of Conspiracy to Defraud the United States, two counts of Willful Subscription to False Individual Income Tax Returns, and two counts of Willful Failure to File Reports of Foreign Bank and Financial Accounts ("FBAR").[1] (CR Docs. 3, 463.)
>
> On September 24, 2013, Movant was convicted on two counts of Willful Subscription to False Individual Income Tax Returns, in violation of 26 U.S.C. § 7206(1).[2] He was sentenced to a 10-month term of imprisonment, to be followed by a one-year term of supervised release. Movant appealed his convictions to the Ninth Circuit Court of Appeals arguing, the following:
>
> - "[Movant] was denied his constitutional right to cross-examine Rusch on three exhibits entered on redirect"
> - "The Government's repeated reference to [Movant's] complicated securities transactions as fraud was prejudicial and the court's allowing such references over objection was error"
> - "[Movant] was denied his constitutional right to counsel by the trial court's allowing Rusch to testify in violation of [Movant's] attorney-client privilege"
> - "The trial court erroneously refused to require production of the special agent's report, [Movant's] individual master file, and the notes of the Government's chief investigator, and refused to review the documents in camera or even preserve them for review by this court"
>
> (United States v. Quiel, No. 13-10503, Doc. 20.)
>
> The Ninth Circuit affirmed Movant's convictions on December 19, 2014, and the mandate issued on February 6, 2015. United States v. Quiel, 595 Fed.Appx. 692 (9th Cir. 2014), cert. denied, 135 S.Ct. 2336 (2015). The Ninth Circuit held, in pertinent part:
>
>> The question of whether Defendants willfully failed to report income ... is one of fact for the jury. See *Rykoff v. United States*, 40 F.3d 305, 307-08 (9th Cir. 1994). The jury could have concluded that Kerr and

> Quiel knew they had a duty to report the income from their foreign accounts, because Christopher Rusch, their attorney and business partner, testified that the accounts were set up using nominees under Kerr's and Quiel's control in order to evade reporting requirements. Even without Rusch's testimony, the jury could have inferred control because (a) the accounts were traded in Kerr's and Quiel's stock for their benefit; (b) the foreign firms never served their stated purpose of finding investors; and (c) these firms were not actual, functioning businesses. Additionally, even without Rusch's testimony, the jury could infer motive from Kerr's having recently paid high tax rates and Quiel's recent payment of a large tax penalty before either engaged in these transactions.

***2** On March 13, 2015, Movant and Kerr filed a Joint Motion for New Trial pursuant to Rule 33 of the Federal Rules of Criminal Procedure alleging newly discovered evidence. (CR Doc. 454.) Specifically, Defendants' argued: (1) "evidence has emerged showing that Rusch engaged in fraudulent activities"; (2) "the Government has agreed 'to look the other way while its witness commits additional crimes' "; and (3) "Pierre Gabris, a Swiss-national and alleged participant in the structuring of the Swiss accounts, would testify that 'he did not prepare or send trial exhibits 51 and 52,' which were offered into evidence on Rusch's re-direct" and "contain emails originally sent from Gabris to Rusch, who forwarded them to Defendants, regarding accounting statements from Defendants' Swiss corporations." (CR Docs. 454, 463.) The Court denied the Joint Motion for New Trial on July 15, 2015, (CR Doc. 463), and on July 28, 2015, Movant and Kerr filed a Notice of Appeal from the July 15, 2015 Order (CR Doc. 467).

On December 28, 2015, in the appellate court case, Movant and Kerr filed a Joint Motion for Remand to the District Court & Motion to Stay Briefing Schedule, arguing that the Court of Appeals should remand the action to the district court so it can: (1) "consider evidence that was before it but which that [the district] Court did not consider," and (2) consider new evidence and argument that either came to light after the Joint Motion for New Trial was filed or "was [not] otherwise ... presented." (United States v. Kerr, et al., No. 15-10393, Doc. 17.)

The Ninth Circuit denied the Motion for Remand without prejudice to the filing of "a renewed motion accompanied by an indication that the district court is willing to entertain the limited remand motion." (United States v. Kerr, et al., No. 15-10393, Doc. 19.) On March 7, 2016, Movant and Kerr filed a Joint Motion to Accept Remand to Consider New Evidence for a New Trial in the district court. (CR Doc. 471.) Defendants argued: (1) "This Court should accept a remand so as to consider new evidence and argument that were not before this Court but which came to light while the motion was pending, after it was appealed, or that was otherwise not presented"; and (2) "This Court should accept remand so as to consider evidence that was presented to this Court" but "which this Court did not consider." (CR Doc. 471.) Defendants' newly discovered evidence consisted of four declarations, one of which came from Jerome Perucchi that was signed on June 4, 2015, and was used as part of civil lawsuit in a state court matter. (CR Doc. 471.)

While the Joint Motion was pending before the district court, on May 17, 2016, Movant filed a Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody. (CV Doc. 1; CR Doc. 474.) Thereafter, the district court directed the parties to show cause why the § 2255 proceeding should not be stayed pending the Court's determination on the Joint Motion to Accept Remand. (CV Doc. 3.)

Then, on July 22, 2016, the Court denied the Joint Motion to Accept Remand (CR Doc. 475),[3] and on August 2, 2016, the Court discharged the Order to Show Cause after concluding that it had been mooted by the Court's ruling on the Joint Motion (CV Doc. 6). In the same August 2, 2016 Order, the Court also denied Movant's § 2255 Motion with leave to amend and gave Movant 30 days to file an amended motion using the court-approved form. (CV Doc. 6.)

On September 1, 2016, Movant filed an amended Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct Sentence by a Person in Federal Custody (CV Doc. 7). In the amended § 2255 Motion, Movant alleges four grounds for relief. In Ground One, he claims that he received ineffective assistance of counsel because his trial attorney refused to call any witnesses or submit any evidence after the government rested its case in chief. In Ground Two, Movant appears

> to argue that his due process rights were violated by the introduction at trial of perjured testimony that the government knew or should have known was false. Movant further alleges that the government failed or refused to produce evidence that would confirm that perjured testimony was introduced at trial. In Ground Three, Movant claims that the government has not produced evidence that it properly appointed the attorneys who prosecuted him, and the government has not demonstrated that it followed "proper procedure when it began prosecution." In Ground Four, Movant argues that he received ineffective assistance of counsel in connection with "matters that occurred pre and post trial." (CV Docs. 7, 10.)

***3** (Doc. 17 at 1–5.)

On August 22, 2017, Movant filed Movant's Motion to Compel Government to Produce Documents, requesting that the Court order the Government to produce "amended Forms 1040 for the tax years 2000-2003, along with the FBAR returns for 2000-2003 allegedly prepared with these amended forms." (Doc. 19.) On August 29, 2017, the Government filed a motion opposing this request. (Doc. 20.)

On September 27, 2017, the Ninth Circuit Court of Appeals affirmed this Court's denial of Movant's motion for a new trial and motion for remand in the underlying criminal matter. *United States v. Kerr*, No. 15-10393, 2017 WL 4284757 (9th Cir. Sept. 27, 2017).

II. Legal Standard

This Court may "accept, reject, or modify, in whole or in part, the findings or recommendations made by the magistrate judge" in the R&R. 28 U.S.C. § 636(b)(1) (2012). "Within fourteen days after being served with a copy, any party may serve and file written objections" to the R&R. *Id.* This Court "must review the magistrate judge's findings and recommendations de novo *if objection is made*, but not otherwise." *United States v. Reyna-Tapia*, 328 F.3d 1114, 1121 (9th Cir. 2003) (en banc) (emphasis in original); *see also Schmidt v. Johnstone*, 263 F. Supp. 2d 1219, 1226 (D. Ariz. 2003) ("Following *Reyna-Tapia*, this Court concludes that *de novo* review of factual and legal issues is required if objections are made, 'but not otherwise.' " (internal citation omitted) (emphasis in original)). Movant objects to all of the Magistrate Judge's legal findings and many of her factual findings, (Doc. 18); therefore, this Court will review all of Movant's claims de novo.

III. Discussion

A. Jurisdiction

***4** Under 28 U.S.C. § 2255, this Court has limited jurisdiction to adjudicate a collateral action by a "prisoner in custody under sentence of a court established by Act of Congress." 28 U.S.C. § 2255 (2012); *see United States v. Reves*, 774 F.3d 562, 565 (9th Cir. 2014) (noting that the "in custody" requirement is jurisdictional and must be satisfied before consideration of the merits). One is in custody when sentenced by a federal court to incarceration or conditional release. *Maleng v. Cook*, 490 U.S. 488, 491 (1989) (per curiam); *see Reves*, 774 F.3d at 565. This jurisdictional requirement is satisfied when a collateral action is initiated before custody ends. *Maleng*, 490 U.S. at 491.

According to Movant, his term of supervised release terminates on January 13, 2017. (CR Doc. 477.) Movant initiated this collateral action on May 17, 2016. (Doc. 1.) Therefore, because Movant initiated his collateral action before the end of custody, this Court has jurisdiction under Section 2255.

B. Timeliness

Under the Antiterrorism and Effective Death Penalty Act of 1996 ("AEDPA"), collateral actions under Section 2255 are subject to a 1-year statute of limitations. 28 U.S.C. § 2255(f) (2012). As relevant, the limitations period proceeds from the date that a movant's conviction becomes final *Id.*

The statute of limitations is not jurisdictional, and is treated as an affirmative defense to be raised by the Government, unless a court discretionarily raises the issue *sua sponte*. *Day v. McDonough*, 547 U.S. 198, 209 (2006). Each claim that is challenged by the government as time-barred, or which a court considers *sua sponte*, must individually meet the requirements of the statute of limitations. *See Mardesich v. Cate*, 668 F.3d 1164, 1170–

71 (9th Cir. 2012) (applying a "claim-by-claim" approach to Section 2244's statute of limitations); *see also Clay v. United States*, 537 U.S. 522, 528–30 (2003) (reading portions of the statute of limitations requirements in Sections 2244 and 2255 to have the same meaning despite "verbal differences"). When a defendant petitions the Supreme Court for certiorari, the conviction "becomes final when the Supreme Court either denies the writ or issues a decision on its merits." *Clay*, 537 U.S. at 529 n.4 (internal citation omitted).

Federal Rule of Civil Procedure 6(a) provides four guides for calculating Section 2255's statute of limitations. *Patterson v. Stewart*, 251 F.3d 1243, 1246 (9th Cir. 2001); *see also* Rule 12 of Rules Governing Section 2255 Proceedings ("The Federal Rules of Civil Procedure and the Federal Rules of Criminal Procedure, to the extent that they are not inconsistent with any statutory provisions or these rules, may be applied to a proceeding under these rules."). First, exclude the day of the triggering event. Fed. R. Civ. P. 6(a)(1). Second, include all intermediate days. *Id.* Third, include the last day, but if it is a Saturday, Sunday, or legal holiday, then proceed to the end of the next unqualified day. *Id.* Fourth, the last day ends at midnight when filing electronically or when the clerk's office closes when filing by other means. *Id.* A year is 365 days in a normal year and 366 days in a leap year. *See United States v. Tawab*, 984 F.2d 1533, 1534 (9th Cir. 1993); *United States v. Marcello*, 212 F.3d 1005, 1010 (7th Cir. 2000).

The Government asserts that the statute of limitations bars "much of [Movant's] false testimony claim." (Doc. 11 at 4.) The Supreme Court denied certiorari, making Movant's claim final, on May 18, 2015. *Quiel v. United States*, 135 S. Ct. 2336 (mem.) (2015). Movant filed this collateral attack in a leap year on May 17, 2016. (Doc. 1.) Therefore, Movant's claim was timely filed on the day before the limitations period ended. The Government concedes that Movant's filing was punctual, but argues that any new facts that surfaced in the September 1, 2016 amendment, particularly Movant's quotations from a declaration by Jerome Perucchi ("Perucchi Declaration"), are time-barred. (Doc. 11 at 4–5.) Movant, in contrast, claims that he cited the Perucchi Declaration in the original filing, making the time-bar inapplicable. (Doc. 14 at 10.)

***5** In a Section 2255 action, relation back of claims is governed by Federal Rule of Civil Procedure 15(c). *Mayle v. Felix*, 545 U.S. 644, 649 (2005). Under Rule 15(c), relation back occurs when an "amendment asserts a claim or defense that arose out of the conduct, transaction, or occurrence set out—or attempted to be set out—in the original pleading." Fed. R. Civ. P. 15(c)(1)(B). Meaning, in the context of a Section 2255 proceeding, that the amended claims must "arise from the same core facts as the timely filed claims," and not "depend upon events separate in 'both time and type' from the originally raised episodes." *Mayle*, 545 U.S. at 657 (internal citation omitted).

Contrary to Movant's characterization, (Doc. 14 at 10), the Perucchi Declaration was not cited in the original filing. *See* (Doc. 1 at 21.) Nor was the Perucchi Declaration attached to the original filing, as it was with the amended filing. (Doc. 7-4.) Rather, the original filing discusses Rusch's allegedly perjured testimony that he surreptitiously notarized Perucchi's signature and references Perucchi's involvement with one of the Swiss funds. (*Id.*) As part of this discussion, Movant cites documents that themselves cite the Perucchi Declaration. (*Id.*) (citing CR Docs. 471 & 473.) The disputed quotations from the Perucchi Declaration concern the same narrow grouping of facts as the discussion in the original filing; namely, Perucchi's role in the Swiss fund, his awareness of the fund's operations, and which documents he personally signed. (Doc. 7 at 6; Doc. 7-1 at 8.) Thus, because both the new quotations and the original filing discuss the same common core of operative facts, which concern events that occurred at the same time and were of the same type, the quotations relate back to the original filing date and are not time-barred. The Government does not specifically identify, and the Court does not find, any other claims barred by the statute of limitations. Thus, none of Movant's claims are time-barred.

C. The Law of the Case, Waiver, and Procedural Default

The Government argues that many of Movant's claims have been waived, procedurally-defaulted, or already considered by this Court. (Doc. 11.)

The Ninth Circuit Court of Appeals affirmed this Court's determination that the information in the Perucchi Declaration and information relating to Rusch continuing to practice law under a pseudonym do not provide any basis for relief. *United States v. Kerr*, No. 15-10393, 2017 WL 4284757 (9th Cir. Sept. 27, 2017); *see* (CR Doc. 475 at 12 n.5; CR Doc. 463; CR Doc. 475 at 12.) Under the law of the case doctrine, this Court is generally prohibited from reconsidering issues already decided by an appellate court, *United States v. Alexander*, 106 F.3d 874 (9th Cir. 1997); therefore, this Court cannot reconsider these issues.

For the Court to reach the merits of Movant's remaining claims, Movant must show that his claims are neither procedurally defaulted nor waived. *Bousley v. United States*, 523 U.S. 614, 622 (1998). A defendant waives defenses or objections, not raised before trial, regarding "defect[s] in instituting the prosecution"—including "error[s] in the grand-jury proceeding"—and "defect[s] in the indictment." Fed. R. Crim. P. 12(b)(3); *see also Davis v. United States*, 411 U.S. 233, 241–42 (1973) (holding that Rule 12 waiver applies to Section 2255 proceedings). Procedural default bars habeas review of a movant's viable claims that were not raised on direct review. *Bousley*, 523 U.S. at 622.

In the Section 2255 context, a movant can only overcome waiver and procedural default by showing either "cause" and "prejudice" or "actual innocence." *Id.* Failure to satisfy either of the cause-and-prejudice factors obviates the need to evaluate the other. *See United States v. Frady*, 456 U.S. 152, 167 (1982). Learning that a new claim is a possibility—based upon previously undiscovered facts that were discoverable with reasonable diligence—does not, alone, amount to cause. *See Murray v. Carrier*, 477 U.S. 478, 488 (1986). There must be some "objective factor external to the defense" that impeded counsel's ability to comply with a procedural rule, such as "a factual or legal basis for a claim [that] was not reasonably available to counsel" or a severe error rendering counsel constitutionally ineffective that "impute[s]" default to the Government. *Id.* (applying these rules to the analogous Section 2254 exhaustion context); *see Coleman v. Thompson*, 501 U.S. 722, 745–46 (1991) (discussing the overlapping policy interest in finality that influences procedural default rules in Section 2255 and Section 2254 actions); *Frady*, 456 U.S. at 166 (noting that federal prisoners under Section 2255 do not receive "preferred status when they seek postconviction relief," when compared to Section 2254 prisoners). The actual innocence exception is "very narrow," *Sawyer v. Whitley*, 505 U.S. 333, 339–41 (1992), requiring a showing that " 'in light of all the evidence,' 'it is more likely than not that no reasonable juror would have convicted' " the movant. *Bousley*, 523 U.S. at 623 (quoting *Schlup v. Delo*, 513 U.S. 298, 327–28 (1995)).

***6** Waiver and procedural default do not apply to claims of ineffective assistance of trial counsel, *Massaro v. United States*, 538 U.S. 500, 509 (2003), or claims that challenge a court's subject-matter jurisdiction, *Sebelius v. Auburn Reg'l Med. Ctr.*, 568 U.S. 145, 153 (2013); *United States v. Durham*, 941 F.2d 886, 892 (9th Cir. 1991) (refusing to evaluate procedural default due to challenge to court's jurisdiction based upon allegedly improper appointment of a government attorney).

Therefore, Movant's Ground One and Ground Four ineffective assistance of counsel claims are neither procedurally defaulted nor waived.

1. Ground Two

In Ground Two, Movant makes four Due Process arguments alleging Government perjury. (Doc. 7 at 6; Doc. 7-1 at 7–13.) First, Movant claims that Cheryl Bradley and Christopher Rusch, Government witnesses, committed perjury by testifying that Movant had prepared FBAR forms, which Movant claims do not exist. (Doc. 7-1 at 7.) Second, Movant claims that Rusch perjured himself by testifying that he printed and faxed emails that would become Exhibits 52 and 53 to Movant; Movant claims he never received these documents. (*Id.* at 9.) Third, Movant claims that Rusch provided "false testimony" by using Movant's "passport and personal information without [Movant's] knowledge or permission." (*Id.*) Fourth, Movant claims that Rusch perjured himself by testifying that Rusch created and oversaw the Swiss funds for Movant's benefit, while Movant contends that he was only "to be the initial investor into the foreign hedge funds." (*Id.* at 9–10.)

All of Movant's remaining Ground Two claims are procedurally-defaulted. Movant did not raise any of these arguments on direct appeal and he fails to show cause. Movant's second, third, and fourth claims concern facts Movant knew before appeal. Movant's first claim, concerning the existence of the FBARs, involves information that Movant could have learned with reasonable diligence prior to appeal. Finally, Movant does not suggest, and the Court does not find, that he has made a showing of actual innocence.

2. Ground Three

Whether Movant has waived or procedurally defaulted his Ground Three claims turns on their meaning. In Ground Three, Movant makes two arguments. One challenges the appointment of the Government attorneys who prosecuted the underlying criminal case. (Doc. 7 at 7; Doc. 7-1 at 17.) The other concerns his criminal referral. (*Id.*)

First, Movant argues that the Government should be compelled to disclose the documents proving that the attorneys representing the United States were properly appointed. (Doc. 7-1 at 16.) If such disclosure establishes that the attorneys were improperly appointed, Movant argues, then "the charges were wrongfully brought" against Movant. (*Id.*) Movant's suggested import of this claim is not clear. Movant could be arguing that because the Government attorneys were improperly appointed, the indictment is nullified. Alternatively, Movant could be arguing that the Article III case and controversy requirement was not satisfied, because the United States was not a party to the action, preventing the Court from having had subject-matter jurisdiction over the criminal matter. *See* (*Id.*)

Second, Movant asks that the Court to order Government disclosure of Movant's criminal referral from the IRS, which Movant claims an "appellate body" has already ordered the Government to disclose. (Doc. 7 at 7.)

***7** To the extent that both of Movant's Ground Three claims relate to defects in the indictment or with the criminal referral, they are waived and procedurally defaulted. Movant did not raise these issues pretrial, as required by Rule 12(b), and did not raise them on direct review, as required by the procedural default standard. Further, Movant has not shown cause, because information relating to the appointment of attorneys and the criminal referral was discoverable with reasonable diligence prior to trial. Movant does not allege that the factual or legal basis for the claim was not reasonably available to counsel or that counsel was constitutionally ineffective for failing to uncover these facts or make these claims.

Furthermore, Movant has not presented any evidence that would meet the extremely narrow test of actual innocence. Errors in the indictment or with the grand jury process, taken as true, would not be so forceful as to prevent any reasonable juror from convicting Movant, taking all evidence into consideration. Thus, Movant's claims, as stylized, will not be considered, because Movant has shown neither cause nor actual innocence.

In contrast, to the extent that Movant's appointment claim can be read as suggesting that this Court did not have subject-matter jurisdiction in the underlying criminal case, it is neither waived nor procedurally-defaulted.

D. Grounds One and Four: Ineffective Assistance of Counsel

Movant identifies two attorneys who allegedly provided him with constitutionally ineffective assistance of counsel. The first is Michael Minns, Movant's attorney during trial and on appeal. (Doc. 7 at 5; Doc. 7-1 at 1–6.) The second is Joy Bertrand, Movant's local counsel (Doc. 7 at 8.)

The Sixth Amendment provides criminal defendants who face incarceration with the right to effective assistance of counsel at "all critical stages of the criminal process." *Iowa v. Tovar*, 541 U.S. 77, 80–81 (2004); *see* U.S. Const. amend. VI; *Strickland v. Washington*, 466 U.S. 668, 686 (1984). Critical stages of the criminal process include, but are not limited to, the guilt-phase of a trial, *United States v. Wade*, 388 U.S. 218, 226–27 (1967), sentencing, *Mempa v. Rhay*, 389 U.S. 128, 137 (1967), and motions for a new trial filed before a direct appeal-by-right is waived or decided, *Rodgers v. Marshall*, 678 F.3d 1149, 1156–59 (9th Cir. 2012), *rev'd on other grounds*, 569 U.S. 58 (2013) (per curiam); *United States v. Del Muro*, 87 F.3d 1078, 1080 (9th Cir. 1996) (per curiam); *Menefield v. Borg*, 881 F.2d 696, 699 (9th Cir. 1989); *but cf. Rodgers*, 569 U.S. at 61 (assuming, without deciding, that the posttrial, preappeal period for a new trial motion is a critical stage of the proceeding).

To establish ineffective assistance of counsel in violation of the Sixth Amendment, a movant must show both deficient performance and prejudice. *Strickland*, 466 U.S. at 687. A court is free to evaluate either factor first and need not proceed with the inquiry if a movant fails to satisfy the first considered factor. *Id.* at 696.

Deficient performance exists where counsel's performance "fell below an objective standard of reasonableness" in light of "prevailing professional norms." *Id.* at 688. "Judicial scrutiny of counsel's performance must be highly deferential," given "the variety of circumstances faced by defense counsel [and] the range of legitimate decisions regarding how best to represent a criminal defendant." *Id.* at 689. Given "the distorting effects of hindsight," a court "must indulge a strong presumption" that counsel's performance is not objectively unreasonable. *Id.* at 689–90. "Strategic choices made after thorough investigation of law and facts relevant to plausible options are virtually unchallengeable." *Id.* at 691. Professional standards of conduct serve as non-dispositive guides for evaluating counsel's performance. *Id.* at 688. Mere conclusory allegations of ineffective assistance do not provide the basis for Section 2255 relief. *See James v. Borg*, 24 F.3d 20, 26 (9th Cir. 1994).

***8** Prejudice requires a movant to "show that there is a reasonable probability that, but for counsel's unprofessional errors, the result of the proceeding would have been different." *Id.* at 694. "The likelihood of a different result must be substantial, not just conceivable." *Harrington v. Richter*, 562 U.S. 86, 112 (2011). A court evaluates a movant's showing in light of "the totality of the evidence" that was before the trial court. *Strickland*, 466 U.S. at 695–96.

Ultimately, this analysis is aimed at determining "whether counsel's conduct so undermined the proper functioning of the adversarial process that the trial cannot be relied on as having produced a just result." *Id.* at 686.

1. Ground One

Movant claims that his trial counsel, Mr. Minns, was constitutionally ineffective for failing to call any witnesses or to present any evidence after the Government rested its case-in-chief. (Doc. 7 at 5.) Movant alleges that Mr. Minns acted upon a belief that the Government had not met its burden of proof. (*Id.*) Specifically, Movant cites four defense expert witnesses that had prepared reports, but who Mr. Minns did not call during the guilt-phase; "multiple factual witnesses ready to testify on" Movant's behalf, who Mr. Minns did not call during the guilt-phase; Movant's unfulfilled desire to testify at trial; and unfavorable statements made by Mr. Minns as to his own performance. (*Id.*; Doc. 7-1 at 1–6.)

The Court rejects the factual basis that Mr. Minns was ineffective for not calling any witnesses at trial. While Mr. Minns did not personally call any witnesses, Mr. Kimerer, attorney for Movant's co-defendant, called Gary Stuart, a joint-defense expert witness. (CR Doc. 336.) Mr. Stuart was retained by both Movant and his co-defendant, had met with Mr. Minns and Movant, referred to both Movant and his co-defendant when giving testimony, formed his opinion, in part, on documents provided by both Movant and his co-defendant, (*Id.* at 2648, 2654, 2657, 2664–65, 2670), and Mr. Minns referred to the witness as "a joint witness" as to which Mr. Kimerer and Mr. Minns "both had a great deal of input," (CR Doc. 323 at 45.) Mr. Stuart testified that Cristopher Rusch, Movant's former attorney turned Government witness, had engaged in multiple violations of The California Rules of Professional Conduct. (*Id.*) If believed, Mr. Stuart's testimony could have served to impeach Rusch as a witness and to insulate Movant and his co-defendant from criminal liability by establishing a reliance-on-counsel defense based, in part, upon Rusch's alleged violation of his duties as an attorney. *See* (CR Doc. 336 at 2658.) Thus, while it is technically not false that Mr. Minns did not personally call nor directly examine a witness as part of the defense's case-in-chief, it is certainly factually incorrect to suggest that Mr. Minns was not involved in the presentation of an expert witness for the defense.

Furthermore, insofar as Movant is claiming that counsel was ineffective for failing to call unidentified witnesses or to call identified factual witnesses whose purported testimony has not been established, Movant has not shown prejudice. Prejudice cannot be established by mere speculation that unidentified witnesses could be found, that they would agree to testify, and that the content of their testimony would be favorable. *Wildeman v. Johnson*, 261 F.3d 832, 839 (9th Cir. 2001); *Dows v. Wood*, 211 F.3d 480, 486 (9th Cir. 2000); *United States v. Harden*, 846 F.2d 1229, 1231–32 (9th Cir. 1988) (denying a movant's ineffective assistance claim, in part, upon failure to show that a proposed witness would be willing to testify); *United States v. Murray*, 751 F.2d 1528, 1535 (9th Cir. 1985) (denying an ineffective assistance claim, in part, on a movant's failure to "identify any witnesses that his counsel should have called that could have been helpful."); *Evans v. Cockrell*, 285 F.3d 370, 377 (5th Cir. 2002) ("[C]omplaints of uncalled witnesses are not favored in federal habeas corpus review because allegations of what the witness would have testified are largely speculative.").

***9** Additionally, Movant has not shown that counsel was deficient by declining to call the four identified expert witnesses: Matthew Kadish, Gail Prather, Cynthia King, and Ron Braver. There are a number of reasonable strategic considerations that could influence an attorney's decision to call, or refrain from calling, an expert witness, including: the attorney's theory of the case, the strength and focus of the opposing party's case, the conclusions and the certainty of the expert's report, an evaluation of the expert's potential demeanor and presence on the stand, the expert's vulnerability to cross-examination, the role the expert will have in either clarifying or diluting issues in the case, and financial considerations. As the American Bar Association describes in its aspirational rules for criminal defense counsel:

> Defense counsel has no obligation to present evidence, and should always consider, in consultation with the client, whether a decision not to present evidence may be in the client's best interest. In making this decision, defense counsel should consider the impact of any evidence the defense would present and the potential damage that prosecution cross-examination or a rebuttal case could do, as well as the quality of the prosecution's evidence.

ABA Criminal Justice Standard for the Defense Function 4-7.6 (4th ed. 2017).

Movant was convicted under 26 U.S.C. § 7206(1) for willfully filing a false tax return, which required the Government to prove beyond a reasonable doubt that (1) "the defendant made and signed a tax return for the respective years that he knew contained false information as to a material matter," (2) "the returns contained a written declaration that they were being signed subject to the penalties of perjury," and (3) "in filing the false tax returns the defendant acted willfully." (CR Doc. 339 at 3018.) A matter is material if "it had a natural tendency to influence or was capable of influencing the decisions or activities of the Internal Revenue Service." (*Id.*)

The primary focus of these witnesses' testimony was on matters for which Movant was ultimately not convicted. Mr. Kadish's opinion was expressly limited to Movant's duty to file FBARs, (CR Doc. 198-1 at 1), a charge that was dismissed with prejudice, (CR Doc. 308.) Ms. Prather and Mr. Braver concluded that Movant owed no net tax, (CR Doc. 198-2 at 2; CR Doc. 370), which is not an element of Section 7206(1). Ms. King's report only discusses securities laws, (CR Doc. 198-3), under which no charges were filed.

Beyond the general considerations that bear on an attorney's decision to call a witness, and the irrelevancy of most the proposed experts' opinions, there were specific reasons that could have influenced Mr. Minns' decision not to call Mr. Kadish and Mr. Braver. Rusch, to the defense's surprise, testified that the shares in the Swiss funds were bearer shares. (Doc. 335 at 2605.) Mr. Kadish told Mr. Minns that this may trigger FBAR reporting duties for U.S. citizens holding those shares. (*Id.*) Mr. Minns became concerned that this might raise "a question of first impression" as to the FBAR reporting requirements, because Movant never held bearer shares, but was accused of accessing the account through a nominee who did hold those shares. (*Id.*) Thus, there was a risk on cross-examination that Mr. Kadish would admit that Movant had an FBAR reporting duty. (*Id.*) Given that Mr. Kadish's testimony was meant to rebut the FBAR reporting charge, it would have been risky to call him given his newfound uncertainty of Movant's duty to report.

Furthermore, there were reasonable strategic reasons not to call Mr. Braver during the guilt-phase of the trial. While Mr. Braver ultimately concluded that Movant owed no net tax, which benefitted Movant during sentencing, he did testify that Movant had unreported income during 2007 and 2008, which would have reinforced the Government's case for the crime that Movant was ultimately convicted. (CR Doc. 370 at 125–26, 131.) Additionally, it made sense to not call both Mr. Braver and Ms. Prather, as Mr. Braver disagreed with Ms. Prather's calculations, which would have allowed the Government to highlight inconsistency in defense expert testimony. (CR Doc. 370 at 105–06.)

***10** Additionally, Mr. Minns' decision regarding when to call witnesses seemed to be influenced by the witnesses the Government actually called; thus establishing that Mr. Minns was making a reasoned choice of which witnesses to utilize rather than unreasonably failing to call witnesses. (Doc. 370 at 104) (stating that Mr. Minns did not call Mr. Braver during the guilt-phase of the trial due to the Government not calling particular experts).

Movant claims that it was "not a sound trial strategy" for Mr. Minns to refuse to call these experts based upon his evaluation of the strength of the Government's case. (Doc. 18 at 3.) Movant's argument, however, is conclusory, and does not rebut the extensive presumption of reasonableness given to trial counsel's strategic decisions. Mr. Minns investigated the possibility of using these experts, observed the strength and focus of the Government's case, and ultimately chose not to call on them to testify. Thus, even if the witnesses' testimony would have been tangentially responsive to the Government's case, Mr. Minns acted within the wide range of reasonableness in refusing to call them.

For this same reason, Movant cannot show prejudice. Movant contends that as part of their testimony, these expert witnesses would have presented evidence that could have negated willfulness. (Doc. 18 at 4–11.) Weighing the expert's testimony in their reports against the Government evidence during trial, there is not a reasonable probability that the jury would not have found willfulness. Movant is attempting to dissect and magnify the conclusions in these expert reports. While small portions of these experts' testimony would have been relevant in responding to the Government's case, they do not present the necessary evidentiary force to show a reasonable probability that the outcome would have been different.

Movant argues that this Court's finding during sentencing, where Mr. Minns did directly call an expert witness, that the Government did not establish a tax loss on a preponderance of the evidence standard shows a reasonable probability that the outcome of the guilt-phase of the proceeding would have been different had Mr. Minns called the experts. (Doc. 14 at 8.) As noted above, however, tax loss is not an element of the offense of which Movant was convicted. This Court's finding was relevant as to the sentence imposed and not as to Movant's guilt. A specific finding by a specific authority following testimony on a specific topic by a specific witness does not establish, as Movant suggests, that other findings by another authority would be made following testimony on other topics by other witnesses. *See* (*Id.* at 9) ("Had witnesses testified and evidence [been] presented at trial, the fact finder, like this Court, reasonably would have found that the government had not met its burden of proof on any count.").

Additionally, Mr. Minns' recommendation that Movant not testify at trial establishes neither deficient performance nor prejudice. It is reasonable for an attorney to recommend that a criminal defendant not waive their Fifth Amendment right against self-incrimination. *Cf.* U.S. Const. amend. V; *Brown v. United States*, 356 U.S. 148, 155–56 (1958) (discussing Fifth Amendment waiver). Mr. Minns, after consideration, ultimately decided that it would be imprudent to call Movant as a witness given Rusch's testimony. *See* (CR Doc. 330 at 1417–18) (noting that Mr. Minns' recommendation that Movant testify was contingent on Rusch's testimony); (CR Doc. 338 at 2948) (noting that Mr. Minns told his client, after deliberation, not to testify); *see also* (CR Doc. 323 at 9) (discussing Mr. Kimerer's pretrial uncertainty as to whether Movant and his co-defendant would testify). Further, Movant does not describe the content of his proposed testimony, and thus cannot show prejudice due to a failure to show a reasonable probability that the outcome of the proceeding would have been different.

***11** Furthermore, Mr. Minns' statements regarding his own performance do not establish constitutionally ineffective assistance of counsel. First, Movant highlights Mr. Minns' statement "we really shouldn't have professional witnesses. We should have experts. We need experts," (Doc. 7-1 at 1), as an admission that Mr. Minns believed the defense needed to call experts to put on their case. Movant fails to appreciate the context surrounding this statement. Mr. Minns was not admitting that the defense needed experts, but was criticizing the Government for using what he calls "professional witnesses," who he claims "go to witness-testifying school," while conceding that experts are important to the adversarial process. (CR Doc. 338 at 2953.) Second, Mr. Minns' statement during sentencing that he made "some seriously bad strategy decisions" does not establish that he provided constitutionally ineffective assistance of counsel. An admission of imperfect performance is not necessarily an admission to the sort of seriously grave error required to establish constitutional ineffectiveness.

This is particularly true in the sentencing context, where an attorney could wrongfully surmise that such prostration would garner sympathy for the soon-to-be-sentenced client. Additionally, attorneys are equally subject to the hindsight bias that courts must guard against when evaluating past performance with the benefit of future knowledge, making their own after-the-fact admissions suspect.

Finally, Movant's claim that Mr. Minns presented no evidence, making him ineffective, shows neither deficient performance nor prejudice, because it is conclusory and does not suggest what evidence Mr. Minns should have presented and how this would have affected the outcome of the case. *See Secrease v. Walker*, No. 2:09-cv-299 JAM TJB, 2011 WL 2790155, at *10 (E.D. Cal. July 13, 2011) (citing *James v. Borg*, 24 F.3d 20, 26 (9th Cir. 1994)), *adopted by*, No. 2:09-cv-299 JAM TJB (E.D. Cal. July 22, 2011).

2. Ground Four

Movant makes four claims of ineffective assistance of counsel concerning Ms. Bertrand's work before and after trial. First, Movant claims that Ms. Bertrand was paid for work, regarding the investigation of jurors, that she did not complete. (Doc. 7 at 8.) Second, Movant argues that Ms. Bertrand's representation of him in an ultimately dismissed state court proceeding and in a federal bond hearing behooved her to present that dismissal to this Court. (*Id.*) The effect of this presentation, Movant claims, would have been to lower his custody level, which would have resulted in incarceration in Arizona, near his family, rather than in Texas. (*Id.*) Movant's third claim is difficult to dissect. It appears that Movant is claiming that Ms. Bertrand was aware of an affidavit by Pierre Gabris and that she told Movant of this fact, but later claimed that she learned of this affidavit from Movant. (*Id.*) Further, she was allegedly in direct contact with Mr. Gabris, Mr. Perucchi, and Movant's counsel in Movant's civil case against Mr. Perucchi. (*Id.*) Despite all of this, Movant claims, Ms. Bertrand failed to "obtain and file" the Perucchi Declaration with this Court. (*Id.*) Finally, Movant's fourth claim is that following Movant's incarceration, Ms. Bertrand refused to directly communicate with Movant, except for occasional phone calls, even regarding Movant's Rule 33 motion for a new trial, effectively "denying [Movant] access to the [C]ourt." (*Id.*) This prevented Movant from providing allegedly new information to the Court, such as the Perucchi Declaration. (*Id.*)

The Government argues that Movant was not owed constitutionally effective assistance of counsel in preparing his Rule 33 motion for a new trial. (Doc. 11 at 6.) Because this Court previously treated that motion as a collateral action for the purposes of AEDPA's statute of limitations, the Government argues, it should treat it similarly for determining Movant's constitutional protections. (*Id.*) This Court disagrees; its previous holding was limited to the statute of limitations context and is not determinative for Movant's right to effective assistance of counsel. Therefore, following the Ninth Circuit Court of Appeals precedent discussed above, Movant had a right to effective assistance of counsel in filing his Rule 33 motion.

First, assuming that it is objectively unreasonable for an attorney to fail to perform work for which the attorney was paid, Movant was not prejudiced by Ms. Bertrand's alleged failure to "complete[ ] her work [or her] refus[al] to return unused funds." (*Id.*) Movant's claim suggests that Ms. Bertrand could have remedied her allegedly incomplete performance by returning the unearned funds. (*Id.*) Thus, Movant's claim is focused on compensation, not procedural outcome. Therefore, because Movant does not suggest that there is a reasonable probability that the outcome of the proceedings would have been different if Ms. Bertrand completed her allegedly deficient jury investigation, Movant is not prejudiced.

***12** Second, assuming that Ms. Bertrand knew of, and failed to disclose, the information relating to the dismissal of Movant's state court proceeding, Movant has failed to show prejudice. Movant does not argue that the result of the sentence would have been different, but rather that Movant's custody level would have been lowered if this information was known. Custody level determinations, however, are not made by this Court, but by the Bureau of Prisons, and cannot be reviewed in a Section 2255 action. *Johnson v. United States*, Nos. 3:11-cv-345-FDW, 3:07-cr-173-FDW, 2012 WL 6642085, at *3 (W.D.N.C. Dec. 20, 2012). Therefore, Movant has failed to show that there is a reasonable probability that the result of the proceeding would have been different; therefore, he fails to show prejudice.

Third, even assuming that Ms. Bertrand was aware of the Gabris affidavit before Movant was, that she was in contact with Mr. Gabris, Mr. Perucchi, and Movant's state-court attorney, and that she failed to obtain and submit the Perucchi Declaration, Movant has failed to show prejudice. The Ninth Circuit Court of Appeals affirmed this Court's express rejection of the claim that the Perucchi Declaration contained information that would provide any basis for requiring a new trial. *United States v. Kerr*, No. 15-10393 (9th Cir. Sept. 27, 2017); (CR Doc. 475 at 12 n.5). Thus, because Movant has not shown a reasonable probability that the outcome of the proceeding would have been different had Ms. Bertrand submitted the Perucchi Declaration, he was not prejudiced.

Fourth, assuming that Ms. Bertrand refused to communicate with Movant directly, Movant fails to show prejudice. Movant's only specific claim in this regard is that the failure to communicate resulted in Ms. Bertrand failing to file the Perucchi Declaration. As discussed in the previous paragraph, that alleged failure does not constitute prejudice. For the same reason, the purported cause of that non-prejudice—Ms. Bertrand's alleged failure to communicate—does not constitute prejudice.

E. Ground Three: Appointment and Criminal Referral Issues

The strongest formulation of Movant's non-defaulted and un-waived appointment claim proceeds in five steps. *See* (Doc. 7 at 7; Doc. 7-1 at 13–17.) The Assistant United States Attorneys ("AUSAs") and Department of Justice ("DOJ") trial attorneys who initiated and pursued prosecution were improperly appointed. Therefore, they were not proper representatives of the United States in the criminal proceeding. Thus, the United States was not a party to the action. As a result, this Court had no subject-matter jurisdiction over the criminal proceeding. Accordingly, this Court must vacate the criminal conviction that was rendered without proper authority.

Federal courts are courts of limited jurisdiction and must have subject-matter jurisdiction to authoritatively render judgment. *United States v. Jacobo Castillo*, 496 F.3d 947, 951 (9th Cir. 2007) (en banc); *see* Restatement (Second) of Judgements § 1 (Am. Law. Inst. 1982). For circuit and district courts, the outer bounds of this jurisdiction are defined by the Constitution, while the inner bounds are defined by federal law. U.S. Const. art. III, § 2, cls. 1 & 2 (stating that the original jurisdiction of the Supreme Court cannot be modified by federal law). Article III requires that a "case" or "controversy" exist for a federal court to have subject-matter jurisdiction over a proceeding. U.S. Const. art. III, § 2, cl. 1; *see Flast v. Cohen*, 392 U.S. 83, 94–96 (1968) ("[T]he judicial power of federal courts is constitutionally restricted to 'cases' and 'controversies.' ").

The Constitution enumerates particular cases and controversies over which federal courts have subject-matter jurisdiction, including those "Controversies to which the United States" is a party and "Cases ... arising under ... the Laws of the United States." U.S. Const. art. III, § 2. Thus, in a federal criminal proceeding, federal courts have jurisdiction where the United States is a party for two reasons. First, by the mere fact that the United States is a party. Second, because the United States has standing to bring criminal proceedings under federal law. In contrast, when the United States is not a party to a federal criminal proceeding, a federal court has no subject-matter jurisdiction, because the United States is not a party and because private individuals have no standing to claim alleged violations of federal criminal law. *See Linda R.S. v. Richard D.*, 410 U.S. 614, 619 (1973) (holding that private individuals have no "judicially cognizable interest in the prosecution or nonprosecution of another"); *cf. Young v. United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 797–801 (1987) (discussing the rare situation, motivated by separation of powers concerns and the inherent power of courts to regulate judicial proceedings, where a court can empower a private individual to prosecute criminal contempt proceedings as a representative of the United States).

***13** It is well-settled that a federal court's jurisdiction cannot be expanded by statute to extend beyond the Constitution's limits. *See* U.S. Const. art. VI, cl. 2 ("This Constitution, and the Laws of the United States *which shall be made in Pursuance thereof* ... shall be the supreme Law of the Land"); *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 180 (1803) ("[A] law repugnant to the constitution is void."); *Hodgson v. Browerbank*, 9 U.S. (5 Cranch) 303, 304 (1809) (A "statute cannot extend the jurisdiction [of a federal court] beyond the limits of the constitution."). By statute, district courts have original jurisdiction over "offenses against the laws of the United States." 18 U.S.C.

§ 3231 (2012). This broad statutory grant of authority over criminal matters is constrained, however, by the Article III case-and-controversy requirement.

When a trial court rendered a judgment without subject-matter jurisdiction, a habeas court can provide relief. *Bowen v. Johnston*, 306 U.S. 19, 23–24 (1939).

The United States is a party to a proceeding if a single "proper representative" participates, *United States v. Providence Journal Co.*, 485 U.S. 693, 708 (1988); *United States v. Durham*, 941 F.2d 886, 892 (9th Cir. 1991); *United States v. Garcia-Andrade*, No. 13-CR-993-IEG, 2013 WL 4027859, at *5 (S.D. Cal. Aug. 6, 2013). This designation is not defeated by the presence of improper representatives. *United States v. Plesinski*, 912 F.2d 1033, 1038 (9th Cir. 1990). Indeed, an unauthorized attorney may appear "in court alone on several occasions" and jurisdiction is not defeated so long as that attorney "was at all times acting under the direction and supervision of" a proper representative. *Plesinski*, 912 F.2d at 1038. Only "officers of the Department of Justice, under the direction of the Attorney General" may be proper representatives of the United States in criminal proceedings, "[e]xcept as otherwise authorized by law." 28 U.S.C. § 516 (2012); accord Fed. R. Crim. P. 1(b).

Officers must be appointed in accordance with the Appointments Clause. U.S. Const. art. II, § 2, cl. 2. AUSAs and DOJ trial attorneys are inferior officers of the United States. *See Plesinski*, 912 F.2d at 1036–37. The default rule is that inferior officers may be appointed only by the President with the advice and consent of the Senate. U.S. Const. art. 2, § 2, cl. 2. Congress, however, may vest this appointment authority "in the President alone, in the Courts of Law, or in the Heads of Departments." *Id.*

Congress has vested the appointment power of AUSAs, 28 U.S.C. § 542(a) (2012), and DOJ trial attorneys, *id.* § 515, in the Attorney General, who is the head of the Department of Justice, *id.* § 503. The Attorney General may delegate this appointment power to others within the Department of Justice. *See id.* § 510 (permitting delegation of "any function of the Attorney General"); *Plesinski*, 912 F.2d at 1036–37.

AUSAs are required to take an oath of office "to faithfully execute [their] duties," 28 U.S.C. § 544 (2012), and failure to take this oath prevents an AUSA from being a proper representative of the government, *Plesinski*, 912 F.2d 1039; *see* Fed. R. Crim. P. 1(b). Mere failure to re-administer a lapsed oath, however, does not prevent an attorney from properly representing the United States if that attorney is unaware of the lapse. *Plesinski*, 912 F.2d at 1039. DOJ trial attorneys must also take an oath, *see* 28 U.S.C. § 515(a) (2012); 5 U.S.C. § 3331 (2012); however, there is no caselaw in this circuit discussing whether this oath is a condition precedent to their representative capacity. This Court assumes, without deciding, that this oath must be taken before DOJ trial attorneys can act in their representative capacity.

***14** According to Movant, Timothy J. Stockwell, a DOJ trial attorney who prosecuted Movant's case, was properly appointed and originally took an oath which has since lapsed. (Doc. 7-1 at 13; Doc. 7-22.) According to the Court's records, Mr. Stockwell was involved throughout the entire life of the underlying criminal case. Thus, Mr. Stockwell was a proper representative of the government in the underlying criminal case, providing this Court with subject-matter jurisdiction in that proceeding.

Movant also "questions whether the present attorney appearing for the government" in this Section 2255 action is properly appointed. (Doc. 14 at 11 n.8.) Movant fails to provide evidence establishing that there is no properly appointed attorney who took their oath in the present action; therefore, this Court is satisfied as to its present subject-matter jurisdiction. [4]

F. Discovery, Evidentiary Hearing, and Motion to Compel

In a Section 2255 proceeding, a court need not order an evidentiary hearing or permit discovery where a movant's claims, if true, would not entitle him to relief. Rule 6(a) of Rules Governing Section 2255 Proceedings (stating that discovery is discretionarily allowed on a finding of good cause); *Bracy v. Gramley*, 520 U.S. 899, 908–09 (1997) (defining good cause as movant's showing that if his claims were true he would be entitled to relief (quoting *Harris v. Nelson*, 394 U.S. 286, 300 (1969))); 28 U.S.C. § 2255(b) (2012) (requiring an evidentiary hearing except where "the motion and the files and records of the case conclusively show that the prisoner is entitled to no relief.").

Because Movant's un-waived and non-defaulted claims, taken as true, would not entitle him to relief, this Court will not allow any form of discovery.

IV. Conclusion

This Court has reviewed all of Movant's claims de novo and finds that Movant is not entitled to Section 2255 relief.

Based on the foregoing,

IT IS ORDERED that the Magistrate Judge's Report & Recommendation, (Doc. 17), is **ACCEPTED** and Movant's objections, (Doc. 18), are **OVERRULED**; accordingly,

- Movant's amended Motion Under 28 U.S.C. § 2255 to Vacate, Set Aside, or Correct a Sentence by a Person in Federal Custody (Doc. 7; CR Doc. 474) is denied and dismissed with prejudice and the Clerk of the Court shall enter judgment accordingly;
- Leave to proceed *in forma pauperis* on appeal is denied;
- A Certificate of Appealability is denied, because Movant has not made a substantial showing of the denial of a constitutional right, *see Slack v. McDaniel*, 529 U.S. 473, 483–84 (2000);

IT IS FURTHER ORDERED that Movant's Motion to Compel Government to Produce Documents, (Doc. 19), is **DENIED**.

All Citations

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Footnotes

[1] Co-defendant Stephen Kerr ("Kerr") was charged with these same counts, (CR Docs. 3, 463), and Christopher Rusch ("Rusch"), Movant and Kerr's former attorney, was also charged with one count of Conspiracy to Defraud the United States and an additional count of failure to file an FBAR, which was added later (CR Docs. 3, 463, 331 at 1607). Rusch subsequently entered into a plea agreement compelling him to testify at the request of the United States. (CR Docs. 463, 415.)

[2] The record reflects that shortly after the jury returned its verdict, Movant filed a Motion for a Judgment of Acquittal or for a New Trial. (CR Docs. 301, 302, 304.) The Court denied the Motion on August 16, 2013. (CR Doc. 346.)

[3] On July 27, 2016, Movant and Kerr filed a Joint Amended Notice of Appeal seeking to appeal both the district court's denial of the Joint Motion for New Trial (CR Doc. 463) and the denial of the Joint Motion to Accept Remand (CR Doc. 475). In their Joint Brief filed on December 12, 2016, Defendants argued:

> I. When A District Court Does Not Even Consider Evidence And Then Analyzes Other Allegations But Not The Evidence Itself, Is It An Abuse Of Discretion?
>
> II. When A District Court Fails To Properly Analyze The Evidence With The Appropriate Legal Standards, Is It An Abuse Of Discretion?
>
> III. When A District Court Fails To Properly Apply The Law To Newly Discovered Evidence, As Well As Analyze The Evidence, Is It An Abuse Of Discretion?

(United States v. Kerr, et al., No. 15-10393, Doc. 32.)

[4] Because subject-matter jurisdiction is a condition precedent to this Court's adjudicatory power, the Government must inform the Court if it knows that no Government attorney, appearing in the underlying criminal case or the present Section 2255 action, satisfies the appointment and oath requirements.

End of Document

2011 WL 924264
Only the Westlaw citation is currently available.
United States District Court,
N.D. Indiana,
South Bend Division.

UNITED STATES of America
v.
James A. SIMON.

Cause No. 3:10–CR–00056(01)RM.
|
March 14, 2011.

Attorneys and Law Firms

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ORDER AND OPINION ON BRADY MOTION; SENTENCING FINDINGS

ROBERT L. MILLER, JR., District Judge.

***1** For several years, James Simon supported his family with money taken from a variety of entities in which he had an ownership interest. During those years, he executed no loan documents with those entities, repaid none of the entities, and didn't report the money as income on either his federal tax returns or applications for financial aid for his children's schooling. He also failed to disclose on his tax returns that he had an interest in foreign bank accounts. A jury found Mr. Simon guilty of four counts of filing false federal income tax returns, 26 U.S.C. § 7206(1), three counts of failing to report foreign financial interests, 31 U.S.C. § 5314, six counts of mail fraud, 18 U.S.C. § 1341, and four counts of federal financial aid fraud, 20 U.S.C. § 1097.

Mr. Simon and the government filed a breathtaking range of objections to the presentence report. The court addresses each as the issues arise. A sentencing court must first compute the guidelines sentence correctly, then decide whether the guidelines sentence is the correct sentence for that defendant. *United States v. Santiago,* 495 F.3d 820, 825 (7th Cir.2007). The court applies the 2010 version of the sentencing guidelines. Before reaching the sentencing objections, the court addresses Mr. Simon's most recent motion to dismiss.

I. Motion to Dismiss Under Brady v. Maryland

At trial, Mr. Simon's counsel requested and received a copy of a report prepared by IRS Special Agent Paul Muschell that contained a summary of the government's tax loss computations for the years 2003–2006. An appendix to that report (Appendix A) containing Special Agent Muschell's actual computations and notations wasn't included. One of the notations in the appendix provided:

> For purposes of computing Criminal Tax Due and Owing, all income and loss items flowing from JAS PARTNERS are not being considered. JAS PARTNERS was incorporated for the sole purpose of creating artificial business losses and disguising income as loans.

Mr. Simon made a post-trial motion for disclosure of *Brady* material for sentencing purposes [Doc. No. 143], seeking, among other things, the government's computation of tax harm. In response, the government argued that *Brady v. Maryland,* 373 U.S. 83, 83 S.Ct. 1194, 10 L.Ed.2d 215 (1963), doesn't apply to its computations of tax loss because the computations weren't "favorable to the accused." *Citing Mosley v. City of Chicago,* 614 F.3d 391, 397 (7th Cir.2010). Still, the government agreed to provide Mr. Simon with copies of those computations, which included Appendix A to the Special Agent Report produced at trial. Mr. Simon now contends that the agent's computations (and more specifically the notation just quoted) constitute exculpatory evidence that should have been produced before trial under *Brady v. Maryland,* 373 U.S. 83, 83 S.Ct. 1194, 10 L.Ed.2d 215. He now moves to dismiss all charges based on the government's alleged failure to provide the appendix [1]

To establish a *Brady* violation, a defendant must show: "(1) the evidence at issue was favorable to the accused, either because it was exculpatory or impeaching; (2) the evidence was suppressed by the Government, either willfully or inadvertently; and (3) the denial was prejudicial." *United States v. Roberts,* 534 F.3d 560, 572 (7th Cir.2008); *United States v. Baker,* 453 F.3d 419, 422 (7th Cir.2006). Mr. Simon contends that: (1) the information contained in the appendix was exculpatory because it "revealed that the Government was taking inconsistent positions and that the concealed position was more favorable to the Defendant with respect to the taxability of funds issue;" (2) the government intentionally concealed and withheld that information when it produced the Special Agent's report without the appendix; and (3) the government's failure to disclose was prejudicial because "it precluded the defense from many avenues of cross examination and undermined its unsuccessful arguments at trial for the introduction of its evidence regarding the non-taxability of the funds."

***2** The government renews its argument that *Brady v. Maryland* doesn't apply to Special Agent Muschell's computations of tax loss or the notations to those computations because the amount of loss isn't an element of the offenses with which Mr. Simon was charged and wasn't material to the issues at trial or favorable to Mr. Simon. *Citing United States v. Bagley,* 473 U.S. 667, 675, 105 S.Ct. 3375, 87 L.Ed.2d 481 (1985) ("the prosecutor is not required to deliver his entire file to defense counsel, but only to disclose evidence favorable to the accused that, if suppressed, would deprive the defendant of a fair trial"). The government contends that it produced the bulk of the information in the computations during trial, although it wasn't required to do so, and that its position at trial wasn't inconsistent with the notations in Appendix A, or prejudicial to the defendant. It maintains that it didn't present any evidence or take any position with respect to the amount of loss at trial because the amount of the loss wasn't an element of the offenses charged and wasn't material to Mr. Simon's guilt, so Agent Muschell's computations and notations aren't covered by *Brady.* The government also contends that it's position was then, and is now, that money Mr. Simon received from JAS Partners was taxable income that should have been reported on his tax returns, and that Agent Muschell's computations and notations are consistent with that position. The court agrees.

Mr. Simon's counsel's suggestion that the court might have allowed Mr. Simon's experts to testify had the information in the appendix been disclosed before trial is unfounded. As noted in its opinion and order of January 3, 2011 denying Mr. Simon's third motion for acquittal and new trial [Doc. No. 139], the court repeatedly has considered and rejected Mr. Simon's arguments with respect to the admissibility of expert testimony, holding that an expert may provide an opinion to help the jury understand the facts, but he can't give testimony stating ultimate legal conclusions based on those facts, or "usurp either the role of the trial judge in instructing the jury as to the applicable law or the role of the jury in applying that law to the facts before it," *United States v. Bilzerian,* 926 F.2d 1285, 1294 (2d Cir.1991); *accord, Good Shepard Manor Found. Inc. v. City of Momence,* 323 F.3d 557, 564 (7th Cir.2003) ("expert tetimony as to legal conclusions that will determine the outcome of the case is inadmissible"); *United States v. Sinclair,* 74 F.3d 753, 757–58 n. 1 (7th Cir.1996) ("Federal Rules of Evidence 702 and 704 prohibit experts from offering opinions about legal issues that will determine the outcome of a case."); *Panter v. Marshall Field & Co.,* 646 F.2d 271, 294 n. 6 (7th Cir.1981) ("It is not for witnesses to instruct the jury as to applicable principles of law, but the judge."), and finds no basis for reconsidering those prior determinations now.

Mr. Simon's contention that the government's trial position was inconsistent with the comments in Appendix A ignores the second sentence of the quoted comment: "JAS PARTNERS was incorporated for the sole purpose of creating artificial business losses and disguising income as loans." The government consistently has taken the position that JAS Partners was created for the sole purpose of funneling funds from other corporate entities to Mr. and Mrs. Simon for their personal use under the guise of loans to avoid tax consequences. As the following discussion demonstrates, the government's position was amply supported by the evidence presented at trial, and was known to Mr. Simon well in advance of trial.

***3** Special Agent Muschell's computations of tax loss and how he arrived at those numbers weren't material to guilt or favorable to Mr. Simon and weren't subject to pretrial disclosure under *Brady v. Maryland,* 373 U.S. 83, 83 S.Ct. 1194, 10 L.Ed.2d 215 (1963). *See United States v. Bagley,* 473 U.S. 667, 682, 105 S.Ct. 3375, 87 L.Ed.2d 481 (1985) (evidence is material under Brady if there is a reasonable probability that had the evidence been disclosed, the result of the proceedings would have been different). Accordingly, the court denies Mr. Simon's motion to dismiss for failure to provide *Brady* material [Doc. No. 147].

II. Facts of the Offenses

Mr. Simon was a principal of a dizzying array of corporations and partnerships—sufficiently dizzying that in testimony at the sentencing hearing, a director of two of the corporations seemed to confuse the names of two of the entities. Mr. Simon had a history of entrepreneurship, and was engaged in a telecommunications venture in Ukraine during the years at issue at trial. One of the entities, Ichua Ltd., solicited investments for that venture. Distinguished and respected people invested in Ichua and sat on its board of directors with Mr. Simon.

Money weaved through Ichua and a number of other entities that Mr. Simon controlled: JS Elekta Leasing Limited, Elekta Limited, JAS Partners, and William R. Simon Farms, Inc. Millions of those dollars wound up in the personal accounts of James and Denise Simon, and were spent for personal expenses of the Simon family. The Simons didn't report any of that money as income on their federal income tax returns. In the bookkeeping of their personal accounts and the business accounts that they maintained, the Simons showed these payments as loans. None of the loans (other than one in 1997, which isn't at issue here) were repaid or memorialized by notes during the years in question.

Mr. Simon also had an interest—no more than signatory authority in some instances—in foreign bank accounts as a result of his involvement with these entities. He didn't disclose those interests on his tax returns and didn't file the required reports concerning those interests in a timely manner.

Mr. Simon obtained financial aid for his children to attend private schools—Culver Academies and the Canterbury School in Indiana and Mary Baldwin College in Virginia. When applying for that aid, Mr. Simon attached the federal income tax returns that omitted the millions of dollars that had been funneled to him and his wife through the entities, and also falsified reports of expenditures of those funds, such as vacations and other travel.

Mrs. Simon took her own life shortly after federal authorities executed a search warrant at the Simon home. Mr. Simon was indicted on four counts of filing false federal income tax returns, 26 U.S.C. § 7206(1), four counts of failing to file reports of foreign bank and financial accounts, 31 U.S.C. § 5314, eleven counts of mail fraud relating to the financial aid applications to the Indiana schools, 18 U.S.C. § 1341, and four counts of federal financial aid fraud relating to Mary Baldwin College, 20 U.S.C. § 1907. The charges related to the Simons' tax returns for 2003–2006. One of the foreign bank account report counts was dismissed on the government's motion on the eve of trial. The jury acquitted Mr. Simon on three of the mail fraud counts—evidence that the financial aid documents in those counts had been mailed was thin—and convicted him on all other counts.

***4** Mr. Simon objects to ¶¶ 8–16 of the presentence report, which comprise the government's version of the crimes. The court finds none of those objections to be persuasive. The statements in those paragraphs to which objection is made are supported by credible evidence presented at trial. The court overrules Mr. Simon's objections to ¶¶ 8–16 of the presentence report.

A. The Tax Counts

1. Base Offense Level

a. Duplicitness of Counts of Conviction

The guidelines direct that the counts of conviction be grouped for purposes of determining the offense level. U.S.S.G. § 3D 1.2(d). Counts 1–4 are grouped and treated as a single offense for purposes of determining their offense level. U.S.S.G. § 3D1.2(d). The presentence report and the government contend that the tax loss for those counts consists of $3,167,506 in unreported income from 1999 to 2007 (the trial addressed only 2004–2007; the remaining years are included as relevant conduct, *see* U.S.S.G. § 1B1.3(a) (2)) multiplied by 28 percent, U.S.S.G. § 2T1.1(c), or $886,901. A tax loss in that amount produces a base offense level of 20. U.S.S.G. § 2T4.1(H).

Mr. Simon objects to that calculation. He contends, for two reasons, that no tax loss can be assessed. First, Mr. Simon argues that the general verdict on counts 1–4 doesn't tell us whether the jury found his tax returns to be false because income was understated, or rather because (as was also charged) the returns didn't include disclosure of the foreign accounts. Failure to check the box that indicates foreign accounts, Mr. Simon argues, isn't a crime that causes a tax loss; since we can't say for certain that the jury found him guilty of any crime that caused a tax loss, we can't compute his offense level with reference to tax loss. So, he says, his offense level must be six.

Mr. Simon grounds this argument on *United States v. Sturdivant,* 244 F.3d 71 (2d Cir.2001). Mr. Sturdivant sold 3.4 grams of crack cocaine to an informant in the afternoon of February 9, 1997. In the evening of the same day, Mr. Sturdivant sold another 2.8 grams of crack cocaine to the same informant, but Mr. Sturdivant had gotten the drug from another supplier. Mr. Sturdivant went to trial on one count of conspiracy to distribute more than five grams of crack cocaine and distribution of more than five grams of crack cocaine. At the conclusion of the government's case, the district judge found that the evidence was insufficient to establish the existence of the single conspiracy charged in the first count, and dismissed that count. The case proceeded on the second count, and the jury returned a general verdict of guilty. The district court applied the mandatory minimum and guidelines triggered by more than five grams of crack cocaine, and sentenced Mr. Sturdivant to 63 months.

The court of appeals held that Mr. Sturdivant (who, like Mr. Simon in our case, hadn't objected to the count's duplicitness at or before trial) had waived a duplicitness argument because the duplicity wasn't apparent on the face of the indictment at the outset: given the conspiracy charge, the two same-day sales appeared to have been part of a single continuing scheme. 244 F.3d at 76. Further, the court held, plain error analysis would be available in any event. 244 F.3d at 77. Because the only count of conviction charged two crimes and the sentencing judge made no relevant conduct findings, the court of appeals held, a sentence based on both crimes alleged in the count couldn't stand. 244 F.3d at 77–79. The remedy, the court decided, was for Mr. Sturdivant to be re-sentenced on the basis of the less serious of the two possible crimes of conviction: the evening 2.8 gram sale. 244 F.3d at 80. Importantly, the court of appeals specifically said that the resentencing court could consider whether the 3.4 gram afternoon sale should be considered as relevant conduct. *Id.*

***5** *Sturdivant* doesn't affect the calculation of Mr. Simon's sentencing range because counts 1–4 of Mr. Simon's indictment are not duplicitous. A charge is duplicitous when it alleges more than one crime, *United States v. Starks,* 472 F.3d 466, 470 (7th Cir.2006), a situation often seen when the statute cited in the count defines more than one crime. *See, e.g., United States v. Savoires,* 430 F.3d 376, 379–380 (6th Cir.2005) (18 U.S.C. § 924(c) creates two separate crimes of “use” and “possession”). “Duplicity creates a risk that the jury might return a less than unanimous guilty verdict, potentially exposes the defendant to prejudice at trial and sentencing, and in some cases subjects the defendant to double jeopardy.” *United States v. Pansier,* 576 F.3d 726, 734 (7th Cir.2009). But when the statute defines a single crime that can be committed in any of several ways, a count that charges that the defendant committed that single crime in more than one way, the “ways in which [the statutory crime] can be committed may be alleged in the conjunctive in one count ... and proof of any of them will support [a] conviction.” *United States v. Haynes,* 582 F.3d 686, 704 (7th Cir.2009).

The crime charged in counts 1–4 of Mr. Simon's indictment alleges commission of the crime charged in 26 U.S.C. § 7206(1):

> Any person who—
>
> > (1) Declaration under penalties of perjury.-Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter ...
>
> shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution.

That statute defines a single crime, committed by wilfully making and subscribing a sworn return not believed to be true in every manner. The making and subscribing the false return is the crime; the statute doesn't make each false entry in a single return a separate crime.

Counts 1–4 of Mr. Simon's indictment, then, were not duplicitous. They didn't raise the risk that Mr. Simon would, like Elbert Sturdivant, be convicted by a jury consisting of some jurors thinking him guilty of one crime and some jurors thinking him guilty of another. Mr. Simon's jury found, beyond a reasonable doubt, that Mr. Simon wilfully made a subscribed a sworn return he didn't believe to be true for the calendar year 2003, did so again in 2004, and again in 2005, and again in 2006. There is no uncertainty as to the crimes of which Mr. Simon was convicted in counts 1–4, so there is no need to ignore any provision of the sentencing guidelines (or, eventually, any other sentencing consideration under 18 U.S.C. § 3553) triggered by convictions for violation of 26 U.S.C. § 7206(1).

b. Sufficiency of Evidence of Tax Loss

***6** Mr. Simon also objects to the presentence report's tax loss calculation on the grounds set forth in testimony by Herbert Long, an accountant and former Internal Revenue Service agent, hearing officer, and associate chief of the appeals office. Mr. Long has offered, either through testimony or proffer, various opinions in these proceedings that various payments to the Simons were reimbursements of expenses, loan receipts, loan repayments, or distribution of capital. He has evaluated the tax loss at anywhere from zero to $173,000.

Mr. Long was a very likeable witness, but in the end was not a persuasive one. When asked what caused him to change or expand his opinions at various points during these proceedings, he seemed to say that he proposed any plausible scenario that would favor his client. He supported his opinions by assuming the truth of what Mr. Simon said or wrote, and by inferring that since Mr. Simon loaned to others, others loaned to him.

The trial evidence is far more persuasive to the court than Mr. Long's suppositions. The moneys that the Simons funneled to themselves were taken without authorization and used as income would have been used. No one viewed them as reimbursements or as distributions of capital.

Nor, despite the accounting entries the Simons made, did anyone truly view them as loans. There was scant evidence (and no credible evidence) that anyone associated with the entities from which the money came knew that they were “loaning” Mr. Simon anything; it does not appear that Mr. Simon negotiated or bargained with anyone to get the money; no note or other instrument memorializes any loan to Mr. Simon after 1997, much less any terms for time or method of repayment or interest due. The lack of documentation is particularly noteworthy with respect to JAS Partners, which claimed to have been in the business of lending, but actually seems to have done little but serve as a pipeline into the Simons' personal accounts.

The court finds, by a preponderance of the evidence, that Mr. Simon received from the entities at issue, and did not report or pay taxes on, the following sums in the following years (these figures include years as to which no charges were filed, pursuant to U.S.S.G. § 1B1.3(a)(2):

1999	$177,400
2000	$380,781
2001	$258,228
2002	$158,402
2003	$245,800
2004	$341,143
2005	$472,637
2006	$739,920
2007	393,195
	$3,167,506

Because the crimes involved filing tax returns that under-reported gross income, the tax loss is defined at 28 percent of the unreported gross income, unless a more accurate determination of the loss can be made. U.S.S.G. § 2T 1.1(c)(1)(A). No more accurate determination can be made on this record—other calculations are possible, but none are more accurate.

The court overrules Mr. Simon's objections to ¶¶ 11, 13, 16, 20–22, and 65 of the presentence report. The tax loss is 28 percent of $3,167,506, or $886,901.69. The offense level is 20. U.S.S.G. § 2T4.1(H).

2. Tax Counts Enhancements

a. Sophisticated Means

***7** U.S.S.G. § 2T1.1(b) requires a two-level offense enhancement if "the offense involved sophisticated means...." The presentence report and the government contend this enhancement applies. Mr. Simon objects, arguing that the entities primarily involved in the transactions (JS Elekta and Elekta Limited) used domestic bank accounts and that in any event, the use of offshore accounts is unremarkable for one with twenty years of experience as an international businessman.

Mr. Simon insists on greater sophistication than the guidelines require for this enhancement. Application Note 4 tells us that

> For purposes of subsection (b)(2), "sophisticated means" means especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense. Conduct such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore financial accounts ordinarily indicates sophisticated means.

This definition, while more demanding than the earlier standard of " 'a greater level of planning or concealment' than a typical fraud of that kind," *United States v. Wayland,* 549 F.3d 526, 528 (7th Cir.2008) (*citing United States v. Robinson,* 538 F.3d 605, 607–608 (7th Cir.2008), doesn't require sophistication so great that nothing more intricate can be imagined.

Mr. Simon used multiple entities to hide and disguise income. There were no apparent legitimate reasons for so many business entities. JAS Partners seems to have existed solely as a chute for money into the Simons' personal accounts. He used accounts in foreign countries one wouldn't associate with either the entity or his business. Funds were broken into other checks, often routed through two or three entities to Mrs. Simon, all in a single day, as on July 15, 2004 and July 26, 2005. Those complexities and intricacies allowed Mr. Simon to walk off with tax-fee compensation for about eight years, *see United States v. Wayland,* 549 F.3d at 529 ("his overall scheme, which lasted nine years and involved a series of coordinated fraudulent transactions, was complex and sophisticated"), bamboozled worldly and urbane investors in Ichua, and involved especially complex and especially intricate offense conduct pertaining to the execution or concealment of the scheme. The court overrules Mr. Simon's objection to ¶¶ 23 and 66 of the presentence report. His offense level on counts 1–4 is increased by two levels, to level 22.

b. Role in the Offense

The guidelines require a two-level enhancement for a defendant who was an organizer, leader, manager, or supervisor of another criminal participant. U.S.S.G. § 3B 1.1(c). The government and the presentence report contend this enhancement is required because Mr. Simon led his wife Denise in the process that led to the false income tax returns. Mr. Simon objects, arguing that the record establishes neither that he led or supervised his wife nor that she was a criminal participant. He also challenges the enhancement's applicability when the participants are spouses.

***8** The law doesn't support Mr. Simon's proposition that the role in offense enhancement doesn't apply when one spouse directs another. In *United States v. Herrera,* 878 F.2d 997 (7th Cir.1989), the defendant directed his wife's participation in drug distribution. The court of appeals rejected the argument Mr. Simon makes today: "It is also irrelevant that the criminal participants happen to be husband and wife. The guidelines contain no spousal exception; rather, 3B 1.1(c) applies any time there is more than one participant, regardless if the participants happen to be husband and wife." *Id.* at 1002 (citation omitted).

Denise Simon was a participant in the tax fraud scheme. She received most of the money, often via several checks in the same day. She was the primary record-keeper who entered the money as "loans ." She was an account signatory for JAS Partners, Elekta Limited, and J.S. Elekta Ltd. She signed the false tax returns and apparently filed some of them by mailing them. Mrs. Simon served as bookkeeper for several of the related entities, kept minutes for them, and participated in several of their board meetings and some of their correspondence.

Denise Simon was a knowing participant, and so a criminal participant, in the tax fraud scheme. Many (perhaps most) of the money arrived at the Simons' doorstep by way of checks payable to Mrs. Simon. She had to have known when she entered those checks as "loans" in the records she maintained that she hadn't borrowed money from the payor entity. Her knowledge is demonstrated by her false statement to I.R.S. Special Agent Paul Muschell, on the morning that the search warrant was executed at the Simon residence, that no financial records were in the residence and that all the records were with James Simon in Ukraine; in truth, the records were on a computer at the residence, under Mrs. Simon's screen name.

Finally, Mr. Simon directed Denise Simon in the execution of the tax fraud scheme, as demonstrated by the e-mails admitted into evidence at the sentencing hearing as Government Exhibits 4 through 8, in which James Simon instructed Denise Simon as to what to do with various financial instruments.

Mr. Simon managed Denise Simon in this criminal activity. The court overrules Mr. Simon's objections to ¶¶ 15, 24, and 68 of the presentence report. His offense level on counts 1–4 is increased by two levels, to level 24, because of his role in the offense.

c. Abuse of Position of Trust

U.S.S.G. § 3B 1.3 requires a two-level offense enhancement for a defendant who abused a position of trust in a way that significantly facilitated the commission or concealment of the offense. The government and the presentence report contend that Mr. Simon did both: that his use of the entities' money abused the trust of the entities themselves and the entities' other owners, who placed Mr. Simon in a lightly supervised position of extraordinary discretion; and that Mr. Simon's training and experience as an accountant and financial expert facilitated his weaving a web of accounts, some in unexpected offshore locations, through which he could pass money to himself. Mr. Simon objects on several grounds. He denies that he held positions of trust in the entities, and denies that he used his skills and knowledge in any sophisticated way the facilitated the crimes or their concealment.

***9** Mr. Simon's argument is difficult to understand. Mr. Simon was managing director of Ichua Limited and JS Elekta Leasing Ltd. He was president of William R. Simon Farms, Inc. and Elekta Ltd. He was general partner of JAS Partners. Beyond the repose of trust inherent in naming a person to such positions (much less to all the positions) with broad inherent discretion, Mr. Simon had significantly less supervision than would employees whose responsibilities are generally less discretionary. He (and in some instances his wife) had signature authority on the business accounts, and he had (as evidence by the way things played out) authority to issue checks without board or majority partner approval. The sentencing hearing testimony of Roland Bopp demonstrates that while Ichua and JS Elekta Leasing had conscientious and capable board members, Mr. Simon had sufficiently thinly supervised discretion to pilfer hundreds of thousands of dollars that investors (including some of the directors) had intended for construction of a telecommunication system in Ukraine.

That lightly supervised discretion in the operation of these companies and partnerships made it possible for Mr. Simon to divert millions of the entities' dollars to his personal use. He abused a position—indeed, five positions—of private trust. The court overrules Mr. Simon's objections to ¶¶ 25 and 69 of the presentence report. His offense level on counts 1–4 is increased by two levels, to level 26, because of his abuse of his positions of trust.

The pre-grouping offense level for counts 1–4 is 26.

B. The FBAR Counts

1. Base Offense Level

Counts 6–8, the foreign bank account report ("FBAR") counts, are grouped as a single offense, as well. U.S.S.G. § 3D 1,2(d). The base offense level for violation of 31 U.S.C. § 5314 is "6 plus the number of offense levels from the table in § 2B 1.1 (Theft, Property Destruction, and Fraud) corresponding to the value of the funds...." U.S.S.G. § 2S1.3(a)(2). The total value of the foreign bank accounts (according to the return Mr. Simon belatedly filed in 2010) from 2003 to 2007 was $50,064,000. The referenced table assigns 24 levels to a value of more than $50 million. U.S.S.G. § 2B 1.1(b)(1)(M). The offense level for Mr. Simon's FBAR counts, then, starts at 30.

The presentence report recommends that calculation of the pre-grouping offense level for counts 6–8 end there. The parties disagree, though for different reasons.

Mr. Simon argues for application of U.S.S.G. § 2S1.3(b)(3), which requires that the offense level be reduced to six if (a) the defendant didn't know or believe that the funds were proceeds or, or were intended to promote, unlawful activity, and the crime didn't involve bulk cash smuggling, (b) the offense wasn't committed as part of a pattern of unlawful activity involving more than $100,000 in a twelvemonth period, (c) the defendant didn't act with reckless disregard of the source of the funds, (d) the funds were the proceeds of lawful activity, and (e) the funds were to be used for a lawful purpose. Mr. Simon bears the burden of demonstrating the applicability of this "safe harbor" provision by a preponderance of the evidence. *United States v. Keleta,* 552 F.3d 861, 866 (D.C.Cir.2009).

***10** Mr. Simon has met this burden. He has shown that the money that went into the related entities were proceeds of lawful activity—raising funds to develop and construct a telecommunications company in Ukraine. Mr. Simon hasn't accounted for each dollar that went into the related entities, but the guideline doesn't require him to do so; guideline issues must be proven by a preponderance of the evidence. *See, e.g., United States v. Saenz,* 623 F.3d 461, 467 (7th Cir.2010) (defendant must prove entitlement to reduction by preponderance). He has explained why people put money into those entities, and the record contains no suggestion that any of these accounts were used to launder proceeds from sales of weaponry, drugs, classified secrets, gambling, prostitution, or other racketeering activities. Unlike the district courts in *United States v. Sweeney,* 611 F.3d 459, 477 (8th Cir.2010) and *United States v. Keleta,* 552 F.3d 861 (D.C.Cir.2009), this court has enough information to find that it is more likely than not that the funds in the entities' accounts were the proceeds of lawful activity.

The funds were to be used for lawful purposes—again, to develop and construct a telecommunications company in Ukraine. Even after Mr. Simon diverted them from that purpose, they were used for lawful purposes—the support, education, and entertainment of the Simon family. It might be true, as the government suggests, that Mr. Simon committed wire fraud to divert those funds, but that crime simply shifted the money from one lawful purpose to another.

The safe harbor provision in U.S.S.G. § 2S1.3(b)(3) applies. The court sustains Mr. Simon's objections to the presentence report's recommendation against application of the safe harbor provision, and reduces Mr. Simon's offense level for counts 6–8 to six.

2. FBAR Count Enhancements

The government argues that the enhancements for sophisticated means, aggravating role, and abuse of position of trust or use of a special skill apply to the FBAR counts (indeed, to all the counts), not just to the tax counts.

The government doesn't identify a guideline under which an offense level calculated under U.S.S.G. § 2S1.3(b)(3) might be enhanced for the use of sophisticated means. In any event, whatever the sophistication and complexity of the overall scheme, there is nothing complex about failing to file reports with a federal income tax return. Mr. Simon strove mightily and stealthily to extract tax-free dollars from the entities with which he was associated, but that's not what he was charged with having done in counts 6–8. In those counts, as Mr. Simon's was told, jury the criminal activity consisted of (1) Mr. Simon having signature or other authority over bank, securities, or other financial accounts in a foreign country in the year addressed in the count, (2) that had a balance exceeding $10,000 in aggregate value; (3) that Mr. Simon knew that he had a legal duty to file a report of foreign financial accounts; and (4) that Mr. Simon knowingly and willfully failed to file the report on or before June 30 of the year addressed in the count. There is no sophistication involved in not filing those reports.

***11** On the same reasoning, Mr. Simon's positions of private trust and his special skills as an accountant had much to do with Mr. Simon being in a position in which he was supposed to file these reports, but had no facilitating role in his failure to do so. No enhancement under U.S.S.G. § 3B 1.3 is appropriate with respect to counts 6–8.

Denise Simon signed the tax returns and filed at least one by mailing it. She knew of the foreign accounts and had signature authority with respect to several of the accounts. She was a knowing participant, managed by Mr. Simon, in the scheme that led her to that circumstance. The court agrees with the government that Mr. Simon's offense level must be increased by two levels under U.S.S.G. § 3B 1.1(c) with respect to the FBAR counts. The court sustains the government's objection to ¶ 62 of the presentence report and increases Mr. Simon's offense level by two levels, to level eight, on counts 6–8.

The court overrules the government's objections to ¶¶ 60 and 64 of the presentence report. The pre-grouping offense level for counts 6–8 is eight.

C. The Mail Fraud and Education Fraud Counts

1. Base Offense Level

Mail fraud is punishable by imprisonment for as long as twenty years, so the base offense level for counts 9–12, 15, and 17–23 is seven. U.S.S.G. § 2B 1.1(a)(1). The court is to enhance that offense level according to a loss table if the loss exceeded $5,000. Mr. (and Mrs.) Simon attached false returns to private and federal financial aid applications that produced a total of $166,670.35 in financial aid for their children. The loss table requires a ten-level enhancement in offense level if the loss amount is more than $120,000 but not more than $200,000. U.S.S.G. § 2B 1.1(b)(F). The government and the presentence report recommend that the court apply that ten-level enhancement.

Mr. Simon objects to the ten-level enhancement because, he contends, there was no tax loss. His argument stands on two legs. First, the court denied the government's forfeiture motion with respect to the mail fraud counts because the government had presented too little evidence "that the Simons wouldn't have received any need-based financial aid from Culver or Canterbury had they reported their income honestly." December 21, 2010 Opinion and Order (Doc. No. 138 at p. 4). And second, the Indiana schools have disclaimed any desire for restitution.

Mr. Simon's argument misapprehends what the court is to measure. "Loss," for purposes of U.S.S.G. § 2B 1.1(b), is the greater of actual loss and intended loss. Application Note 3(A). Intended loss is the pecuniary harm that was intended to result from the offense. Application Note 3(A)(ii). The government was unable to prove, for forfeiture purposes, actual loss from the mail fraud with respect to the Indiana schools, and appears to fall short as well with respect to proof of actual loss that is needed for an order of restitution.

None of those concerns address intended loss. It is inescapable to the court that the Simons attached their false federal income tax returns, with numbers bolstered by their omission of large sums spent on family travel (into which the applications inquired) because they intended to get financial aid that they wouldn't have received otherwise. But for their sham pretenses of need, the financial aid awards they sought might have gone to other applicants or not been awarded at all. What the Simons received from the financial institutions as a result of their fraudulent applications is within what the guidelines mean by "intended loss."

***12** The loss—here, the intended loss—from these fraudulent applications for financial aid was more than $120,000 but not more than $200,000, requiring a ten-level enhancement in offense level. U.S.S.G. § 2B 1.1(b)(F). The court overrules Mr. Simon's objections to ¶¶ 14, 16, 35, and 73 of the presentence report. Mr. Simon's offense level for 9–12, 15, and 17–23 is increased by ten levels, to level 17, because of the amount of the loss.

2. Mail Fraud and Education Fraud Counts Enhancements

The guidelines require a two-level enhancement if the fraud crime involved sophisticated means. U.S.S.G. § 2B1.1(b)(9)(C). "Sophisticated means" has the same meaning for the fraud guidelines that it had with respect to the tax fraud calculation. U .S.S.G. § 2B 1.1 Application Note 8(B). The presentence report and Mr. Simon recommend against applying this enhancement; the government objects. Once the tax forms were created and filed (completing the crime of filing a false tax return), there was nothing especially complex or intricate about using the forms as attachments to financial aid forms. The court agrees with the presentence report and Mr. Simon that the fraud crimes didn't involve sophisticated means within the meaning of U.S.S.G. § 2B1.1(b)(9)(C). The court overrules the government's objection to ¶ 73 of the presentence report. Mr. Simon's offense level for counts 9–12, 15, and 17–23 remains at 17.

The government contends that the two-level role in the offense enhancement applies with respect to counts 9–12, 15, and 17–23 because Mr. Simon directed Denise Simon in the commission of the financial aid fraud. The court agrees with the government. Evidence at trial indicated that Mrs. Simon delivered papers to the schools in conjunction with the financial aid applications, pursuant to James Simon's direction. The court sustains the government's objection to ¶ 75 of the presentence report. Mr. Simon's offense level with respect to counts 9–12, 15, and 17–23 is increased by two levels, to level 19, because of his managerial role in the fraud.

The government contends that Mr. Simon's offense level on the fraud counts should be increased by another two levels pursuant to U .S.S.G. § 3B1.3, the “abuse of position of trust or use of a special skill” enhancement applied in calculating the offense level for the tax counts. Mr. Simon and the presentence report disagree, as does the court. Enhancement of Mr. Simon's offense level for his role in the offense forecloses any further enhancement for use of a special skill, U.S.S.G. § 3B1.3 (“if this adjustment is based solely on the use of special skill, it may not be employed in addition to an adjustment under § 3B1.1 (Aggravating Role)”), and Mr. Simon held no position of private trust with respect to Culver Academies, Canterbury School, or Mary Baldwin College. The court overrules the government's objection to ¶ 77 of the presentence report.

The pre-grouping final adjusted offense level for counts 9–12, 15, and 17–23 is 19.

D. Grouping the Offense Levels

***13** Mr. Simon's offense level for counts 1–4 is 26; his offense level for counts 6–8 is 8; his offense level for counts 9–12, 15, and 17–23 is 19. The group with the highest offense level—counts 1–4, at level 26—is counted as one unit. U.S.S.G. § 3D 1.4(a). The group that is seven levels less serious than the most serious—counts 9–12, 15, and 17–23, at level 19—is counted as one-half a unit. U.S.S.G. § 3D 1.4(b). The group that is 18 levels less serious than the most serious group—counts 6–8, at level 8—is disregarded for purposes of calculating the post-grouping offense level. U.S.S.G. § 3D 1.4(c).

Because there are one and one-half units in Mr. Simon's guideline calculation, the offense level of the most serious group is increased by one level. The post-grouping offense level is 27.

E. Acceptance of Responsibility

The sentencing guidelines require a two-level offense level reduction for a defendant who clearly accepted responsibility for the offenses of conviction. U.S.S.G. § 3E1.1(a). Mr. Simon's decision to go to trial steepens his climb to this reduction, but doesn't make it impossible; “[i]n rare situations a defendant may clearly demonstate an acceptance of responsibility for his criminal conduct even though he exercises his constitutional right to a trial. This may occur, for example, where a defendant goes to trial to assert and preserve issues that do not relate to factual guilt....” Application Note 2 to U.S.S.G. § 3E1.1. Mr. Simon contends that he didn't deny the conduct alleged in the tax counts—the transactions themselves—but rather challenged the funds' proper legal characterization. With respect to the FBAR counts, he says he was trying to preserve his claim that an IRS notice meant that he didn't have to file FBARs during the years charged. Mr Simon says that the financial aid was awarded without reliance on the tax returns or expenditure information he submitted with the applications.

Mr. Simon hasn't accepted responsibility within the meaning of the sentencing guidelines. Through the sentencing hearing, he has denied that the money that cascaded into his personal accounts was income. He moved for judgment of acquittal on all counts at the close of the government's case in chief, at the close of all the evidence, and post-trial, based on the insufficiency of the evidence. Mr. Simon has expressed no remorse whatsoever.

Mr. Simon denied essential factual elements at trial and put the government to its burden of proof. He had every right to do so. But he hasn't accepted responsibility within the meaning of the guidelines, and is not entitled to a reduction in offense level for having done so. The court overrules Mr. Simon's objections to ¶ 76 of the presentence report. His final post-grouping adjusted offense level is 27.

III. Summary of Rulings on Objections

Although the objections don't affect the advisory guideline range, the government has objected to the presentence report to the extent it opines that Mr. Simon doesn't have the money to pay a fine. Noting Mr. Simon's substantial income in 2009, what would appear to be extraordinary expenditures by Mr. Simon during this prosecution, and that JAS Partners had assets of just under $4 million as of the end of 2008. The presentence report responds that Mr. Simon reported having liquidated most of JAS Partners for his defense. The government voices a very reasonable suspicion, given Mr. Simon's handling of these accounts in the past, but a party objecting to a presentence report's factual content bears a higher burden. The objector must furnish some evidence that calls into question the reliability or correctness of the presentence report. *United States v. Mays,* 593 F.3d 603, 608 (7th Cir.2010). The party that agrees with the presentence report has the burden of demonstrating the report's accuracy only when the objector creates real doubt as to the information's reliability. *United States v. Maiden,* 606 F.3d 337, 339 (7th Cir.2010); *United States v. Panice,* 598 F.3d 426, 439 (7th Cir.2010). The government has not raised real doubt about Mr. Simon's present ability to pay a fine in addition to restitution that will, according to the presentence report, exceed $1 million. The court overrules the government's objection to ¶¶ 127 and 128 of the presentence report.

***14** In summary, the court sustains Mr. Simon's objections to the presentence report's recommendation against application of the safe harbor provision in U.S.S.G. § 2S1.3(b)(3), and sustains the government's objections to ¶¶ 62 and 75 of the presentence report. Those rulings require the court to reject the grouping paragraphs (¶¶ 78–84) of the presentence report, as well. The court adopts as its own findings ¶¶ 1–61, 63–74, 76–77, and 85–144 of the presentence report, specifically including ¶¶ 90–127 concerning Mr. Simon's financial condition and earning ability.

IV. Calculation of Advisory Range

This is Mr. Simon's first criminal conviction of any sort, so he is assigned to criminal history category I. Given the offense level of 27, the sentencing guidelines recommend a sentencing range of 70 to 87 months' imprisonment. A hearing to determine a reasonable sentence will be scheduled in a separate order after consultation with counsel's schedules.

All Citations

Not Reported in F.Supp.2d, 2011 WL 924264, 107 A.F.T.R.2d 2011-1393

Footnotes

[1] In closing argument at the sentencing/motion hearing on March 8, defense counsel argued for the first time that the government's production of the Special Agent's report at trial was also untimely, and requested leave to amend the motion to dismiss to include that allegation. The court denied the request as untimely.

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272 F.Supp.3d 96
United States District Court, District of Columbia.

Donald DEWEES, Plaintiff,
v.
UNITED STATES of America, Defendant.

Case No. 16–cv–01579 (CRC)
|
Signed 08/08/2017

Synopsis
Background: Taxpayer brought action against the United States, alleging that the government violated the Excessive Fines Clause of the Eighth Amendment, and violated his due process and equal protection rights under the Fifth Amendment with respect to collection assistance provisions of the United States-Canada Tax Convention, pursuant to which the Canadian Revenue Agency withheld his Canadian tax refund in abeyance due to his outstanding $120,000 debt to the Internal Revenue Service (IRS) for the penalty it imposed after taxpayer failed to report his foreign financial assets for 12 years. United States moved to dismiss.

Holdings: The District Court, Christopher R. Cooper, J., held that:

[1] imposition of $120,000 penalty did not violate the Excessive Fines Clause of the Eighth Amendment;

[2] taxpayer was not denied adequate due process; and

[3] taxpayer lacked standing to bring claim alleging that his Fifth Amendment equal protection rights were violated because he was not allowed to participate in streamlined program that imposed lower penalties for failure to report foreign financial assets.

Motion granted.

Attorneys and Law Firms

***98** Mark A. Feigenbaum, Thornhill, ON, for Plaintiff.

Christopher James Williamson, U.S. Department of Justice, Washington, DC, for Defendant.

MEMORANDUM OPINION

CHRISTOPHER R. COOPER, United States District Judge

The arm of the U.S. tax man is long, but in this case it needed extend only over our northern border to find Plaintiff Donald Dewees. Dewees is a U.S. citizen living in Canada, where he operates a consulting business. Because the business is incorporated abroad, Dewees was required to furnish certain annual information about the company to the IRS. 26 U.S.C. § 6038(b). Unfortunately for Dewees, he neglected to do so for over a decade.

Enter the tax man. After Dewees voluntarily disclosed his failure to file the required informational returns, the IRS assessed a statutory penalty of $120,000, $10,000 for each year of non-compliance. Dewees challenged the penalty before the IRS without success and refused to pay it. But what Dewees likely did not anticipate is that, pursuant to the U.S.–Canada tax treaty, the Candian tax authority would hold Dewees' domestic tax refund in abeyance until the IRS penalty was paid in full. After paying the penalty, Dewees filed suit in this Court challenging the relevant treaty provisions as unconstitutional under the Eighth Amendment and both the Due Process and Equal Protection Clauses of the Fifth Amendment. The Government now moves to dismiss. Finding that Dewees has failed to state a claim for relief on his Eighth Amendment and due process claims, and lacks standing to bring his equal protection claim, the Court will grant the Government's motion and dismiss the case.

I. Background

U.S. citizens who hold controlling interests in foreign corporations must annually file IRS Form 5471, which discloses certain ownership and financial information about the corporation. In addition, U.S. citizens living abroad must disclose holdings in foreign bank accounts over certain thresholds by filing a Report of Foreign Bank and Financial Accounts ("FBAR"). See Def.'s Mot. to Dismiss ("MTD") 7; Compl. ¶ 12. In 2009, Dewees learned that he had failed to comply with these requirements, ***99** and, on the advice of a tax specialist, applied to participate in the IRS's Offshore Voluntary Disclosure Program

("OVDP"). See Compl. ¶¶ 13–16. OVDP is intended to encourage taxpayers who have not disclosed their offshore assets, and who are not already under investigation by the agency, to voluntarily comply with applicable disclosure requirements. See IRS, *2009 Offshore Voluntary Disclosure Program*, https://www.irs.gov/uac/2009–offshore-voluntary-disclosure-program; Maze v. IRS ("Maze I"), 206 F.Supp.3d 1, 5–6 (D.D.C. 2016), aff'd, 862 F.3d 1087 (D.C. Cir. 2017). In return for their disclosures, the program offers taxpayers compromise terms on penalties for outstanding taxes, assurance that the IRS will not refer the matter to the Department of Justice for criminal prosecution, and finality regarding previous non-disclosures. See Maze I, 206 F.Supp.3d at 6–7. The IRS assessed a penalty of $185,862 against Dewees for not filing FBARs from 2003 to 2008, but did not at that time calculate a penalty for Dewees' failure to file Form 5471. See Compl. ¶¶ 22, 24–25; IRS, *Taxpayers with Foreign Assets May Have FBAR and FATCA Filing Requirements in June*, https://www.irs.gov/uac/newsroom/taxpayers-with-foreign-assets-may-have-fbar-and-fatca-filing-requirements-in-june. Dewees refused to pay the assessed penalty and withdrew from the OVDP. See id. ¶¶ 26–27.

In September 2011, the IRS notified Dewees that it had assessed a different penalty of $120,000 against him for failing to file Form 5471 from 1997 to 2008. See id. ¶¶ 1, 29. Section 6038(c) of the Tax Code authorizes the IRS to impose a $10,000 penalty for each missed filing. See 26 U.S.C. § 6038(c). The total penalty was based entirely on Dewees' failure to file; he was not liable for any unpaid taxes. See Compl. ¶ 47. Dewees requested an abatement of this penalty for reasonable cause, which was denied, as was his subsequent appeal of that decision. See id. ¶¶ 35–36.

Well after Dewees' appeal had been rejected, the IRS introduced another program to encourage taxpayers to voluntarily disclose offshore assets—the Streamlined Filing Compliance Procedures ("SFCP"). The SFCP differs from the OVDP in several respects: The SFCP involves less paperwork and imposes lower penalties than the OVDP, but only covers three years of non-compliance as opposed to the OVDP's eight-year coverage period. See Def.'s MTD 3–4; Compl. ¶ 50; Maze v. IRS, 862 F.3d 1087, 1089 (D.C. Cir. 2017) ("Maze II"). And, unlike the OVDP, the SFCP does not offer immunity from criminal prosecution. See id., at 1092 n.2. Transferring between the two programs is generally disfavored, but taxpayers who are otherwise eligible for the SFCP and made their OVDP submissions before July 1, 2014, may remain in the OVDP while requesting the more favorable terms available under the SFCP. See Maze I, 206 F.Supp.3d at 7–8.

In May 2015, the Canadian Revenue Agency notified Dewees that it was holding his Canadian tax refund in abeyance due to his outstanding $120,000 debt to the IRS. See Compl. ¶ 37. This international collection assistance is permitted by Article XXVI(A) of the United States-Canada Income Tax Convention. See Def.'s MTD 9–10; Compl. ¶ 37. Dewees promptly sent the Canadian Revenue Agency a check for $134,116.34, representing the $120,000 penalty plus interest. See Compl. ¶ 38. In September 2015, he filed a claim seeking a refund of that amount, which was rejected in May 2016. See Compl. ¶ 5. He then brought this action, requesting that the Court find the collection assistance provisions of the United States-Canada Tax Convention unconstitutional for violating ***100** (1) the Excessive Fines Clause of the Eighth Amendment, (2) the Due Process Clause of the Fifth Amendment, and (3) the Equal Protection Clause of the Fifth Amendment. See id. ¶¶ 42–47, 66–67, 52–53.

II. Standards of Review

[1] **[2]** The Government moves to dismiss for failure to state a claim upon which relief can be granted with respect to all three of Dewees' claims. See Def.'s MTD 1. Alternatively, it asks that Dewees' equal protection claim be dismissed for lack of subject matter jurisdiction. See id. at 18. Under Federal Rule of Civil Procedure 12(b)(1), the Court must dismiss any action over which it cannot properly exercise jurisdiction. "[D]efect[s] of standing" constitute "defect[s] in subject matter jurisdiction." Haase v. Sessions, 835 F.2d 902, 906 (D.C. Cir. 1987). The "plaintiff bears the burden of ... establishing the elements of standing," and each element " 'must be supported in the same way as any other matter on which the plaintiff bears the burden of proof, *i.e.*, with the manner and degree of evidence required at the successive stages of the litigation.' " Arpaio v. Obama, 797 F.3d 11, 19 (D.C. Cir. 2015) (quoting Lujan v. Defenders of Wildlife, 504 U.S. 555, 561, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992)).

To survive a 12(b)(6) motion, a "complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " Ashcroft v. Iqbal, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d

868 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). A court "accept[s] as true all of the allegations contained in [the] complaint," disregarding "[t]hreadbare recitals of the elements of a cause of action" and "mere conclusory statements." Iqbal, 556 U.S. at 678, 129 S.Ct. 1937. The court then examines the remaining "factual content [to determine if it may] draw the reasonable inference that the defendant is liable for the misconduct alleged." Id. A court must also consider "documents incorporated into the complaint by reference." Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007).

III. Analysis

A. Excessive Fines Claim

[3] **[4]** "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const. amend. VIII. In analyzing an excessive fines claim, the Court must first decide whether a penalty is a fine before determining if it is unconstitutionally excessive. See United States v. Bajakajian, 524 U.S. 321, 334, 118 S.Ct. 2028, 141 L.Ed.2d 314 (1998). A payment to the government is only considered a "fine" under the Eighth Amendment if it is "punishment for some offense." Bajakajian, 524 U.S. at 328, 118 S.Ct. 2028 (quoting Austin v. United States, 509 U.S. 602, 609–10, 113 S.Ct. 2801, 125 L.Ed.2d 488 (1993)). In other words, the purpose of the penalty must be primarily retributive or deterrent rather than remedial. Id. In the context of forfeiture, for example, a penalty that is solely "designed to punish the offender" is considered punishment and is thus limited by the Excessive Fines Clause. Id. at 333–34, 118 S.Ct. 2028.

[5] Tax penalties, by contrast, having been held to fulfill a remedial purpose are therefore not subject to the Excessive Fines Clause. The Supreme Court first articulated this principle almost 80 years ago in Helvering v. Mitchell, 303 U.S. 391, 58 S.Ct. 630, 82 L.Ed. 917 (1938), reasoning that tax penalties are remedial because they exist as "a safeguard for the protection ***101** of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud." Id. at 401, 58 S.Ct. 630 (citing a string of supporting precedent). Since then, the lower courts have erected "an insurmountable wall of tax cases" to support this proposition. See, e.g., McNichols v. Comm'r of Internal Revenue, 13 F.3d 432, 434 (1st Cir. 1993) (holding that the Excessive Fines Clause does not apply to civil tax penalties and characterizing the proposed extension of rule from forfeiture cases to tax penalties as an unsupported "giant leap"); Little v. Comm'r of Internal Revenue, 106 F.3d 1445, 1455 (9th Cir. 1997) (holding that the Excessive Fines Clause was not violated because plaintiff "failed to establish that the additions to tax in question [were] penal sanctions unrelated to the government's fundamental interest in raising revenue"); Thomas v. Comm'r of Internal Revenue, 62 F.3d 97, 102–03 (4th Cir. 1995) (same). A Bankruptcy Court recently applied this precedent in holding the same Form 5471 non-compliance penalties challenged here are not fines. See In re Wyly, 552 B.R. 338, 606 (Bankr. N.D. Tex. 2016). The Court concludes likewise. Because "a small, fixed-penalty provision," such as the $10,000 penalty here, "can be said to do no more than make the Government whole," it is outside the Eighth Amendment's reach. Austin, 509 U.S. at 622 n.14, 113 S.Ct. 2801 (internal quotations omitted).

Dewees nonetheless attempts to scale this "insurmountable wall" of precedent by arguing that a smaller penalty would have achieved the same objective of making the Government whole. See Pl.'s Opp'n 3. But that is beside the point. Congress authorized a $10,000 penalty for every instance of non-compliance because it recognized the expenses and loss that could result if U.S. taxpayers no longer felt obligated to disclose their foreign assets. The IRS strictly applied that statutorily authorized amount across Dewees' twelve years of non-compliance, resulting in a total penalty of $120,000 —an amount designed to mitigate the harm suffered by the Government. Because Congress authorized this penalty for a legitimate remedial purpose, Dewees' Eighth Amendment claim fails.

B. Due Process Claim

[6] **[7]** Dewees likewise fails to establish a due process violation because he has been afforded an adequate "opportunity to be heard at a meaningful time and in a meaningful manner." Mathews v. Eldridge, 424 U.S. 319, 333, 96 S.Ct. 893, 47 L.Ed.2d 18 (1976) (quoting Armstrong v. Manzo, 380 U.S. 545, 552, 85 S.Ct. 1187, 14 L.Ed.2d 62 (1965)). Courts judge procedural due process challenges to property deprivations by weighing (1) "the private interest that will be affected by the official action;" (2) "the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards;" and (3) "the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." Id. at 335, 96 S.Ct. 893.

[8] **[9]** **[10]** Mere postponement of an opportunity to challenge the imposition of a tax penalty "is not a denial of due process, if the opportunity given for the ultimate judicial determination of the liability is adequate." Phillips v. Comm'r of Internal Revenue, 283 U.S. 589, 596–97, 51 S.Ct. 608, 75 L.Ed. 1289 (1931). Such delays are "an inevitable consequence" of disputes between taxpayers and the IRS, and are not unconstitutional. Bob Jones Univ. v. Simon, 416 U.S. 725, 747, 94 S.Ct. 2038, 40 L.Ed.2d 496 (1974). Federal district courts ***102** have jurisdiction over lawsuits against the Government for the refund of tax penalties. See 28 U.S.C. § 1346(a)(1). Full payment of the amount owed followed by a lawsuit in a district court seeking a refund is a proper procedure for challenging penalties assessed under § 6038. See Wheaton v. United States, 888 F.Supp. 622, 627 (D.N.J. 1995) (citing 28 U.S.C. § 1346(a)). Section 1346 gives district courts original jurisdiction over "any civil action against the United States for the recovery of ... any penalty claimed to have been collected without authority or any sum alleged to have been excessive on in any manner wrongfully collected under the internal-revenue laws[.]" Id. That is so even if this results in the taxpayer being "in the position of paying a substantial tax penalty without prepayment review." Id.; see also Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 543, 132 S.Ct. 2566, 183 L.Ed.2d 450 (2012) ("[T]axes can ordinarily be challenged only after they are paid, by suing for a refund.").

Dewees claims that he was denied adequate due process because he had no opportunity to appeal his penalty "through administrative means or the U.S. Tax Court" before it was collected. Compl. ¶ 67. But the absence of Dewees' requested avenue of relief does not mean his due process rights have been violated. The ability to challenge tax penalties in *district courts* under § 1346(a)(1) fulfills the Fifth Amendment's requirements. Accordingly, Dewees has failed to state a claim for relief under the Due Process Clause of the Fifth Amendment.

C. Equal Protection Claim

[11] **[12]** **[13]** Finally, the Government moves to dismiss Dewees' equal protection claim for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted. See Def.'s MTD 18. The Court must start with the jurisdictional issue. In order to have standing to litigate a claim in federal court, a plaintiff must establish an injury in fact, which is traceable to the defendant, and which is likely to be redressed by prevailing in court. Lujan, 504 U.S. at 560–61, 112 S.Ct. 2130. A sufficient injury in fact is concrete and particularized, and actual or imminent as opposed to merely hypothetical. Id. at 560, 112 S.Ct. 2130. It is the plaintiff's burden to demonstrate that his claim satisfies all of these elements. Id. at 561, 112 S.Ct. 2130. In considering a motion to dismiss for lack of standing, the Court must assume the truth of the plaintiff's factual allegations but not his legal conclusions, which must be supported by more than "mere conclusory statements." Williams v. Lew, 819 F.3d 466, 472 (D.C. Cir. 2016) (quoting Iqbal, 556 U.S. at 663, 129 S.Ct. 1937).

Dewees bases his equal protection claim on the contention that he was not allowed to participate in the SFCP while other similarly situated taxpayers were, and thus he was denied the opportunity to have a lower penalty imposed. See Compl. ¶¶ 52–53. This argument suffers from a fatal flaw because, as the Government points out, Dewees has not pled that he sought entrance into the SFCP or that his application was denied. See Def.'s MTD 18. And because Dewees has not shown (or attempted to show) that the IRS ever denied him the opportunity to participate in the SFCP, he cannot establish that he suffered an *actual* injury. By failing to show that he was injured, Dewees lacks standing and this Court lacks jurisdiction to hear his claim.[1]

*103 IV. Conclusion

For the reasons discussed above, the Court finds that Dewees has failed to state a viable claim with respect to his excessive fines and due process claims, and that it lacks subject matter jurisdiction over Dewees' equal protection claim. Accordingly, it will grant the Government's motion to dismiss. A separate Order accompanies this Memorandum Opinion.

All Citations

272 F.Supp.3d 96, 120 A.F.T.R.2d 2017-5429, 2017-2 USTC P 50,321

Footnotes

[1] The Government alternatively moves to dismiss under Rule 12(b)(6) for failure to state a claim. Because the Court lacks subject matter jurisdiction, it will not consider this contention. The Court notes, however, that a fellow court in this district denied a similar equal protection claim, holding that a taxpayer who participated in OVDP prior to July 1, 2014 "*may* be able to receive the favorable penalty terms of the Streamlined Procedures, but must remain in the OVDP in order to do so." Maze I, 206 F.Supp.3d at 7–8. Applying that principle here, Dewees' decision to leave the OVDP—and not the IRS's actions—rendered him ineligible for the SFCP.

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2016 WL 416377
Only the Westlaw citation is currently available.
United States District Court,
C.D. California, Western Division.

United States of America, Plaintiff,
v.
Letantia Bussell, Defendant.

Case No. CV 15-02034-SJO(VBKx)
|
Signed January 11, 2016.

Attorneys and Law Firms

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JUDGMENT IN FAVOR OF PLAINTIFF UNITED STATES OF AMERICA AND AGAINST DEFENDANT LETANTIA BUSSELL

S. JAMES OTERO, United States District Judge

***1** Pursuant to the Court's Order Granting in Part and Denying in Part the Government's Motion for Summary Judgment Reducing Penalty Assessment to Judgment filed on December 8, 2015 (ECF Docket No. 25),

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. Pursuant to 31 U.S.C. Section 5321(a)(5)(C), defendant Letantia Bussell is personally liable and indebted to the United States of America for the Report of Foreign Bank and Financial Accounts (“FBAR”) penalty assessment for the year 2006 in the amount of in the reduced amount of $1,120,513, plus statutory interest accruing from the date of assessment on June 5, 2013, as provided by law, until such obligation is paid in full.

2. Defendant Letantia Bussell is personally liable and indebted to the United States of America for the failure-to-pay the assessed FBAR penalty, pursuant to 31 U.S.C. Section 3717(e)(2), as provided by law.

All Citations

Not Reported in F.Supp.3d, 2016 WL 416377

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2011 WL 1304438
Only the Westlaw citation is currently available.
United States District Court,
N.D. Indiana,
South Bend Division.

UNITED STATES of America
v.
James A. SIMON.

Cause No. 3:10–CR–56(01) RM.
|
April 5, 2011.

Attorneys and Law Firms

Jesse M. Barrett–AUSA, US Attorney's Office, South Bend, IN, for United States of America.

OPINION AND ORDER

ROBERT L. MILLER, JR., District Judge.

***1** James Simon was sentenced to six years in prison on March 29 on four counts of filing false income tax returns, 26 U.S.C. § 7206(1), three counts of failing to file reports of foreign bank and financial accounts, 31 U.S.C. §§ 5314, 5322, eight counts of mail fraud, 18 U.S.C. § 1341, and four counts of federal financial aid fraud, 20 U.S.C. § 1097. Mr. Simon now seeks bail pending appeal under 18 U.S.C. § 3143(b), (c).

I

To be released pending appeal, Mr. Simon must show (1) by clear and convincing evidence that he presents no danger or flight risk and (2) that his appeal raises a substantial question of law or fact likely to result in reversal, a new trial, or a sentence that includes either no imprisonment or imprisonment for a shorter time than the appeal is expected to take. 18 U.S.C. § 3143(b). A substantial question is "a 'close' question or one that very well could be decided the other way." *United States v. Bilanzich,* 771 F.2d 292, 299 (7th Cir.1985). In other words, "a toss-up or nearly so." *United States v. Shoffner,* 791 F.2d 586, 590 n. 6 (7th Cir.1986). In making these determinations, a district court should be humble with respect to the correctness of its own decisions.

A

Mr. Simon has satisfied his burden of proof concerning danger and flight. The government agrees that Mr. Simon poses no danger to the community or to any person in it. The government suspects that Mr. Simon has stashed away enough untaxed money to finance flight; the government points to the sums Mr. Simon must have spent in defending these charges. The government might be right; Mr. Simon has woven a sufficiently complex web that one can never be certain that everything is accounted for. Nonetheless, the court is persuaded by clear and convincing evidence (though not to a certainty) that Mr. Simon will not flee and leave his children behind.

B

Were that sufficient to provide the court with discretion to allow bail pending appeal, the court wouldn't hesitate to grant Mr. Simon bail. His children would benefit from another year or so of direct parenting, and Mr. Simon and his family might accept his imprisonment better after the court of appeals affirmed the judgment they haven't yet accepted.

But Congress doesn't grant courts such discretion until a convicted defendant makes a further showing that a substantial question of law or fact is likely to (in the sense that the issue is nearly a toss-up) result in reversal, a new trial, or a much shorter sentence. Mr. Simon hasn't made that showing.

1

Mr. Simon raises arguments that would challenge first his FBAR convictions and less directly his tax convictions. Mr. Simon argues that because the Internal Revenue Service extended the deadlines for filing FBARs (and indeed purported to foreswear enforcement under certain circumstances), his failure to file the forms when they otherwise would have been due wasn't a crime. This court denied Mr. Simon's dismissal motion based on that argument on October 8, reasoning that if Mr. Simon committed a crime by not filing a required form when he was supposed to, the Internal Revenue Service had no magic wand to absolve him of that crime retroactively. Mr. Simon will appeal that ruling.

***2** From this argument, Mr. Simon reasons that if he succeeds, his convictions on the tax counts must fall, as well, because they charged that his income tax returns were false, not solely because he omitted what the government contends was taxable income, but also because he denied having reportable interests in foreign accounts. *See Yates v. United States,* 354 U.S. 298, 311–312, 77 S.Ct. 1064, 1 L.Ed.2d 1356 (1957); *United States v. Lee,* 558 F.3d 638 (7th Cir.2009).

The government cites a horde of cases that support the proposition that amendment of a regulation doesn't relieve criminal liability for pre-amendment conduct, *citing United States v. United States Coin and Currency,* 401 U.S. 715, 737–738, 91 S.Ct. 1041, 28 L.Ed.2d 434 (1971); *Allen v. Grand Central Aircraft Co.,* 347 U.S. 535, 553–555, 74 S.Ct. 745, 98 L.Ed. 933 (1954); *United States v. Hark,* 320 U.S. 531, 536, 64 S.Ct. 359, 88 L.Ed. 290 (1944); *United States v. Curtiss–Wright Export Corp.,* 299 U.S. 304, 332, 57 S.Ct. 216, 81 L.Ed. 255 (1936); *United States v. Grimaud,* 220 U.S. 506, 522, 31 S.Ct. 480, 55 L.Ed. 563 (1911); *United States v. Uni Oil, Inc.,* 710 F.2d 1078, 1986 (5th Cir.1983); *City & County of Denver v. Bergland,* 695 F.2d 465, 480 (10th Cir.1982); *United States v. Resnick,* 455 F.2d 1127, 1134 (5th Cir.1972); *Crary v. Porter,* 157 F.2d 410, 415 (8th Cir.1946); *Bowles v. Jones,* 151 F.2d 232, 234 (10th Cir.1945); *O'Neal v. United States,* 140 F.2d 908, 913–914 (6th Cir.1944); *United States v. Philipp,* 63 F.Supp. 853 (E.D.Pa.1945), and notes that the Notice on which Mr. Simon relies didn't rise to the level of a regulation. The government notes that the only case on which Mr. Simon relies (*United States v. Tenzer,* 950 F.Supp. 554 (S.D.N.Y.1996)) is “a reversed district court case, the reasoning of which, according to Westlaw, no court anywhere has ever followed.”

The court agrees with the government that Mr. Simon's argument on this point doesn't raise a close question of law. The court can't describe this issue as anything resembling a “toss-up.”

2

Mr. Simon next points to evidentiary rulings he plans to appeal, specifically the rulings excluding evidence of loans to the entities with which Mr. Simon was associated but not involving Mr. Simon, and the court's refusal to allow witnesses to give opinions or explanations of the law. As to the first, the court ruled before trial that evidence of transactions between Mr. Simon and the entities with which he was associated would be relevant to Mr. Simon's claim that the moneys he and his family got from those entities were loans. The court doesn't believe that evidence of any such transactions was excluded, unless the court excluded evidence of transactions that were too remote from the time period covered by the indictment. But the court also ruled that where the entities got the money that eventually went to Mr. Simon was irrelevant and very likely to confuse the jury.

Neither Mr. Simon's earlier arguments nor those put forth in his motion has persuaded the court that the source of the funds, as they went into the related entities before moving on to Mr. Simon or his family, makes more or less likely any fact of consequence to the case. When the motion was addressed on the eve of trial (and often during trial), the question for the jury was to be whether the moneys Mr. Simon received from those entities were loans or taxable income. As the trial went on and after the trial, an additional issue arose: whether the moneys from the related entities were distributions that weren't taxable because they didn't exceed Mr. Simon's basis. The court remains unable to discern how loans or other transactions among the related entities or others (apart from Mr. Simon) would help resolve those issues. If the money to Mr. Simon consisted of loans or distributions, it wasn't because of where or how the related entities got the money.

***3** Mr. Simon cites, without extensive analysis, *Boulware v. United States,* 552 U.S. 421, 128 S.Ct. 1168, 170 L.Ed.2d 34 (2008), in support of his evidentiary argument. Whatever *Boulware* might be thought to have said about the admissibility of basis evidence in cases involving facts far different from those before the *Boulware* Court, it says nothing about the relevancy of evidence that an entity borrowed money that was then transferred to one of the entity's principals. Moreover, as the government notes in its opposition to the motion for bail, Mr. Simon's arguments and offers (which rarely attained any degree of specificity) elided the distinction between partnerships and corporations—and Mr. Simon was involved with, and received money from, both.

For Mr. Simon to succeed on his claim that the court should have allowed him to present expert testimony on the law, he would have to persuade the court of appeals to jettison decades of case law holding that it's the judge's job (and not that of an expert witness) to tell the jury what the law is. *See, e.g., United States v. Lupton,* 620 F.3d 790, 799–800 (7th Cir.2010) ("The court was correct in noting that the meaning of statutes, regulations, and contract terms is 'a subject for the court, not for testimonial experts. The only legal expert in a federal courtroom is the judge.' "); *United States v. Caputo,* 517 F.3d 935, 942 (7th Cir.2008) ("The 'expert' would have testified about the meaning of the statute and regulations. That's a subject for the court, not for testimonial experts."); *Bammerlin v. Navistar Int'l Transp. Corp.,* 30 F.3d 898, 900 (7th Cir.1994) ("The meaning of federal regulations is not a question of fact, to be resolved by the jury after a battle of experts. It is a question of law, to be resolved by the court."); *Harbor Ins. Co. v. Continental Bank Corp.,* 922 F.2d 357, 366 (7th Cir.1990) ("By allowing the insurance companies' witness to tell the jury what the witness's legal research had turned up on the meaning of a key term in the case, the judge allowed the jury to infer that it could look to that witness for legal guidance; and by doing this the judge impermissibly tilted the balance of power between the parties toward the insurance companies."). Mr. Simon hasn't disclosed to this court (either at trial or since) the argument by which hopes to persuade the court of appeals to do so.

For these reasons, the court can't find that Mr. Simon has identified an evidentiary issue that satisfies the bail statute's requirements.

3

Finally, Mr. Simon says he will appeal his sentence because the court ruled against his argument based on *United States v. Sturdivant,* 244 F.3d 71, 78–79 (2d Cir.2001). He contends that since the tax counts each allege that the returns were false in either of two respects (stated income or denial of foreign accounts) and the record doesn't reflect which theory the jury accepted, *Sturdivant* compels that the sentence be calculated based on the less serious charged conduct—which Mr. Simon sees as the denial of foreign accounts because that conduct carries no tax loss. This argument doesn't persuade the court that the bail statute's requirements are met for two reasons. First, Mr. Simon has simply repeated his earlier argument without giving the court any new perspective as to why the reasoning at pages 9–12 of its sentencing findings (doc. # 156) should be seen as wrong. Second, as the government notes, success on this argument wouldn't reduce his sentence to the brevity the bail statute requires.

***4** If the false tax return counts were held to have caused no loss, the base offense level on those counts would be 6. U.S.S.G. § 2T4.1(A). His offense level on those counts would be increased by two levels because of the use of sophisticated means, U.S.S.G. § 2T1 .1(b), by two more levels because of his management role over his wife, U.S.S.G. § 3B1.1(c), and by two more levels because of his abuse of his positions of trust, U.S.S.G. § 3B1.3, producing a post-remand offense level of 12 on Counts 1–4. The other groups would be unaffected (though the FBAR counts might be grouped with the tax return counts), so the offense level for the FBAR counts still would be 8 and the offense level for the fraud counts still would be 19. The guidelines still would treat these as one-and-a-half units, U.S.S.G. § 3D1.4(a, b), so the fraud group's offense level of 19 would be increased by one, producing a post-grouping offense level of 20, rather than the 27 the court computed in its sentencing findings. Because Mr. Simon is a Category I first offender, the sentencing guidelines would recommend a sentencing range of 33 to 41 months' imprisonment. U.S.S.G. § 5A.

The court has no reason to believe the appeal process would exceed the sentencing range the guidelines would recommend if Mr. Simon prevails on his *Sturdivant* argument, so the requirements of the bail statute are not satisfied.

II

The bail statute, 18 U.S.C. § 3143(b), limits the courts' authority to grant bail pending appeal to situations in which the defendant makes specified showings. Mr. Simon hasn't made those showings, so the court DENIES his motion for bond pending appeal (doc. # 161).

SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2011 WL 1304438

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2010 WL 2842931
United States District Court, E.D. Virginia,
Alexandria Division.

UNITED STATES of America, Plaintiff,
v.
J. Bryan WILLIAMS, Defendants.

Civil Action No. 1:09–cv–437.
|
March 19, 2010.

Attorneys and Law Firms

Gerard J. Mene, United States Attorney's Office, Alexandria, VA, for Plaintiff.

David H. Dickieson, Schertler & Onorado, Washington, DC, for Defendants.

ORDER

LIAM O'GRADY, District Judge.

***1** This matter comes before the Court on Plaintiff's Motion for Summary Judgment (Dkt. no. 11). A hearing on the matter was held on March 12, 2010 before the Court. Upon consideration of the motion, Defendant's response thereto, and for the reasons that follow, it is hereby

ORDERED that Plaintiff's Motion for Summary Judgment (Dkt. no. 11) is DENIED. The parties continue to dispute genuine issues of material fact and this case must proceed to trial.

I. *Background*

In this case, the government seeks to enforce two "Report of Foreign Bank and Financial Accounts" ("FBAR") penalties it assessed against Defendant J. Bryan Williams ("Williams") for failing to report his interest in two Swiss bank accounts for the year 2000 as required by 31 U.S.C. § 5314 and the Department of Treasury's corresponding promulgations under 31 C.F.R. § 103.24–27. The following factual background is undisputed.

In 1993 Williams opened two bank accounts at Credit Agricole Indosuez, SA, in the name of ALQI Holdings, Ltd., a British Corporation ("ALQI"). From that point in 1993 to the year 2000, an amount in excess of $7,000,000 was deposited in the two accounts. In August 2000, the Swiss government requested to interview Williams with respect to the ALQI accounts and Williams thereafter retained Swiss and U.S. attorneys. On November 13, 2000, Williams discussed the ALQI accounts with Swiss authorities working with the U.S. Government. In June 2001, Williams retained tax attorneys to advise him with respect to the two ALQI accounts. The deadline for filing the FBAR form for the tax year 2000 was June 30, 2001. In January 2002, Williams' attorneys met with IRS attorneys to discuss a possible resolution to unfreeze the two accounts and pay taxes on the income derived from those accounts, and in January 2003, Williams applied to participate in an IRS amnesty program for individuals with undeclared overseas accounts. Then, in February 2003, Williams filed amended returns for 1999 and 2000 which disclosed information about the ALQI accounts.

The government subsequently informed Williams in April 2003 that he would not be accepted into the amnesty program.[1] Thereafter, in May 2003, Williams agreed to plead guilty to tax fraud and on June 12, 2003, Williams pleaded guilty to one count of conspiracy to defraud the United States and to one count of criminal tax evasion in connection with funds held in the Swiss bank accounts during the years 1993 through 2000. *See* Gov. Ex. 2 (criminal plea hearing transcript in the case *United States v. J. Bryan Williams,* 03–cr–406 (S.D.N.Y.2003)). On January 18, 2007, Williams filed a Form TDF 90–22.1 for all years going back to 1993.

II. *Legal Standard*

Summary judgment is appropriate where "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." FED.R.CIV.P. 56(c). In evaluating a motion for summary judgment, the Court "view[s] the facts and the reasonable inferences drawn therefrom in the light most favorable to the nonmoving party." *See EEOC v. Navy Fed. Credit Union,* 424 F.3d 397, 405 (4th Cir.2005); *see also Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). "The mere existence of *some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment." *Anderson,* 477 U.S. at 247–48 (emphasis in original).

III. *Jurisdiction*

***2** Title 28, § 1345 of the U.S.Code provides subject matter jurisdiction over this case, as this is a suit "commenced by the United States." Further, the government states that it commenced this action at the request and with the authorization of the Chief Counsel for the IRS and at the direction of the Attorney General, pursuant to 26 U.S.C. § 7401, which mandates that "[n]o civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Secretary authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced."

IV. *Analysis*

a. Statutory Framework

The FBAR penalty at issue in this case arises from 31 U.S.C. § 5314, which requires qualifying individuals to disclose their interests in foreign bank accounts. Section 5314(b) allows the Secretary of Treasury to delegate its authority for enforcement of the section and to prescribe the methods for doing so. In 31 C.F.R. § 103.24–27, the Department of Treasury promulgated the disclosure requirements at issue here, including the requirement to file the Form TDF 09–22.1.[2] As the government notes, an individual is required to file the Form if: (1) the individual was a resident or a person doing business in the United States; (2) the individual had a financial account or accounts that exceeded $10,000 during the calendar year; (3) the financial account was in a foreign country; and (4) the U.S. person had a financial interest in the account or signatory or other authority over the foreign financial account. *See* 31 C.F.R. § 103.24; 103.27.

Civil penalties for willful violations of § 5314 are provided in 31 U.S.C. § 5321(a)(5)(B),[3] which allows for a maximum assessment of $100,000, two of which were assessed here. Section 5321(b)(1) states that the Secretary of Treasury can assess these penalties and § 5321(b)(2) states that the Secretary of Treasury can commence a civil action to enforce the penalties. In turn, 31 CFR § 103.56(g) delegates the authority to assess these penalties to the IRS.

b. Whether Williams "Willfully" Violated the Statute

The initial and primary issue at this point in the case is a question of intent: whether Williams' failure to submit the Form TDF 90–22.1 by June 30, 2001 was a "willful" act. This is an inherently factual question about which too many material disputes remain to permit the entry of summary judgment in favor of the government.

On this point, the parties' briefs initially focus on the effect the Court should give to Williams' 2003 guilty plea. In the Fourth Circuit, the doctrine of judicial estoppel can prevent a party in a civil action from re-litigating previously-established facts underlying a criminal plea. *See Lowery v. Stovall,* 92 F.3d 219, 223–224 (4th Cir.1996). This Circuit also applies the doctrine of collateral estoppel when a criminal defendant accepts a guilty plea and later seeks to re-litigate the same issues in a civil proceeding. *See United States v. Wight,* 839 F.2d 193, 195–197 (4th Cir.1987). According to this doctrine, "a defendant is precluded from retrying issues necessary to his plea agreement in a later civil suit." *Id.; see also United States v. Moore,* 765 F.Supp. 1251, 1255 (E.D.Va.1991); *United States v. One 1987 Mercedes Bern 300E,* 820 F.Supp. 248, 253 (E.D.Va.1993).

***3** In applying either doctrine, the question is not whether, as a general proposition, Williams can be precluded from disaffirming the facts underlying his 2003 guilty plea. He can. Rather, as became clear at the March 12 hearing, the issue presented in this case is defining which specific facts were necessarily part of Williams' plea.

For instance, in his plea, Williams clearly admitted "[in] the calendar year returns for #93 through 2000, I chose not to report the income to my—to the Internal Revenue Service in order to evade substantial taxes owed" on the ALQI accounts. Gov. Ex. 2 at 18. However, Williams argues that there is a disconnect between this broad factual basis underlying his plea and the specific question at issue here: whether on June 30, 2001, Williams willfully failed to submit a Form TDF 90–22.1 for tax year 2000.

At that point in 2001, Williams contends that U.S. authorities were already on notice of the accounts, and indeed, the assets in the accounts had already been frozen.[4] Thus, according to Williams, he did not have the requisite intent to "willfully" fail to disclose the accounts by filing the Form TDF 90–22.1 on June 30, 2001 because he believed their existence had already been disclosed. Further, Williams claims he had no knowledge that Form TDF 90–22.1 existed, nor had his attorneys advised him as to its existence or significance before June 30, 2001. Lastly, Williams also contests whether he had "signatory or other authority over" the accounts as required by 31 C.F.R. § 103.24 by June 30, 2001 because the accounts were frozen.

These disputes are surely material in this case. Drawing all reasonable inferences in favor of Williams as the non-moving party, the Court concludes that genuine issues of material fact remain in dispute in this case. Plaintiff's Motion for Summary Judgment must be denied.

All Citations

Not Reported in F.Supp.2d, 2010 WL 2842931, 106 A.F.T.R.2d 2010-5158

Footnotes

[1] In his Brief in Opposition, Williams argues that the IRS denied him entry into the amnesty program because the government already knew about the accounts before Williams applied to the program.

[2] As the government advises, Form 1040, Schedule B, Part III instructs a taxpayer to report an interest in a financial account in a foreign country by checking "Yes" or "No" in the appropriate box on the form. Form 1040 then refers the taxpayer to use Form TD F 90–22.1 which provides that it should be used to report a financial interest in or authority over bank accounts, securities accounts, or other financial accounts in a foreign country.

[3] As that statute existed prior to amendment in 2004. Willful violations are now addressed in 31 U.S.C. § 5321(a)(5)(C), which provides a different calculation of the maximum available penalty.

[4] At the March 12 hearing, it also appeared that a dispute remains as to when these assets were actually frozen and as to when Williams met with certain authorities about the Swiss accounts.

End of Document

2015 WL 3767147
United States District Court,
S.D. New York.

UNITED STATES of America
v.
Peter CANALE, Defendant.

No. 14 Cr. 713(KBF).
|
Signed June 17, 2015.

OPINION & ORDER

KATHERINE B. FORREST, District Judge.

***1** Before the Court is defendant's motion to dismiss the Indictment as time-barred or, in the alternative, to transfer this case to the Western District of Kentucky. (ECF No. 26.)[1] On June 12, 2015, the Court informed the parties on the record that it would deny defendant's motion and issue its decision in a separate order. This Opinion & Order sets forth the predicted rationale for the Court's decision.

I. BACKGROUND[2]

On October 28, 2014, a grand jury sitting in the Southern District of New York returned an Indictment charging Peter Canale ("defendant" or "Canale"), a resident of Kentucky, with one count of conspiracy to defraud the United States and to commit substantive tax offenses, in violation of 18 U.S.C. § 371. (Indictment ("Ind.") ¶¶ 1, 32, ECF No. 2.) The Indictment alleges that between about 1993 and April 2011, Canale conspired with others to open and maintain undeclared bank accounts in Switzerland —and to hide those accounts, and the income generated therefrom, from the Internal Revenue Service ("IRS"). (Ind.¶ 12 .) Specifically, the Indictment alleges that Canale, his brother Michael Canale, and a now-deceased relative of the brothers (the "Relative") worked with Swiss advisers Beda Singenberger ("Singenberger") and Hans Thomann ("Thomann") to establish and maintain undeclared accounts at Swiss banks. (*See* Ind. ¶¶ 1–4, 6, 13(a).) The Indictment further alleges that the Canale brothers used sham entities to conceal their ownership of the undeclared Swiss accounts from the IRS, filed false and fraudulent federal income tax returns which failed to report their interest in, and income from, the accounts, and failed to file Reports of Foreign Bank and Financial Accounts ("FBARs") disclosing their authority over the accounts.[3] (Ind.¶¶ 13(b)-(d), 28–31.)

The Indictment alleges that the following overt acts occurred in the Southern District of New York in furtherance of the conspiracy:

1. In July 2000, the Relative, who maintained an undeclared account in Switzerland, introduced defendant to Thomann in Manhattan, New York, where they discussed the Relative's undeclared account. (Ind.¶¶ 14, 16.)

2. In late 2000 or 2001, after the Relative's death, defendant and Michael Canale met with Thomann and Singenberger at a Manhattan hotel and discussed continuing to maintain the undeclared assets the two brothers had inherited from the Relative in an undeclared account for the brothers' benefit. (Ind.¶¶ 17–18.)

3. In the mid–2000s, Michael Canale met with Singenberger in Manhattan to discuss his undeclared account. (*Id.* ¶ 36(f).)

II. LEGAL STANDARDS

A. *Statute of Limitations*

"For offenses involving the defrauding or attempting to defraud the United States or any agency thereof, whether by conspiracy or not," the period of limitations is six years. *See* 26 U.S.C. § 6531(1); *see also United States v. Aracri,* 968 F.2d 1512, 1517 (2d Cir.1992). For a § 371 conspiracy charge to be within the statute of limitations, (1) the conspiracy must still have been ongoing within the six-year period preceding the indictment, and (2) at least one overt act in furtherance of the conspiracy must have been performed within that period. *United States v. Ben Zvi,* 242 F.3d 89, 97 (2d Cir.2001); *see also United States v. Fletcher,* 928 F.2d 495, 498 (2d Cir.1991) ("The limitations period begins to run after the last overt act in furtherance of the main goals of the conspiracy." (citations omitted)); *Grunewald v. United States,* 353 U.S. 391, 396–97, 77 S.Ct. 963, 1 L.Ed.2d 931 (1957). The Government is not required to prove that each member of the conspiracy committed an overt act within the statute of limitations. *See Hyde v. United States,* 225 U.S. 347, 369–70, 32 S.Ct. 793, 56 L.Ed. 1114 (1912); *United States v.*

Read, 658 F.2d 1225, 1233–34 (7th Cir.1981) (interpreting *Hyde*). "[T]he crucial question in determining whether the statute of limitations has run is the scope of the conspiratorial agreement, for it is that which determines both the duration of the conspiracy, and whether the act relied on as an overt act may properly be regarded as in furtherance of the conspiracy." *United States v. Salmonese,* 352 F.3d 608, 614 (2d Cir.2003) (quoting *Grunewald,* 353 U.S. at 397) (internal quotation marks omitted).

B. *Venue*

***2** A criminal defendant has the right to be tried in the "district wherein the crime shall have been committed." U.S. Const. amend. VI; *see also id.* art. III, § 2, cl. 3 ("The Trial of all Crimes ... shall be held in the State where the said Crimes shall have been committed."); Fed.R.Crim.P. 18 ("Unless a statute or these rules permit otherwise, the government must prosecute an offense in a district where the offense was committed."). The Second Circuit has held that:

> there is no single defined policy or mechanical test to determine constitutional venue. Rather, the test is best described as a substantial contacts rule that takes into account a number of factors-the site of the defendant's acts, the elements and nature of the crime, the locus of the effect of the criminal conduct, and the suitability of each district for accurate factfinding.

United States v. Rowe, 414 F.3d 271, 278 (2d Cir.2005) (quoting *United States v. Reed,* 773 F.2d 477, 481 (2d Cir.1985)). "[T]he two chief ills that the constitutional venue provisions are meant to guard against" are "bias and inconvenience ." *Id.* at 280–81.

"The crime of conspiracy, 18 U.S.C. § 371, is a continuing offense, the prosecution of which is proper 'in any district in which such offense was begun, continued or completed.' " *United States v. Tannenbaum,* 934 F.2d 8, 12 (2d Cir.1991) (quoting 18 U.S.C. § 3237(a)). Thus, in a conspiracy prosecution, "venue may lie in any district in which the conspiracy was formed or in any district in which a conspirator committed an overt act in furtherance of the criminal scheme." *United States v. Rommy,* 506 F.3d 108, 119 (2d Cir.2007) (citations omitted).

The Government bears the burden of proving venue by a preponderance of the evidence. *United States v. Bala,* 236 F.3d 87, 95 (2d Cir.2000). Prior to trial, however, "it suffices for the government to allege with specificity that the charged acts support venue in this district." *United States v. Martino,* No. S1 00 CR 389(RCC), 2000 WL 1843233, at *1 (S.D.N.Y. Dec.14, 2000) (citation and internal quotation marks omitted).

C. *Rule 21(b*)

Rule 21(b) of the Federal Rules of Criminal Procedure provides that "[u]pon the defendant's motion, the court may transfer the proceeding ... to another district for the convenience of the parties, any victim, and the witnesses, and in the interest of justice." Fed.R.Crim.P. 21(b). "Disposition of a Rule 21(b) motion is vested in the sound discretion of the district court." *United States v. Maldonado–Rivera,* 922 F.2d 934, 966 (2d Cir.1990) (citations omitted). In considering a motion to transfer, a district court should consider the so-called *Platt* factors: "(1) location of the defendant; (2) location of possible witnesses; (3) location of events likely to be in issue; (4) location of documents and records likely to be involved; (5) possible disruption of defendant's business if the case is not transferred; (6) expense to the parties; (7) location of counsel; (8) relative accessibility of the place of trial; (9) docket conditions of each district involved"; and (10) any other special elements that might affect the transfer. *United States v. Keuylian,* 602 F.2d 1033, 1038 (2d Cir.1979) (citing *Platt v. Minnesota Min. & Mfg. Co.,* 376 U.S. 240, 243–44, 84 S.Ct. 769, 11 L.Ed.2d 674 (1964)). "No one of these considerations is dispositive, and '[i]t remains for the court to try to strike a balance and determine which factors are of greatest importance.' " *Maldonado–Rivera,* 922 F.2d at 966 (quoting *United States v. Stephenson,* 895 F.2d 867, 875 (2d Cir.1990)).

***3** As a general rule, a criminal prosecution should be retained in the district in which it was filed, and the criminal defendant bears the burden of justifying a transfer. *United States v. Riley,* 296 F.R.D. 272, 275 (S.D.N.Y.2014).

III. DISCUSSION

Defendant's principal argument as to timeliness is that the conspiracy count is time-barred because the Government has not alleged overt acts or offenses personally involving him which occurred both in this district and within the six-year statute of limitations. This argument fails as a matter of law. Defendant is not charged with the substantive offenses of tax evasion or the willful filing of false tax returns; he is charged with a conspiracy. As a result, the Indictment is not time-barred so long as at least one overt act in furtherance of the main goals of the conspiracy occurred within the limitations period. The law is clear that this overt act may be committed anywhere-and not necessarily in the district where the defendant is charged. *See Tannenbaum,* 934 F.2d at 13 (holding that "[r]ules governing venue and limitations serve distinct purposes" and that overt acts establishing venue need not have been committed within the statute of limitations).

Here, the Indictment is clearly timely. The charged conspiracy was allegedly ongoing until April 2011–well within the six-year period preceding the Indictment, which was filed on October 28, 2014–and the Indictment alleges at least one overt act that was performed in furtherance of the conspiracy within the six-year limitations period. *See Ben Zvi,* 242 F.3d at 97. Specifically, the Indictment alleges that "[i]n or about March 2010, PETER CANALE, the defendant, filed, and caused to be filed, tax returns for 2009 that falsely and fraudulently claimed that CANALE did not maintain an interest in or signature or other authority over a financial account in a foreign country during 2009." (Ind.¶ 36(g).) This alleged act was clearly within the scope of-and committed in furtherance of-the charged conspiracy to defraud the IRS, engage in tax evasion, and file false tax returns. (*See* Ind. ¶¶ 33–35.)[4] Accordingly, defendant's motion to dismiss the Indictment as time-barred is DENIED.

Defendant's venue objection is also baseless: as set forth above, the Indictment alleges that a number of overt acts in furtherance of the charged conspiracy occurred in this district, including two meetings during which defendant and his co-conspirators discussed the maintenance of undeclared Swiss accounts for the benefit of the Canale brothers. That is sufficient to make venue proper in this district. *See Rommy,* 506 F.3d at 119. As set forth above, it is immaterial that the overt acts in this district occurred outside the statute of limitations.

In response, defendant argues that the overt acts alleged to have occurred in this district were merely preparatory and thus could not support venue here. According to defendant, "[o]ther than arranging the foreign account in the Southern District of New York, the government does not have a scintilla of evidence which would support a charge that Mr. Canale either attempted to evade or defeat a tax in violation 26 U.S.C. § 7201, or that Mr. Canale filed a fraudulent and false statement in violation of 26 U.S.C. § 7206." (Memorandum of Law in Support of Change of Venue ("Def.'s Venue Mem .") at 6, ECF No. 28.) This argument once again misinterprets the crime charged in the Indictment. Defendant is charged not with substantive tax offenses but with a conspiracy-and the objects of this conspiracy include not only the offenses under 26 U.S.C. §§ 7201 and 7206 but also the object of defrauding the IRS.[5] The overt acts alleged to have occurred in this district-multiple meetings by various co-conspirators in which they discussed the establishment and continued maintenance of undeclared Swiss accounts for the benefit of the Canale brothers-were not "preparatory"; they were part and parcel of the charged conspiracy.[6] Accordingly, venue is proper in this district.[7]

***4** Finally, upon carefully considering the *Platt* factors, the Court finds that a transfer to the Western District of Kentucky pursuant to Rule 21(b) is unwarranted. This case was investigated and charged in this district. Manhattan is a more accessible location than Bowling Green, Kentucky-where this case would likely be tried if transferred. Moreover, defendant's local counsel in Kentucky has indicated that he intends to withdraw, such that counsel-of-record for both parties will be located in New York. The "expense" factor also weighs against transfer: While defendant has represented that it would cost substantially more to defend this case in New York than in Kentucky, he has not estimated his projected expenses and has not alleged that he has insufficient funds to cover them. *See Riley,* 296 F.R.D. at 277 (the expense factor is generally afforded serious weight only in cases involving indigent defendants). On the other hand, a trial in Kentucky would require the Government to transport and house two prosecutors, as well as a paralegal and several case agents, in a remote location. *See United States v. Carey,* 152 F.Supp.2d 415, 422 (S.D.N.Y.2001) (denying a motion to transfer where, *inter alia,* the effect of a transfer would be "merely to shift the economic burden to the government").

As to the location of trial witnesses, while defendant has represented that a substantial majority of the potential defense witnesses are in Kentucky, there is no suggestion that any of these witnesses will be unable to appear to testify in New York. *See United States v. Brooks,* No. 08 CR. 35(PKL), 2008 WL 2944626, at *2 (S.D.N.Y. July 31, 2008) ("Generally, a defendant is required to give 'specific examples of witnesses' testimony and their inability to testify because of the location of the trial.' " (quoting *United States v. Spy Factory, Inc.,* 951 F.Supp. 450, 456 (S.D.N.Y.1997))); *see also United States v. Estrada,* 880 F.Supp.2d 478, 483 (S.D.N.Y.2012). Given that many of the Government's witnesses are in New York, the "location of the witnesses" factor does not support transfer. As to the location of the relevant events, the conduct alleged in the Indictment occurred in several states, including New York, as well as internationally; this factor does not support a transfer of this action to Kentucky. As to location of documents, the Court has no reason to believe that a significant number of relevant documents are located in Kentucky, much less that they are not available in easily accessible electronic format. *See Estrada,* 880 F.Supp.2d at 484 ("[G]iven the conveniences of modern transportation and communication, the location of the documents is a minor concern." (citation and internal quotation marks omitted)). As to docket conditions, it appears that judges in the Western District of Kentucky have a lower civil caseload but a higher criminal caseload than judges in this district. More important than caseload statistics, however, is the fact that this Court has already made itself available, familiarized itself with this case, and scheduled a trial date that is convenient for both parties. *See United States v. Stein,* 429 F.Supp.2d 633, 645 (S.D.N.Y.2006) (denying defendants' motions to transfer where, *inter alia,* the court had already "scheduled trial ... ensuring that defendants will receive ample attention regardless of docket conditions"). Transferring this case to Kentucky would very likely result in delays and duplication of judicial resources.

***5** The sole factor in favor of transfer is defendant's location; there is no dispute that defendant resides in Kentucky. However, while courts in this Circuit have recognized a policy of trying defendants where they reside where possible, *see Spy Factory,* 951 F.Supp. at 456, the Supreme Court has made clear that a defendant's residence "has no independent significance" and should not be given dispositive weight. *Platt,* 376 U.S. at 245; *see also Riley,* 296 F.R.D. at 276. Here, any inconvenience to defendant is reduced by the fact that the trial is unlikely to last more than one week. Defendant also has not represented that any business or profession with which he may be involved would be disrupted if he were tried in this district.

In sum, the balance of the *Platt* factors favors a trial in this district.

IV. CONCLUSION

For the foregoing reasons, defendant's motion to dismiss the Indictment as time-barred and for a change of venue is DENIED. The Clerk of Court is directed to terminate the motion at ECF No. 26.

SO ORDERED.

All Citations

Not Reported in F.Supp.3d, 2015 WL 3767147, 115 A.F.T.R.2d 2015-2249

Footnotes

[1] Defendant filed this motion on May 8, 2015. The Government filed an opposition on May 29, 2015. Defendant did not file any reply in support of his motion.

[2] The Court sets forth only those facts which are relevant to resolving defendant's motion.

[3] FBARs must be filed by all U.S. taxpayers who have a financial interest in, or signature authority over, a foreign financial account with an aggregate value of over $10,000. (Ind.¶ 10.)

[4] Defendant argues that "[e]ven if Mr. Canale filed fraudulent and false tax returns in 2007, 2008, 2009 and 2010, those violations would be a separate charge and would be unrelated to the charged conspiracy" because "[t]here is absolutely no evidence that Mr. Canale conspired with anyone to file his tax returns." (Memorandum of Law in Support of Dismissal of the Indictment as Time Barred Pursuant to the Statute of Limitations ("Def.'s SL Mem.") at 4, ECF No. 29.) This argument is meritless. Co-conspirators may-and very often do-play distinct roles in a conspiracy. *See United States v. Ulbricht,*

31 F.Supp.3d 540, 561 (S.D.N.Y.2014) ("The law of conspiracy recognizes that members of a conspiracy may serve different roles." (citing cases)). Co-conspirators need not reach agreement as to every overt act in furtherance of the conspiracy, or carry out all overt acts together.

5 The Government may simultaneously prosecute the same conduct under both the "defraud" and "offense" clauses of the conspiracy statute. *United States v. Bilzerian,* 926 F.2d 1285, 1301–02 (2d Cir.1991).

6 *United States v. Beech–Nut Nutrition Corp.,* 871 F.2d 1181 (2d Cir.1989), on which defendant relies, is distinguishable. In *Beech–Nut,* the Second Circuit held that venue was improper as to substantive counts alleging violations of the Federal Food, Drug, and Cosmetic Act ("FDCA"). The FDCA provision at issue prohibited introduction, or delivery for introduction, into interstate commerce of any adulterated or misbranded food. The Government argued that prosecution in the Eastern District of New York was proper because the defendants' subordinates telephoned brokers to place orders for adulterated apple juice concentrate and mailed confirmations for these concentrate orders into the Eastern District. The Second Circuit disagreed, holding that these acts were merely preparatory to the eventual introduction of the juice into commerce. The Court specifically noted, however, that these acts were in furtherance of the charged conspiracy to sell misbranded and adulterated apple juice in interstate commerce.

Unlike in *Beech–Nut,* the charged offense here is a conspiracy rather than a substantive offense-and the alleged overt acts in this district go to the essential elements of this conspiracy, namely "(1) an agreement among two or more persons, the object of which is an offense against the United States; (2) the defendant's knowing and willful joinder in that conspiracy; and (3) commission of an overt act in furtherance of the conspiracy by at least one of the alleged co-conspirators." *United States v. Svoboda,* 347 F.3d 471, 476 (2d Cir.2003) (citations omitted).

7 In support of his motion as to venue, defendant cites to the sentencing transcript of his brother Michael Canale. However, Michael Canale pled guilty to an FBAR violation, which is a substantive violation distinct from the conspiracy charged here.

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134 F.Supp.3d 697
United States District Court,
S.D. New York.

Susan GIORDANO, as Executrix of
the Estate of Ida Giordano, Plaintiff,
v.
UBS, AG, Defendant.

No. 14 Civ. 8252.
|
Signed Sept. 25, 2015.

Synopsis

Background: Bank customer brought action against Swiss bank for breach of fiduciary duty, malpractice, breach of contract, disgorgement, and fraud. Bank moved to dismiss complaint.

Holdings: The District Court, Sweet, J., held that:

[1] customer was subject to forum-selection and choice-of-law clauses designating Switzerland as exclusive place of jurisdiction;

[2] bank was not subject to general or specific jurisdiction in New York; and

[3] claims were barred under doctrine of in pari delicto.

Motion to dismiss granted.

Attorneys and Law Firms

***699** Ancona Associates, by: Dustin A. Levine, Esq., Mineola, NY, for Plaintiff.

Gibson, Dunn & Crutcher LLP, by: Gabriel Herrmann, Esq., New York, NY, for Defendant.

OPINION

SWEET, District Judge.

Defendant UBS, AG ("UBS–AG" or the "Defendant") has moved pursuant to Rules 12(b)2, 12(b)6 of the Federal Rules of Civil Procedure and the common law doctrine of *forum non conveniens* to dismiss the complaint of plaintiff Susan Giordano, executrix of the Estate of Ida Giordano ("Giordano" or the "Plaintiff") alleging breach of fiduciary duty, malpractice, breach of contract, disgorgement, and fraud. Based upon the conclusions set forth below, the motion of UBS–AG is granted, and the complaint is dismissed.

Prior Proceeding

Giordano filed her complaint on October 15, 2014 containing the following allegations. Plaintiff Susan Giordano, Executrix of the Estate of Ida Giordano, resides in Queens, New York. Compl. ¶ 6. From July ***700** 2000 to May 2009, Plaintiff and the now-deceased Ida Giordano maintained a joint account with UBS in Geneva, Switzerland (the "Swiss Account"). *Id.* at ¶ 13; Müller Aff. ¶¶ 6–7. UBS has a 152–year history as a Swiss financial institution. Müller Aff. ¶ 3. The present-day UBS was formed in 1998, when Union Bank of Switzerland and Swiss Bank Corporation merged to form a new company. *Id.* UBS is incorporated in and has its principal place of business in Switzerland. *Id.* It operates under Swiss law as an "Aktiengesellschaft," a corporation that has issued shares of common stock to investors. *Id.* Between May and July 2000, both Plaintiff and Ida Giordano personally executed several contractual account documents with UBS that governed the account relationship for the Swiss Account (collectively, the "Account Agreements"). The Account Agreements contain at least three provisions designating Swiss law as the governing law for the account relationship and designating Switzerland as the exclusive place of jurisdiction for "any disputes" arising out of the account relationship. Müller Aff. Exs. B, E–F. For example, the account opening document for the Swiss Account contains the following forum-selection and choice-of-law provisions:

> The present Agreement and/or Declaration shall be exclusively governed by and construed in accordance with Swiss law. The place of performance of all obligations of both parties, the place of debt collection, the latter only for Customers domiciled outside Switzerland, as well as the exclusive place of jurisdiction for any disputes arising out of and in connection

> with the present Agreement and/or Declaration shall be Geneve.

Id. Ex. B at 2.

Plaintiff admits that, in years prior to 2009, she "failed to disclose [the] Swiss Account on her U.S. tax returns or pay tax on the income derived from the assets and transactions in the UBS Swiss Account." Compl. ¶ 52. Then, in October 2009, Plaintiff, as Executrix of the Estate of Ida Giordano, participated in the IRS Offshore Voluntary Disclosure Program ("VDP"), which afforded U.S. taxpayers who had hidden foreign income from the IRS an opportunity to admit their misconduct, pay fines and penalties, and receive amnesty from criminal prosecution. Compl. ¶ 15; *see* Declaration of Gabriel Herrmann ("Herrmann Decl.") Ex. 7. Plaintiff's allegation in this case is that UBS should be held responsible for the consequences of Plaintiff's concealment of the Swiss Account from the IRS, and her eventual participation in the VDP, given that she has since "been assessed and has paid back taxes, penalties, and interest to the IRS as a result of her ownership of the UBS Swiss Accounts." Compl. ¶¶ 15–18. The Complaint asserts that UBS "undertook a fiduciary duty" to advise the Giordanos of their U.S. tax obligations by entering into a tax treaty with the U.S. government (the Qualified Intermediary ("QI") Agreement). Compl. ¶ 20. Plaintiff further alleges that UBS breached its alleged fiduciary duty by failing to inform her of her U.S. tax obligations and failing to "prepare and deliver to the Plaintiff the QI agreed IRS Forms W–9 which would have identified [her] as someone who either needed to pay taxes on offshore assets" or needed to "withhold" a portion of the profits of the Swiss Account. Compl. ¶ 23.

Each year, U.S. taxpayers are required to complete an IRS Form 1040, which includes a Schedule B that must be completed if the taxpayer has (1) taxable interest or dividends from, (2) any sort of financial interest in, or (3) signature authority over, a foreign bank account. *See* Herrmann Decl. Ex. 2. Schedule B directs these taxpayers to answer the following straightforward question under penalty of perjury: "did you have a financial interest in or signature authority over a financial account ***701** (such as a bank account, securities account, or brokerage account) located in a foreign country?" *Id.*

Taxpayers who have any such interest in or authority over a foreign account typically must also identify the location of the foreign account and complete Form TD F 90–22.1, a form better known as the Report of Foreign Bank and Financial Accounts, or "FBAR." The FBAR's instructions provide that a taxpayer must file an FBAR if, as Plaintiff alleges here, he or she has more than $10,000 in foreign accounts. *See, e.g., id.* Ex. 5 at 6. The FBAR form also makes clear that failure to disclose may lead to severe criminal penalties. *Id.* at 1 ("Civil and criminal penalties, including in certain circumstances a fine of not more than $500,000 and imprisonment of not more than five years, are provided for failure to file a report, supply information, and for filing a false or fraudulent report.").

Plaintiff also makes reference to a Deferred Prosecution Agreement ("DPA") UBS entered into with the U.S. government in 2009, which acknowledged that UBS had participated in a scheme to "facilitate the evasion of U.S. taxes" by certain of its accountholders. *Compl.* ¶ 50. However, the DPA does not describe any misconduct directed at those UBS accountholders—it concerned steps that were undertaken to assist the efforts of certain UBS clients to conceal their income from the U.S. tax authorities, not a scheme by UBS to trick its own customers into committing tax violations (which would serve neither UBS's interests nor those of its clients). Notably, Plaintiff does not allege that UBS was ever engaged to provide her any tax advice, that it ever assisted her in preparing tax returns, that it ever advised her about what to report in her tax returns, or that it ever told her not to report the Swiss Account on her IRS Form 1040s or FBARs.

The UBS motion was heard and marked filed fully submitted on May 13, 2015.

The Applicable Standard

On a motion to dismiss pursuant to Rule 12(b)(6), all factual allegations in the complaint are accepted as true, and all inferences are drawn in favor of the pleader. *Mills v. Polar Molecular Corp.,* 12 F.3d 1170, 1174 (2d Cir.1993). However, "a plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions." *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 555, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007) (internal quotation marks omitted). A complaint must contain "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 663, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Twombly,* 550 U.S. at 570, 127 S.Ct. 1955).

A claim is facially plausible when "the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal,* 556 U.S. at 663, 129 S.Ct. 1937 (quoting *Twombly,* 550 U.S. at 556, 127 S.Ct. 1955). In other words, the factual allegations must "possess enough heft to show that the pleader is entitled to relief." *Twombly,* 550 U.S. at 557, 127 S.Ct. 1955 (internal quotation marks omitted).

The Forum Selection Clause is Enforceable

[1] Courts, including the Court of Appeals for the Second Circuit, have recognized that a party may not maintain a suit in federal court when it has committed to litigate claims against its contract counter-party in another jurisdiction, such as the courts of a particular state or foreign nation. *See, e.g., Martinez v. Bloomberg LP,* 740 F.3d 211, 219 (2d Cir.2014) (recognizing "a strong federal public policy supporting the enforcement of forum selection ***702** clauses" citing *Atlantic Marine Const. Co. v. U.S. Dist. Court for W. Dist. of Texas,* ––– U.S. ––––, 134 S.Ct. 568, 574, 187 L.Ed.2d 487 (2013), for the proposition that, "in all but the most unusual cases, the interest of justice is served by holding parties to their bargain" (internal quotation and alterations omitted)). Since at least 1972, when the Supreme Court issued its seminal decision in *M/S Bremen v. Zapata Off–Shore Co.,* forum-selection clauses "are prima facie valid and should be enforced" absent extraordinary circumstances. 407 U.S. 1, 10, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972). In *Atlantic Marine,* the Supreme Court reconfirmed this principle and explained that "a valid forum-selection clause [should be] given controlling weight in all but the most exceptional cases." 134 S.Ct. at 581 (alteration in original) (internal quotation omitted); *accord, e.g., Martinez,* 740 F.3d at 219. *Atlantic Marine* clarified that, as a doctrinal matter, enforceability of forum-selection clauses should be analyzed under a modified version of the standard that governs *forum non conveniens* motions and it reaffirmed the principle that, "[w]hen parties have contracted in advance to litigate disputes in a particular forum, courts should not unnecessarily disrupt the parties' settled expectations." 134 S.Ct. at 583.

[2] **[3]** Courts in the Second Circuit "employ a four-part analysis" in determining whether to "dismiss[ ] a claim based on a forum selection clause." *Martinez,* 740 F.3d at 217; *Phillips v. Audio Active Ltd.,* 494 F.3d 378, 383 (2d Cir.2007). The four factors are:

> (1) whether the clause was reasonably communicated to the party resisting enforcement; (2) whether the clause is mandatory or permissive, i.e., whether the parties are required to bring any dispute to the designated forum or simply permitted to do so; and (3) whether the claims and parties involved in the suit are subject to the forum selection clause. If the forum clause was communicated to the resisting party, has mandatory force and covers the claims and parties involved in the dispute, it is presumptively enforceable. A party can overcome this presumption only by (4) making a sufficiently strong showing that enforcement would be unreasonable or unjust, or that the clause was invalid for such reasons as fraud or overreaching.

Martinez, 740 F.3d at 217 (internal quotation, citations, and alterations omitted). While the enforceability of the forum-selection clause is analyzed under this federal law framework, "courts must apply the law contractually chosen by the parties to interpret the clause." *Martinez,* 740 F.3d at 220, 224. Thus, to the extent the language of the parties' forum-selection clause requires interpretation, Swiss law governs matters of contractual construction, as designated by the parties in the Account Agreements. *See Martinez,* 740 F.3d at 220.

[4] Plaintiff and her mother, Ida Giordano, each signed at least three account documents containing contractual forum-selection and choice-of-law provisions that designate Switzerland as the "exclusive place of jurisdiction" for "any disputes" arising out of the account relationship, and that designate Swiss law as the law governing all such disputes, as follows:

> The present Agreement and/or Declaration shall be exclusively governed by and construed in accordance with Swiss law. The place of performance of all

> obligations of both parties, the place of debt collection, the latter only for Customers domiciled outside Switzerland, as well as the exclusive place of jurisdiction for any disputes arising out of and in connection ***703** with the present Agreement and/or Declaration shall be GENEVE.

E.g., Müller Aff. Ex. B at 2.

Here, the forum-selection clause was communicated to Susan and Ida Giordano, as evidenced by their signatures immediately below the forum-selection clauses in at least three Account Agreements. *See id.* Ex. B, E–F. The forum-selection clauses contain operative language in boldface, underlined type, stressing that Geneva was designated as "the exclusive place of jurisdiction" for all disputes arising out of the account relationship. *Id.*

[5] Also, the clause at issue is mandatory because it states that "the exclusive place of jurisdiction" for any disputes "shall be Geneve." *See, e.g., Phillips,* 494 F.3d at 386 ("The parties' use of the phrase 'are to be brought' establishes England as an obligatory venue for proceedings within the scope of the clause."); Müller Aff. Exs. B, E–F. "A forum selection clause is viewed as mandatory when it confers exclusive jurisdiction on the designated forum." *Phillips,* 494 F.3d at 386.

In addition, the broad, inclusive language applying the clause to "any disputes arising out of and in connection with the present Agreement" establishes that the claims and parties involved in the dispute are subject to the forum-selection clauses. *See Phillips,* 494 F.3d at 389.

[6] Finally, because "the forum clause was communicated to the resisting party, has mandatory force and covers the claims and parties involved in the dispute, it is presumptively enforceable." *See Phillips,* 494 F.3d at 383. In the Second Circuit, that presumption cannot be rebutted unless: (1) the "incorporation [of the forum-selection clauses into the agreement] was the result of fraud or overreaching; (2) the law to be applied in the selected forum is fundamentally unfair; (3) enforcement contravenes a strong public policy of the forum [in which suit is brought]; or (4) trial in the selected forum will be so difficult and inconvenient that the plaintiff effectively will be deprived of his day in court." *Phillips,* 494 F.3d at 392. Plaintiff has not alleged any facts suggesting that the inclusion of the forum-selection clauses in the Account Agreements was a product of fraud or overreaching. As discussed further below, there is no public policy that weighs against enforcement of the clause. And Switzerland is a viable and efficient forum for Plaintiff's claims, so Plaintiff would not be deprived of her day in court by enforcing the forum-selection clause. *See id.* Dasser Aff. ¶¶ 24–43. Plaintiff has not met the burden of alleging adequately that the mandatory forum-selection clause here should be set aside.

The *Atlantic Marine* Court held that enforcement of a valid forum-selection clause calls for application of a version of the federal *forum non conveniens* standard that is circumscribed in two critical respects. *See* 134 S.Ct. at 581.

[7] When a defendant seeks to enforce a forum-selection clause, "as the party defying the forum-selection clause, the plaintiff bears the burden of establishing that [litigating in] the forum for which the parties bargained is unwarranted," and Plaintiff's choice of forum "merits no weight." *Id.* Here, Plaintiff cannot show that there are any exceptional circumstances that would warrant setting aside the valid forum-selection clause. Because Switzerland is a viable alternative forum, Plaintiff would not be deprived of her day in court, and the relevant private and public interest factors all weigh in favor of dismissal.

Plaintiff does not allege that Switzerland is an inadequate forum for this dispute and *Atlantic Marine* in any event precludes such argument, because it explains that a "valid forum-selection clause ... 'represents the parties' agreement as to the most proper forum.' " *Id.* (quoting *Stewart* ***704** *Org. v. Ricoh Corp.,* 487 U.S. 22, 31, 108 S.Ct. 2239, 101 L.Ed.2d 22 (1988)). As explained by UBS's expert on Swiss law, the Swiss courts would accept jurisdiction of this case, would allow Plaintiff to bring claims to address the alleged misconduct described in her Complaint, and would provide Plaintiff with an efficient legal system. Dasser Aff. ¶¶ 16, 27–28; *see also LaSala v. UBS AG,* 510 F.Supp.2d 213, 222–23 (S.D.N.Y.2007) (holding Switzerland is an adequate alternative forum); *Rosario Veiga v. World Meteorological Org.,* 486 F.Supp.2d 297, 304–06 (S.D.N.Y.2007) (same); *Dickson Marine Inc. v. Panalpina, Inc.,* 179 F.3d 331, 342 (5th Cir.1999) (same); *Brunswick GmbH v. Bowling*

Switz., Inc., 2008 WL 2795936, at *2 (D.Del. July 18, 2008) (same).

[8] **[9]** Moreover, in evaluating the applicable private —and public-interest factors, when a valid forum-selection clause is present the court "must deem the private-interest factors to weigh entirely in favor of the preselected forum." *Atlantic Marine,* 134 S.Ct. at 582. "As a consequence, a district court may consider arguments about public-interest factors only"-and because those factors will only "rarely" overcome the parties' designation of an exclusive forum, the "practical result" of this analysis is that "a valid forum-selection clause should be given controlling weight in all but the most exceptional cases." *Id.* at 581–83 (internal quotation and alteration omitted).

The Supreme Court has recognized the following "public interest" factors relevant to *forum non conveniens* analysis:

> [1] the administrative difficulties flowing from court congestion; [2] the local interest in having localized controversies decided at home; [3] the interest in having the trial of a diversity case in a forum that is at home with the law that must govern the action; [4] the avoidance of unnecessary problems in conflict of laws, or in the application of foreign law; and
>
> [5] the unfairness of burdening citizens in an unrelated forum with jury duty.

Piper Aircraft Co. v. Reyno, 454 U.S. 235, 241 n. 6, 102 S.Ct. 252, 70 L.Ed.2d 419 (1981) (internal quotation omitted). Here, each of those factors weighs in favor of litigation in Switzerland.

Here, Switzerland's court system is not unduly congested such that any "administrative difficulties" would arise if this dispute is litigated there. A litigant can expect timely resolution of a claim brought in Switzerland; indeed, the average time for resolution of a civil dispute in Switzerland is 368 days. Dasser Aff. ¶ 25. According to the most recent Federal Court Management Statistics, the median time from filing to trial in civil cases in the Southern District of New York is more than 32 months. Plaintiff has not claimed that she would be prejudiced by any supposed court congestion attendant to litigation in Switzerland.

This is not a "localized controversy" for which there is any local interest in having the case decided in New York. The vast majority of alleged facts and conduct arise in Switzerland. Plaintiff's account was located in Switzerland, administered by Swiss personnel, and maintained under Swiss law, and all transactions took place in Switzerland. Müller Aff. ¶¶ 6, 13–14. Thus, if this controversy is localized anywhere, it is in Switzerland.

Voiding the parties' forum-selection clauses would not further any interest in having this case tried "in a forum that is at home with the law," because the parties designated Swiss law as the law governing any disputes arising out of the account relationship. *Piper,* 454 U.S. at 241 n. 6, 102 S.Ct. 252. Thus, it would be more burdensome to litigate here rather than in Switzerland, because this Court would be ***705** required to consider expert evidence on foreign law relating to virtually all of the issues in the case. For the same reasons, dismissal would further the public interest in "avoidance of unnecessary problems in conflict of laws, or in the application of foreign law." *Id.*

Finally, it would be unfair to burden the New York jury pool with a trial of Plaintiff's claims, which relate to Plaintiff's Swiss Account and alleged misconduct that would have transpired entirely in Switzerland. New York's citizenry has little, if any, interest in this dispute, while Switzerland "possesses a strong interest in regulating the conduct of banks within its borders," *LaSala,* 510 F.Supp.2d at 229, as well as conduct "involving contracts governed by its laws," *Yavuz v. 61 MM, Ltd.,* 576 F.3d 1166, 1181 (10th Cir.2009).

Because "a valid forum-selection clause [should be] given controlling weight in all but the most exceptional cases," *Atlantic Marine,* 134 S.Ct. at 581, and Plaintiff has not met her burden of alleging adequately that any exceptional circumstances exist here.

Plaintiff has not disputed that the governing UBS account documents contain forum selection clauses that are before the Court. Pl.'s Ex. D; Opp. ¶¶ 9–14, 23. Nor does she challenge the four-factor test Second Circuit courts apply in deciding whether to "dismiss[ ] a claim based on a forum selection clause." *Martinez v. Bloomberg LP,* 740 F.3d 211, 217 (2d Cir.2014), cited in Opp. ¶ 10. She does not contest UBS AG's showing as to two of those factors: that "the clause is mandatory" and "the claims and parties involved in the suit are subject to the forum selecti[o]n clause." Opp. ¶¶ 10–14. Rather, she has disputed only two of the relevant factors.

[10] **[11]** Plaintiff cannot avoid the forum selection clause by alleging fraud relating to the contract generally; she must show that her assent to the clause itself was fraudulently induced. *See, e.g., Scherk v. Alberto–Culver Co.,* 417 U.S. 506, 519 n. 14, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974) ("This qualification does not mean that any time a dispute arising out of a transaction is based upon an allegation of fraud ... the clause is unenforceable. Rather, it means that a[ ] ... forum-selection clause ... is not enforceable if the inclusion of that clause in the contract was the product of fraud or coercion."); *Mercury W. A.G., Inc. v. R.J. Reynolds Tobacco Co.,* 2004 WL 421793, at *4 (S.D.N.Y. Mar. 5, 2004) ("[I]n order to invalidate the forum selection clause, the clause itself would have to have been the product of fraud."); *Gen. Elec. Capital Corp. v. Mehta,* 2002 WL 511553, at *2 n. 6 (S.D.N.Y. Apr. 4, 2002) ("A party challenging a forum selection clause on the basis of fraudulent inducement must allege facts with respect to the specific clause, not the contract as a whole."). Nor does an alleged absence of negotiations concerning the forum selection clause permit Plaintiff to avoid its enforcement. *See, e.g., Exp.-Imp. Bank of U.S. v. Hi–Films S.A. de C.V.,* 2010 WL 3743826, at *8 (S.D.N.Y. Sept. 24, 2010) ("Luna contends that he did not have an 'opportunity to negotiate the terms of the agreements ... and that the agreements were presented on an as is basis.' This is not sufficient to establish fraud or overreaching.").

The Plaintiff claims the forum selection clause should not be enforced because it "was never communicated to either plaintiff or her mother." *Id.* ¶ 11. Although Plaintiff admits that the clause appeared on the face of the document she signed, *see, e.g., id.;* Pl.'s Ex. D, she claims it was not communicated to her because "[t]he UBS documents [were] complicated," the "type was in very small print," and UBS "never explained that the signing of the joint account agreement would subject me ***706** to bringing my case in Switzerland." Giordano Aff. ¶¶ 16, 21.

[12] These assertions do not evince a failure to "reasonably communicate" the forum clause to Plaintiff. "Absent substantive unconscionability or fraud of a type not alleged here, parties are charged with knowing and understanding the contents of documents they knowingly sign." *Horvath v. Banco Comercial Portugues, S.A.,* 461 Fed.Appx 61, 63 (2d Cir.2012) (clause was reasonably communicated to plaintiff despite his claim that it appeared in separate "terms and conditions" document he did not receive and was written in a language he did not understand); *accord Effron v. Sun Line Cruises, Inc.,* 67 F.3d 7, 9 (2d Cir.1995) (clause found "in fine print" of multipage airline ticket); *Spataro v. Kloster Cruise, Ltd.,* 894 F.2d 44, 46–47 (2d Cir.1990) (clause printed "in small type" on page 6 of 8–page ticket); *Arial Tech., LLC v. Aerophile S.A.,* 2015 WL 1501115, at *3 (S.D.N.Y. Mar. 31, 2015) ("The forum selection clause ... was reasonably communicated to *Arial,* as it appears on the face of the contract that Arial signed and now seeks to enforce.").

Indeed, even when such a clause does not appear in the actual document a plaintiff signs, but is merely incorporated into it by reference, courts consistently reject the contention that the clause was not "reasonably communicated" to the plaintiff. *See, e.g., Horvath,* 461 Fed.Appx. at 63; *Bank Leumi USA v. Ehrlich,* 98 F.Supp.3d 637, 650, 2015 WL 1609854, at *8 (S.D.N.Y. Mar. 23, 2015) (enforcing clause found in separate "terms and conditions" incorporated by reference into application for bank account despite plaintiff's claim that he did not receive them). The clause at issue here was far more clearly communicated to Plaintiff; it appears prominently in underlined type, just above the place where Plaintiff signed the document, in a straightforward, two-page contract that Plaintiff concedes was made available to her. *See* Pl.'s Ex. D. Plaintiff cannot now credibly claim that the clause was not reasonably communicated to her. *See, e.g., Martin v. Creative Mgmt. Grp.,* 2010 WL 2629580, at *2 (S.D.N.Y. June 29, 2010) ("The forum selection clause was located on the signature page, in the same size type as the rest of the Agreement. These facts reflect notice well beyond that required by established precedent.").

In addition, Plaintiff attempts to overcome the "presumption" of enforceability that attaches to the parties' forum selection clause by arguing that enforcement "would be unreasonable and unjust to plaintiff, who is 56 years old and unable to travel to Switzerland ... [ ]or obtain counsel there," and who supposedly would be "unable to stay in Switzerland during a pendency of a trial." Opp. ¶ 13. Courts in this Circuit routinely reject such boilerplate objections to enforcement of a forum selection clause based on allegations of advanced age or the supposed inconvenience of litigating abroad. The same result is compelled here. Indeed, Plaintiff, who claims no special circumstances that would preclude her from litigating in Switzerland, cites no case holding that such bare claims of inconvenience suffice to overcome a forum selection clause-and UBS AG is aware of none.

Jurisdiction Has Not Been Adequately Alleged

[13] Jurisdiction over Defendant has also not been established. With respect to general jurisdiction, Plaintiff cannot credibly deny that the Supreme Court's decision in the *Daimler* case fundamentally narrowed that analysis to focus on those jurisdictions where a defendant is incorporated and maintains its principal place of business-a standard that does not reach UBS AG here. Plaintiff claims that UBS AG's reliance on *Daimler* is misplaced, ***707** Opp. ¶ 6, but she cites no authority for that contention.

Plaintiff also disputes the principle that " 'a foreign bank is not subject to general jurisdiction ... simply because it maintains branches here,' " *id.* (quoting UBS Mem. at 14), but she does not distinguish the Second Circuit precedent that has so held. *See Gucci Am., Inc. v. Weixing Li,* 768 F.3d 122, 135 (2d Cir.2014); *accord AM Trust v. UBS AG,* 78 F.Supp.3d 977, 986–87 (N.D.Cal.2015).

Plaintiff's factual claims fail to adequately allege general jurisdiction. Plaintiff asserts that "UBS AG[ ] is UBS Group AG," Opp. ¶ 7. However, UBS Group AG is a holding company that holds a controlling stake in UBS AG. *See* Herrmann Reply Decl. Ex. 9 at 18–19.4. In any event, the fact that UBS Group AG, or UBS AG, has corporate affiliates that, in turn, are present in New York does not render UBS AG "at home" in New York. Plaintiff cannot aggregate all of the forum contacts of the entire UBS family of entities and attribute them all to UBS AG and does not address UBS AG's specific contacts with the forum. Indeed, that is precisely the sort of analysis the *Daimler* Court rejected because it would unfairly "stack[ ] the deck" in favor of jurisdiction for any foreign corporation that has an in-state affiliate. 134 S.Ct. at 759–60.

[14] Even if the forum contacts of the entire UBS corporate family were imputed to UBS AG, it still would not suffice to establish general jurisdiction over UBS AG, because "even a company's 'engage[ment] in a substantial, continuous, and systematic course of business' is alone insufficient to render it at home in a forum." *Sonera Holding B.V. v. Cukurova Holding A. S.,* 750 F.3d 221, 226 (2d Cir.) (quoting *Daimler AG v. Bauman,* ––– U.S. ––––, 134 S.Ct. 746, 761, 187 L.Ed.2d 624 (2014)), cert. denied, ––– U.S. ––––, 134 S.Ct. 2888, 189 L.Ed.2d 837 (2014). Plaintiff's recitation of various alleged New York contacts fails to make the relevant comparison compelled by Daimler, which requires that UBS AG's in-forum contacts be "judged against" all of its "national and global activities." *Gucci,* 768 F.3d at 135 (emphasis added). Plaintiff offers nothing to show that UBS AG's alleged New York contacts are such a substantial portion of its total global operations that it should be deemed to be "at home" here.

[15] Plaintiff fails to adequately allege specific jurisdiction over UBS AG for purposes of this action. The Complaint and Opposition do not identify the specific alleged contacts, or the account, out of which her claims arise. None of Plaintiff's factual assertions would suffice to show that any of those claims arise out of any contacts UBS AG had with New York. If, as the Complaint initially suggested, Plaintiff's tax liability relates to the Swiss account Ida Giordano allegedly opened sometime in the 1980s, Compl. ¶ 13, 16, then Plaintiff's claims must be dismissed because Plaintiff fails to identify any contacts UBS AG ever had with New York relating to that account.

If, on the other hand, Plaintiff's claims arise out of the account she and Ida Giordano opened in 2000, Plaintiff fails to establish a basis for asserting specific jurisdiction because her claims all arise out of UBS AG's alleged failure to advise her of her tax reporting obligations, to provide her with an IRS Form W–9, and to properly "administer" her IRS reporting obligations. *See* Compl. ¶¶ 23–24, 30, 36, 45, 48. However, Plaintiff does not claim that any of that misconduct transpired in New York. Plaintiff claims only that a UBS banker met with her and her parents in New York at times to discuss their "investment options," to collect occasional deposits, and to socialize with them. Giordano Aff. ¶¶ 6–13. She admits, however, that ***708** she and Ida Giordano traveled to Canada to open that joint account in 2000. *Id.* ¶ 14. Moreover, she claims a UBS banker told her that her mother's investments "would not cause her any tax consequence with the IRS," *id.* ¶ 25, but does not aver that any such alleged discussions occurred in New York. These allegations fail to establish specific jurisdiction as a result of "transacting business" under CPLR 302(a), and thus surely cannot satisfy the jurisdictional demands of constitutional due process either. *See, e.g., Siverls–Dunham v. Lee,* 2006 WL 3298964, at *10–*11 (S.D.N.Y. Nov. 13, 2006) (finding that "a defendant may not be subject to personal jurisdiction under CPLR § 302(a)(1) simply because her contact with New York was a link in a chain of events giving rise to the cause of action," and that "mere solicitation of business within the state does not constitute the transaction of business within the state absent some other New York-directed activities" (citations omitted)).

The Plaintiff's Causes of Action Are Inadequately Alleged and Barred as Claims for Indemnification

[16] Finally, Plaintiff's claims are barred. "On a motion to dismiss under Rule 12(b)(6), a court must assess whether the complaint 'contain[s] sufficient factual matters, accepted as true, to state a claim to relief that is plausible on its face.' " *N.J. Carpenters Health Fund v. Royal Bank of Scotland Grp.,* 709 F.3d 109, 119–20 (2d Cir.2013) (quoting *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009)). Plaintiff's Complaint fails to satisfy this standard for any of the claims alleged. Plaintiff's Complaint is one of a series of cases brought by former UBS accountholders seeking to hold UBS responsible for their own tax fraud. *See, e.g., Thomas v. UBS AG,* 706 F.3d 846 (7th Cir.2013); *Olenicoff v. UBS AG,* 2012 WL 1192911, at *1 (C.D.Cal. Apr. 10, 2012). UBS has acknowledged its role in facilitating U.S. clients' concealment of their accounts from the IRS but denies that it defrauded those clients. As the Complaint has alleged, Plaintiff's theory of the case is that UBS facilitated its clients' own knowing concealment of their Swiss accounts from the IRS. *See, e.g.,* Compl. ¶ 50 (alleging that UBS "participat[ed] in a scheme to facilitate the evasion of U.S. taxes" by its clients and was "actively assisting or otherwise facilitating a number of U.S. individual taxpayers in establishing accounts at UBS in a manner designed to conceal the U.S. taxpayers' ownership or beneficial interest in said accounts," thereby "allowing such U.S. taxpayers to evade reporting requirements").

In dismissing a similar claim, the court in *Olenicoff v. UBS AG* explained that UBS "only admitted to assisting willing clients with tax fraud, not forcing unsuspecting clients into tax evasion. While its argument is ironic, UBS is right. Even assuming that UBS gave Olenicoff fraudulent tax advice, that makes UBS a co-conspirator, not a defendant in this litigation." 2012 WL 1192911, at *1. Similarly, in affirming the dismissal of *Thomas v. UBS AG* on appeal, Judge Posner, writing for the Seventh Circuit, explained the absurdity of the claim, stating that "[t]he plaintiffs are tax cheats, and it is very odd, to say the least, for tax cheats to seek to recover their penalties ... from the source, in this case UBS, of the income concealed from the IRS." 706 F.3d at 850. Judge Posner went on to call the Thomas negligence and malpractice claims "frivolous squared," and admonished plaintiffs that "[t]his lawsuit, including the appeal, is a travesty. We are surprised that UBS hasn't asked for the imposition of sanctions on the plaintiffs and class counsel." *Id.* at 854.

[17] New York's "fundamental concept[ ]" of *in pari delicto,* which "has been ***709** wrought in the inmost texture of [New York] common law for at least two centuries," bars Plaintiff's claims, which all amount to an attempt to seek reimbursement from UBS for the consequences of her own filing of false tax returns. *Kirschner v. KPMG LLP,* 15 N.Y.3d 446, 464, 912 N.Y.S.2d 508, 938 N.E.2d 941 (2010). Even assuming for purposes of this motion to dismiss that Plaintiff's allegations of UBS's wrongdoing are correct, "[t]he doctrine of *in pari delicto* mandates that the courts will not intercede to resolve a dispute between two wrongdoers." *Id.* As the New York Court of Appeals has explained, "the principle that a wrongdoer should not profit from his own misconduct is so strong in New York" that it should apply even "where both parties acted willfully" and "in difficult cases," and it "should not be 'weakened by exceptions.' " *Id.*

In addition, Plaintiff's concealment of her Swiss Account from the IRS prevents her from making a prima facie showing of causation for any of her claims, because on the face of her allegations, her own conduct is responsible for any harm she allegedly suffered. *See, e.g., Rothstein v. UBS AG,* 708 F.3d 82, 97 (2d Cir.2013) (affirming dismissal of complaint because the plaintiff's "conclusory allegations [did] not meet *Twombly's* plausibility standard with respect to the need for a proximate causal relationship between the cash transferred by UBS to Iran and the terrorist attacks by Hizbollah and Hamas that injured plaintiffs"); *Citibank, N.A. v. K–H Corp.,* 968 F.2d 1489, 1496 (2d Cir.1992) (holding complaint was properly dismissed because the plaintiff failed to "adequately allege that the damages it suffered were proximately caused by the alleged misrepresentations").

Plaintiff has asserted five causes of action: (1) breach of fiduciary duty; (2) malpractice/negligence; (3) breach of contract or in the alternative, unjust enrichment; (4) declaratory relief for equitable disgorgement of profits; and (5) fraud and constructive fraud. Plaintiff's own admitted failure to report her UBS Account and income to the IRS prevents her from establishing the required element of causation for each of those causes of action, particularly given the absence of any factual allegation that UBS advised Plaintiff not to report the Swiss Account on her tax returns or was in any way assisted with the preparation of Plaintiff's tax returns. Plaintiff has not alleged any conduct on the part of UBS that was the proximate cause of Plaintiff's purported injury-namely, the obligation to pay back taxes, penalties, and interest as part of her participation in the VDP. Plaintiff admits that she "failed to disclose [her] UBS Swiss Account on her U.S. tax returns or pay tax on the income derived from the assets and transactions in the UBS Swiss Account." Compl. ¶ 52. This means that she falsely answered "no," under penalty of perjury, to a straightforward question on Schedule B of her Form 1040: "did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?" Herrmann Decl. Ex. 2. She has not alleged that UBS told her to answer "no" to that question. She claims UBS should reimburse her for her tax penalties because it failed to prevent her from violating the law. That theory has no legal support. *See, e.g., Thomas,* 706 F.3d at 851 (there is "no common law duty to prevent another person from violating the law").

Plaintiff's own failure to disclose the Swiss Account to the IRS is an insurmountable barrier to proving causation for all of her claims, and it bars recovery under the fundamental doctrine of *in pari delicto.* Thus, even if all facts alleged are taken as true, Plaintiff fails to state a ***710** claim, and the entire Complaint should be dismissed under Rule 12(b)(6).

Plaintiff's Opposition fails to address that the principle of in pari delicto prevents her from recovering damages relating to her own participation in a scheme to avoid paying taxes. Even accepting arguendo Plaintiff's allegation that a UBS representative told her she would not have to pay taxes on the income from her account, does not explain why she would conceal the existence of the account.

Plaintiff's failure to disclose her foreign account therefore precludes her from suing UBS AG for damages resulting from her own misconduct. "The doctrine of *in pari delicto* mandates that the courts will not intercede to resolve a dispute between two wrongdoers." *Kirschner v. KPMG LLP,* 15 N.Y.3d 446, 464, 912 N.Y.S.2d 508, 938 N.E.2d 941 (2010). This "fundamental concept" of New York law holds that a "wrongdoer should not profit from his own misconduct," even "where both parties acted willfully." *Id.* Plaintiff fails to address (or even acknowledge) that settled principle, but she simply cannot hold UBS AG responsible for her own failure to meet her tax obligations.

Plaintiff's eventual participation in the Voluntary Disclosure Program—and the back taxes and penalties she paid as a result—arose because she had filed false tax returns denying that she had an interest in foreign accounts when she knew that she did. Even taking the Plaintiff's allegations as true, the Complaint fails to satisfy the basic Rule 8(a) standard of stating a claim that is plausible on its face or the heightened Rule 9(b) standard for pleading fraud. Plaintiff has not alleged any facts that would relieve her of her own culpability for knowingly filing false tax returns, which is fatal to all of her claims.

Moreover, each of Plaintiff's claims suffers from other fatal deficiencies. The fraud claim fails because Plaintiff cannot establish reasonable reliance, *see, e.g., N.Y. City Educ. Constr. Fund v. Verizon N.Y. Inc.,* 114 A.D.3d 529, 530, 981 N.Y.S.2d 11 (1st Dep't 2014) (no reliance by plaintiff who "fail [ed] to use ordinary intelligence to ascertain the truth of defendant's representations"), and because she fails to allege specific facts—such as when and where misrepresentations were made—with particularity under Rule 9(b), *see, e.g., DeBlasio v. Merrill Lynch & Co.,* 2009 WL 2242605, at *14 (S.D.N.Y. July 27, 2009). The fiduciary duty claim sounds in fraud—it alleges that UBS AG's knowingly "failed to inform the Plaintiff" of her tax obligations, compl. ¶ 24—and thus fails for the same reasons. *See, e.g., id.* at *10. The "malpractice/negligence" claim is barred by the economic-loss rule, *County of Suffolk v. Long Island Lighting Co.,* 728 F.2d 52, 62 (2d Cir.1984), and because UBS cannot be liable for "malpractice" here, *see, e.g., Deutsche Bank Sec., Inc. v. Rhodes,* 578 F.Supp.2d 652, 670 (S.D.N.Y.2008). The contract claim fails because it does not identify any contract provision that UBS AG breached. *See, e.g., 767 Third Ave. LLC v. Greble & Finger, LLP,* 8 A.D.3d 75, 75, 778 N.Y.S.2d 157 (1st Dep't 2004). The disgorgement claim fails because it seeks a remedy that is available only to the SEC—not to private litigants. *See, e.g., SEC v. Wyly,* 56 F.Supp.3d 260, 270–71 (S.D.N.Y.2014).

The Plaintiff has failed to adequately allege her five causes of action.

Conclusion

Based on the conclusions set forth above, the motion of UBS is granted, and the complaint is dismissed. In view of the enforcement of the forum selection clause leave to re plead is not granted.

It is so ordered.

All Citations

134 F.Supp.3d 697

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648 F.3d 1067
United States Court of Appeals,
Ninth Circuit.

In re Grand Jury Investigation M.H.,
M.H., Witness–Appellant,
v.
United States of America, Appellee.

No. 11–55712.
|
Argued and Submitted June 24, 2011.
|
Filed Aug. 19, 2011.

Synopsis
Background: Individual, as the target of grand jury investigation seeking to determine whether he used secret Swiss bank accounts to evade paying federal taxes, was found in contempt by the United States District Court for the Southern District of California, Irma E. Gonzalez, Chief Judge, for refusing to comply with grand jury subpoena duces tecum demanding that he produce certain records related to his foreign bank accounts. Individual appealed.

[Holding:] The Court of Appeals, Tallman, Circuit Judge, held that requested records fell under the required records doctrine, rendering Fifth Amendment privilege against self-incrimination inapplicable.

Affirmed.

Attorneys and Law Firms

***1069** Pamela J. Naughton and Rebecca S. Roberts, Sheppard Mullin Richter & Hampton LLP, San Diego, CA, for appellant M.H.

Frank P. Cihlar, Gregory Victor Davis, Alexander P. Robbins, Tax Division, Department of Justice, Washington, D.C., for appellee United States of America.

Appeal from the United States District Court for the Southern District of California, Irma E. Gonzalez, Chief District Judge, Presiding. D.C. No. 10–GJ–0200.

Before: WILLIAM C. CANBY, JR., RONALD M. GOULD, and RICHARD C. TALLMAN, Circuit Judges.

OPINION

TALLMAN, Circuit Judge:

Appellant M.H. is the target of a grand jury investigation seeking to determine whether he used secret Swiss bank accounts to evade paying federal taxes. The district court granted a motion to compel M.H.'s compliance with a grand jury subpoena duces tecum demanding that he produce certain records related to his foreign bank accounts. The court declined to condition its order compelling production upon a grant of limited immunity and, pursuant to the recalcitrant witness statute, 28 U.S.C. § 1826, held M.H. in contempt for refusing to comply. M.H. appealed.

The foreign bank account information the Government seeks is information M.H. is required to keep and maintain for inspection under the Bank Secrecy Act of 1970 (BSA), 31 U.S.C. § 5311, and its related regulations. M.H. argues that if he provides the sought-after information, he risks incriminating himself in violation of his Fifth Amendment privilege. He asserts that the information he is being asked to produce might conflict with other information M.H. has previously reported to the Internal Revenue Service (IRS). Production might reveal, for instance, that he has accounts he has not reported or that the information he *has* previously reported is inaccurate. On the other hand, if M.H. denies having the records, he risks incriminating himself because failing to keep the information when required to do so is a felony.

The district court concluded that under the Required Records Doctrine, the Fifth Amendment did not apply. That doctrine recognizes that when certain conditions are met, records required to be maintained by law fall outside the scope of the privilege. We agree that, under the Required Records Doctrine, the Fifth Amendment does not apply. We therefore affirm the district court's order of contempt for failing to produce the information the grand jury sought.

I

In 2009, as part of a deferred-prosecution agreement with the United States Department ***1070** of Justice, the Swiss bank UBS AG (UBS) provided the federal government with bank account records identifying approximately 250 U.S. taxpayers UBS might have aided in committing tax evasion. The UBS records showed that in 2002, M.H. transferred securities from his UBS account to a different Swiss bank, UEB Geneva. IRS agents began investigating him.

In June 2010, a San Diego federal grand jury issued a subpoena duces tecum to M.H. for records he was required to keep pursuant to Treasury Department regulations governing offshore banking. The subpoena demanded production of:

> [a]ny and all records required to be maintained pursuant to 31 C.F.R. § 103.32 [subsequently relocated to 31 C.F.R. § 1010.420] relating to foreign financial accounts that you had/have a financial interest in, or signature authority over, including *records reflecting the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during each specified year.*

(Emphasis added).[1] M.H. declined to provide the requested information and also declined to deny having it, reasoning that either response posed a risk of self-incrimination under the Fifth Amendment to the United States Constitution. The district court ordered him to comply anyway. When he again refused to produce the requested documents, the court conducted a show-cause hearing for failing to comply with its order and found him in contempt. However, because the district court considered M.H.'s arguments "substantial and worthy of appellate review," the court stayed the contempt order pending appeal, contingent on M.H.'s posting of a $250,000 cash bond. M.H. is not currently incarcerated and may travel without restriction.

The information identified in the subpoena mirrors the banking information that 31 C.F.R. § 1010.420[2] requires taxpayers using offshore bank accounts to keep and maintain for government inspection. The information the subpoena seeks is also identical to information that anyone subject to § 1010.420 already reports to the IRS annually through Form TD F 90–22.1, known as a "Report of Foreign Bank and Financial Accounts," or "FBAR." Therefore, the information at issue in this contempt proceeding is information that M.H.—if he has a foreign bank account and meets other qualifications specified in the BSA—must keep, report to the Treasury Department, and maintain for IRS inspection.

II

[1] **[2]** We review de novo mixed questions of law and fact contained within the ***1071** analysis of a civil contempt proceeding. *Shoen v. Shoen,* 48 F.3d 412, 414 (9th Cir.1995). We review for clear error any factual findings underlying the contumacious behavior. *United States v. Bright,* 596 F.3d 683, 694 (9th Cir.2010). Where incarceration has been stayed pending appeal and no party is harmed by the delay, we may exceed the thirty-day time limit for deciding appeals that § 1826 would otherwise impose. *In re Grand Jury Witness,* 695 F.2d 359, 361 n. 4 (9th Cir.1982).

III

A

[3] As a preliminary matter, M.H. argues that—for a number of reasons—§ 1010.420 does not apply to him, so he is not required to comply with the grand jury's subpoena and we need not reach the Fifth Amendment question. But at this point in its investigation, the Government need not prove the regulation or the BSA apply. It need only show a "reasonable possibility" that the subpoena will serve the grand jury's legitimate investigative purpose. *United States v. R. Enters., Inc.,* 498 U.S. 292, 300–01, 111 S.Ct. 722, 112 L.Ed.2d 795 (1991).

The Government is not required to justify the issuance of a grand jury subpoena by presenting evidence sufficient to establish probable cause because the very purpose of its inquiry is to establish whether probable cause exists to accuse the taxpayer of violating our tax laws. *See id.* at 297, 111 S.Ct. 722 ("The grand jury occupies a unique role in our criminal justice system. It is an investigatory body charged with the responsibility of determining whether or not a crime has been committed. Unlike this Court, whose jurisdiction is predicated on a specific case or controversy, the grand jury 'can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.' " (citation omitted)).

There are, of course, limits to the grand jury's authority. *See, e.g., id.* at 299, 111 S.Ct. 722 (stating that a grand jury may not "engage in arbitrary fishing expeditions" or base its investigation on "malice or an intent to harass"). But there is no evidence of excess here. We have examined the evidence in the sealed record along with the evidence the district court reviewed in camera. That evidence confirms that the grand jury's inquiry is a legitimate exercise of its investigatory authority. If it is later established that, for whatever legal reason, the regulation at issue does not apply to M.H., then the Government will be unable to successfully prosecute him and there is no risk of a Fifth Amendment violation. Until then, however, M.H.'s obligation to comply with the grand jury subpoena is not contingent upon whether the Government has proven the BSA and its regulations apply to him as a U.S. taxpayer who has previously filed FBARs with the Department of the Treasury.

B

M.H. argues that the Required Records Doctrine—which, if it applies, renders the Fifth Amendment privilege inapplicable—does not apply to this case and that the district court erred in finding otherwise. The Fifth Amendment to the United States Constitution states that "[n]o person ... shall be compelled in any criminal case to be a witness against himself." The Supreme Court has held that where documents are *voluntarily* created and kept, compelling their disclosure does not implicate the privilege against self-incrimination. *See United States v. Doe,* 465 U.S. 605, 611–12, 104 S.Ct. 1237, 79 L.Ed.2d 552 (1984) (citing *Fisher v. United States,* 425 U.S. 391, 409–10, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976)). Where documents are *required* to be kept and then produced, they are arguably compelled. However, the Supreme ***1072** Court has recognized that in such circumstances, the privilege does not extend to records required to be kept as a result of an individual's voluntary participation in a regulated activity. *See Shapiro v. United States,* 335 U.S. 1, 17, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948) (noting that the nature of documents and the capacity in which they are held may indicate that "the custodian has voluntarily assumed a duty which overrides his claim of privilege" (quoting *Wilson v. United States,* 221 U.S. 361, 380, 31 S.Ct. 538, 55 L.Ed. 771 (1911))). Our task is to determine whether the records sought in this case fall into the former or latter category. If they fall into the latter, the Required Records Doctrine applies and the privilege is unavailable to M.H., who has voluntarily participated in a regulated activity.

In *Shapiro*—credited for establishing the principles of what has come to be known as the Required Records Doctrine—the Supreme Court required a wholesaler of fruit and produce to turn over certain records he was obliged to keep and maintain for examination pursuant to the Emergency Price Control Act, which applied in part to records "customarily kept." *See Marchetti v. United States,* 390 U.S. 39, 55, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968). The Court reasoned that the Required Records "principle applies not only to public documents in public offices, but also to records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation, and the enforcement of restrictions validly established." *Shapiro,* 335 U.S. at 17, 68 S.Ct. 1375.

Twenty years after *Shapiro,* the Court considered two cases that examined whether being required to pay an excise tax on one's gambling wagers violated the Fifth Amendment. Those two cases were *Marchetti* and *Grosso v. United States,* 390 U.S. 62, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968). In its analysis in those cases, the Court identified three principles from *Shapiro* that distinguished it from *Grosso* and *Marchetti* where, the Court concluded, the Required Records Doctrine did not apply. *See Marchetti,* 390 U.S. at 56–57, 88 S.Ct. 697 ("We think that neither *Shapiro* nor the cases upon which it relied are applicable here.... Each of the three principal elements of the [Required Records Doctrine], as it is described in *Shapiro,* is absent from this situation."); *Grosso,* 390 U.S. at 67–68, 88 S.Ct. 709 ("The premises of the [Required Records

Doctrine], as it is described in *Shapiro,* are evidently three: first, the purposes of the United States' inquiry must be *essentially regulatory;* second, information is to be obtained by requiring the preservation of records of a kind which the regulated party has *customarily kept;* and third, the records themselves must have assumed *' public aspects*' which render them at least analogous to public documents.... [B]oth the first and third factors are plainly absent from this case." (emphasis added)).

Since *Grosso* and *Marchetti,* the Supreme Court has applied *Shapiro* and the principles underlying the Required Records Doctrine broadly to "items that are the legitimate object of the government's noncriminal regulatory powers," *Baltimore City Dept. of Soc. Servs. v. Bouknight,* 493 U.S. 549, 557, 110 S.Ct. 900, 107 L.Ed.2d 992 (1990), regardless of whether they are required to be kept and regardless of whether they are records. *See, e.g., California v. Byers,* 402 U.S. 424, 427–31, 91 S.Ct. 1535, 29 L.Ed.2d 9 (1971) (applying Required Records Doctrine principles and concluding that a state statute requiring drivers involved in vehicle accidents to stop at the scene of the accident and leave their names and addresses for police did not infringe the Fifth Amendment); *Bouknight,* 493 U.S. at 558, 110 S.Ct. 900 (applying ***1073** the Required Records Doctrine to determine that a parent lacked a Fifth Amendment privilege in producing her child in response to a court's order).

We have recognized that the three principles announced in *Grosso* define the Required Records Doctrine, but have also adopted the Supreme Court's flexibility in applying those principles. *See In re Grand Jury Proceedings* (*Doe M.D.*), 801 F.2d 1164, 1168 (9th Cir.1986) ("Under [the Required Records Doctrine], the Fifth Amendment privilege does not apply if: (1) the purpose of the government's inquiry is regulatory, not criminal; (2) the information requested is contained in documents of a kind the regulated party customarily keeps; and (3) the records have public aspects."); *see also U.S. SEC v. Fehn,* 97 F.3d 1276, 1291–92 (9th Cir.1996) (observing that we have applied the Required Records Doctrine "principles in a variety of contexts, and have accorded them varying emphasis").

Even though M.H. is being asked to turn over reports he is required to keep pursuant to the BSA and its regulations, the Government, citing *Byers, Bouknight,* and *Fehn,* suggests that all three requirements need not be met. While it is true that when the Required Records Doctrine is applied to items other than records a rigid application of all three factors may not be necessary, *see, e.g., Bouknight,* 493 U.S. at 558–60, 110 S.Ct. 900 (applying the "principles" of the Required Records Doctrine and concluding that a mother compelled to produce her child through a court order could not invoke a Fifth Amendment privilege against self-incrimination to resist the order); *United States v. Des Jardins,* 747 F.2d 499, 507–09 (9th Cir.1984) (concluding that the Fifth Amendment privilege does not apply to a requirement under the BSA that travelers transferring more than $5,000 out of the country file a written report, but considering only whether the regulation at issue was essentially regulatory or criminal in nature), *rev'd on other grounds,* 772 F.2d 578 (9th Cir.1985), we need not resolve that issue here. Even if we assume, for purposes of decision, that all three prongs of the test set forth in *Grosso* apply, we conclude that all three requirements are met in this case.

1. "Essentially regulatory"

[4] **[5]** We begin by recognizing that when compelled disclosure has incriminating potential, "the judicial scrutiny is invariably a close one." *Byers,* 402 U.S. at 427, 91 S.Ct. 1535. In evaluating the danger of incrimination, we consider whether the requirement in question is essentially regulatory or criminal in nature. *Doe M.D.,* 801 F.2d at 1168. In doing so, "[i]t is irrelevant that records kept for regulatory purposes may be useful to a criminal grand jury investigation." *Id.* Instead, we consider whether the statutory or regulatory requirement involves an area "permeated with criminal statutes," whether it is "aimed at a highly selective group inherently suspect of criminal activities," *Des Jardins,* 747 F.2d at 508 (internal citations and quotation marks omitted), and whether complying with the requirement would "generally ... prove a significant 'link in a chain' of evidence tending to establish guilt." *Id.* at 509 (internal quotation marks omitted). M.H. argues that, for several reasons, the BSA's record-keeping provision is criminal in nature, not regulatory. Our precedent indicates otherwise.

M.H. first argues that § 1010.420 is criminal in nature because the BSA's "primary purpose is to detect criminal conduct, specifically money laundering, terrorism and tax evasion." To support this position, M.H. points to language in the BSA describing the purpose of the statute as requiring "certain reports or records, where they have a high degree of usefulness ***1074** in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." *See* 31 U.S.C. § 5311. M.H. also cites language from the IRS Web site describing the BSA as the first law to fight money laundering in the United States, along with legislative history indicating congressional interest in combating criminal activity.

The Supreme Court has already considered and rejected these arguments as they relate to the BSA generally. In *California Bankers Ass'n v. Shultz,* 416 U.S. 21, 76–77, 94 S.Ct. 1494, 39 L.Ed.2d 812 (1974), the Court observed that the goal of assisting in the enforcement of criminal laws "was undoubtedly prominent in the minds of the legislators," as they considered the BSA. However, it noted that "Congress seems to have been equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported." *Id.* at 76, 94 S.Ct. 1494. The Court concluded that "the fact that a legislative enactment manifests a concern for the enforcement of the criminal law does not cast any generalized pall of constitutional suspicion over it." *Id.* at 77, 94 S.Ct. 1494. Therefore, that Congress aimed to use the BSA as a tool to combat certain criminal activity is insufficient to render the BSA essentially criminal as opposed to essentially regulatory.

Turning to the specific regulation in question, our analysis in *Des Jardins* is informative. There, we considered whether a particular BSA record-reporting provision, which required travelers to report transporting more than $5,000 in monetary instruments across the United States border, was essentially criminal in nature and determined it was not. In that case, a U.S. Customs Agent working at the Los Angeles International Airport—as part of a project to detect narcotics-related criminal activity—noticed that Des Jardins's travel route paralleled those drug couriers frequently took. *Des Jardins,* 747 F.2d at 501. The agent inspected Des Jardins's luggage and found $5,000. Upon searching Des Jardins's person, the agent discovered several thousand more dollars. *Id.* at 502. Des Jardins was ultimately convicted for violating the reporting requirement.

We considered whether the reporting requirement violated Des Jardins's Fifth Amendment privilege, and we analyzed whether the fact that the regulation was not "*exclusively* regulatory" made it essentially criminal. *Id.* at 508–09 (emphasis added). We determined it did not. *Id.* at 509. We reasoned in part that "[s]ince the transportation of monetary instruments in such amounts is not itself illegal and since there is no reason to suppose that the transportation of monetary instruments in such amounts is generally connected with criminal activity, the vast majority of people subject to the requirement are not suspect of illegality." *Id.*

[6] The same can be said here. There is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account. According to the Government, § 1010.420 applies to "hundreds of thousands of foreign bank accounts—over half a million in 2009." Nothing about having a foreign bank account on its own suggests a person is engaged in illegal activity. That fact distinguishes this case from *Marchetti* and *Grosso,* where the activity being regulated—gambling—was almost universally illegal, so that paying a tax on gambling wagers necessarily implicated a person in criminal activity. Admitting to having a foreign bank account carries no such risk. That the information contained in the required record may ultimately lead to criminal charges does not convert an essentially ***1075** regulatory regulation into a criminal one. *See Des Jardins,* 747 F.2d at 508; *see also Marchetti,* 390 U.S. at 57, 88 S.Ct. 697.

Considering whether the sought-after information would likely serve as a significant chain in a link of evidence establishing guilt, we found relevant in *Des Jardins* the nature of the specific information travelers were required to report (the legal capacity in which the person filing the report was acting; the origin, destination, and route being traveled; and the amount and kind of monetary instruments transported). We concluded that because such evidence lacked an inherently criminal quality, it would not likely serve as a significant link in a chain of evidence. *Des Jardins,* 747 F.2d at 508–09.

M.H. was required to maintain, and through the subpoena is being asked to produce, the following information:

> (1) The name in which each account is maintained;
>
> (2) The number or other designation of such account;

> (3) The name and address of the foreign bank or other person with whom such account is maintained;
>
> (4) The type of such account;
>
> (5) The maximum value of each such account during the reporting period.

This information is not inherently criminal. As in *Des Jardins,* it is the act of *not* reporting (or in this case the act of *not* maintaining for inspection) the information that suggests criminality, not the information itself. Because the information being requested of M.H. is not inherently criminal, being required to provide that information would generally not establish a significant link in a chain of evidence tending to prove guilt. *See Des Jardins,* 747 F.2d at 509 ("Since the requirement concerns such relatively innocuous matters ... any information obtained would be at best tangentially related to criminal activity."); *see also Wilson,* 221 U.S. at 380, 31 S.Ct. 538 ("But the physical custody of incriminating documents does not of itself protect the custodian against their compulsory production. The question still remains with respect to the nature of the documents and the capacity in which they are held.").

M.H. suggests that *Des Jardins* should not apply because in that case we considered a reporting requirement instead of a record-keeping requirement. But *Des Jardins* 's analysis of whether the regulation in question was essentially regulatory did not hinge on the "reporting" aspect of the regulation. *Des Jardins* relied on cases interpreting the Required Records Doctrine and is clearly applicable to the "essentially regulatory" aspect of that doctrine, which does not turn on whether a reporting requirement exists, but—as we have already explained—on whether the information sought is inherently criminal in nature. While *Des Jardins* does not answer the precise question at issue in this case, we apply the rules recognized there to inform our Fifth Amendment inquiry. Those rules suggest that because § 1010.420 does not target inherently illegal activity or a highly selective group of people inherently suspect of criminal activity, it is essentially regulatory, not criminal.

We have held that whether a requirement to maintain records involves a reporting requirement is not determinative for purposes of deciding whether it is essentially regulatory. *See United States v. Rosenberg,* 515 F.2d 190, 199–200 (9th Cir.1975) (holding that the Required Records Doctrine applied even though the statute in question only required records to be kept for two years and did "not expressly provide that records shall be open to inspection by state officials"). Thus, the lack of an "automatic" reporting requirement does not mean § 1010.420 is not essentially regulatory. This conclusion ***1076** makes sense because, as we have already explained, the heart of the "essentially regulatory" inquiry is whether the regulation in question targets inherently illegal activity. As we observed in *Rosenberg,* where the purpose of the record-keeping requirement "is to aid in the enforcement of" the statutory scheme, the Required Records Doctrine may apply, regardless of whether the regulation itself includes a reporting requirement, automatic or otherwise. *Id.* at 200.

Moreover, § 1010.420 *has* a reporting requirement. The regulation mandates that the required records "shall be kept at all times available for inspection as authorized by law." The Supreme Court has indicated that no meaningful difference exists "between an obligation to maintain records for inspection, and such an obligation supplemented by a requirement that those records be filed periodically with officers of the United States." *Marchetti,* 390 U.S. at 56 n. 14, 88 S.Ct. 697.

Because § 1010.420 is essentially regulatory in nature, we conclude that the first prong of the Required Records Doctrine is satisfied.

2. Customarily Kept

[7] We have not assigned a specific definition to the term "customarily kept," but records appear to be customarily kept if they would typically be kept in connection with the regulated activity. As the case law dealing with this requirement suggests, the Fifth Amendment does not apply when the Government compels individuals to create records that they would customarily keep.

In *Shapiro,* the records a fruit wholesaler "customarily kept" in compliance with the Emergency Price Control Act of 1942 were not privileged. By contrast, in *Marchetti,* records regarding a person's gambling expenses were deemed *not* customarily kept and were privileged. Some courts have recognized records as "customarily kept" where they are required to be retained as part of the general regulatory scheme, as they were in *Shapiro. See, e.g., In re Doe,* 711 F.2d 1187, 1191 (2d Cir.1983) ("That the W–2s are records of a kind customarily kept by taxpayers is not open to dispute."). Most, however, seem to simply make a cursory statement that the records are, or are not, customarily kept. *See, e.g., Doe M.D.,* 801 F.2d at 1168 (concluding without analysis that "it is evident that Doe customarily maintained the documents in his possession").

[8] The information that § 1010.420 requires to be kept is basic account information that bank customers would customarily keep, in part because they must report it to the IRS every year as part of the IRS's regulation of offshore banking, and in part because they need the information to access their foreign bank accounts. That M.H.'s bank keeps the records on his behalf does not mean he lacks access to them or that they are records offshore banking customers would not customarily keep. A bank account's beneficiary necessarily has access to such essential information as the bank's name, the maximum amount held in the account each year, and the account number. Both common sense and the records reviewed in camera support this assessment. We conclude that the records sought are customarily kept.

3. "Public aspects"

The Supreme Court has recognized that if the government's purpose in imposing the regulatory scheme is essentially regulatory, then it necessarily has some "public aspects." *Shapiro,* 335 U.S. at 33, 68 S.Ct. 1375 (noting that "the privilege which exists as to private papers cannot be maintained in relation to records required by law to be kept in order that there may be suitable information of transactions which ***1077** are the appropriate subjects of governmental regulation, and the enforcement of restrictions validly established" (citation and internal quotation marks omitted)); *id.* at 34, 68 S.Ct. 1375 (observing that because the Price Control Act required the records in question to be kept, they had "public aspects").

[9] **[10]** **[11]** The mere fact that the government has "formalized its demands in the attire of a statute" does not automatically ascribe "public aspects" to otherwise private documents. *See Marchetti,* 390 U.S. at 57, 88 S.Ct. 697. However, that the information sought is traditionally private and personal as opposed to business-related does not automatically implicate the Fifth Amendment. Where personal information is compelled in furtherance of a valid regulatory scheme, as is the case here, that information assumes a public aspect. *See Byers,* 402 U.S. at 431–32, 91 S.Ct. 1535 (holding that a California statutory requirement that drivers involved in automobile accidents provide their names and addresses to police did not infringe on the Fifth Amendment privilege because "[d]isclosure of name and address is an essentially neutral act. Whatever the collateral consequences of disclosing name and address, the statutory purpose is to implement the state police power to regulate use of motor vehicles"). Similarly, disclosure of basic account information is an "essentially neutral" act necessary for effective regulation of offshore banking.

[12] M.H. argues that the records in question, even if they are essentially regulatory, lack public aspects because "nothing in the record keeping provision of the BSA requires [M.H.] to produce bank records to the Government." However, we have held that a regulation need not have an express reporting requirement in order to have public aspects. *See Rosenberg,* 515 F.2d at 199–200 (finding no Fifth Amendment violation even though the statute required records to be kept but not produced (citing *Shapiro,* 335 U.S. 1, 68 S.Ct. 1375, and *Grosso,* 390 U.S. at 68, 88 S.Ct. 709)).

[13] Furthermore, as we have already noted, § 1010.420 *does* require M.H. to produce to the Government the information being sought upon request, as long as that request is authorized by law. The regulation states that records "shall be retained for a period of 5 years and shall be kept at all times available for inspection as authorized by law." § 1010.420. Additionally, the information required to be kept under § 1010.420 is the same information disclosed in FBAR forms. For purposes of the Required Records Doctrine, it does not matter whether the production of that information is requested through a subpoena (as in this case and *Shapiro*), a court order (as in *Bouknight*), or the regulation itself (as in *Byers*). *See Marchetti,* 390 U.S. at 56 n. 14, 88 S.Ct. 697 (rejecting the argument that "the crucial issue respecting the applicability of *Shapiro* is the method by which information reaches the Government"). Even if § 1010.420 lacked any reporting requirement whatsoever, it would still have public aspects because, as was the case in *Rosenberg,* the documents in question are required to be kept to aid in the enforcement of a valid regulatory scheme.

[14] M.H. next suggests that because the BSA provides that a person need only disclose records "as required by law" and the House report accompanying the legislation specified that the records "will not be made automatically available for law enforcement purposes," the records are not public because they are not "easily accessed" by the Government. But court orders and subpoenas *are* legal processes that prevent law enforcement from automatically retrieving information, and whether a document is easily accessible has nothing to do with whether a document ***1078** has public aspects. *See Marchetti,* 390 U.S. at 56 n. 14, 88 S.Ct. 697; *see also Rosenberg,* 515 F.2d at 199–200. The language "as required by law" does not prevent the sought-after records from assuming public aspects for purposes of the Required Records Doctrine.

[15] M.H.'s argument that, because the law recognizes special privacy interests in bank records and tax documents, those documents cannot have "public aspects" is also flawed. The fact that documents have privacy protections elsewhere does not transform those documents into private documents for the purpose of grand jury proceedings. *See Doe M.D.,* 801 F.2d at 1168 (finding that confidential patient records have "public aspects" for purposes of the Required Records Doctrine and that "expectations of privacy do not negate a finding that there is a public aspect to the files under the ... regulatory schemes"); *see also Fisher,* 425 U.S. at 401, 96 S.Ct. 1569 ("We adhere to the view that the Fifth Amendment protects against 'compelled self-incrimination, not the disclosure of private information.' " (citation and internal markings omitted)).

M.H. emphasizes decisions from other circuits that have found certain personal income tax documents beyond the scope of the Required Records Doctrine. Those cases are not binding in this Circuit, but even if they were, they fail to support M.H.'s position. For example, M.H. relies heavily on *Smith v. Richert,* 35 F.3d 300, 303 (7th Cir.1994). There, the court held that where the "production of personal tax records of the character of W–2's and 1099's would have testimonial force and incriminate the taxpayer ... the required-records doctrine is inapplicable and that production is excused by the self-incrimination clause." *Smith,* 35 F.3d at 304. But the rationale behind that ruling was that "[t]he decision to become a taxpayer cannot be thought voluntary ... [because] [a]lmost anyone who works is a taxpayer, along with many who do not." *Id.* at 303. The court reasoned that the obligatory nature of paying taxes was distinguishable from "the case of the individual who enters upon a regulated activity knowing that the maintenance of extensive records available for inspection by the regulatory agency is one of the conditions of engaging in the activity." *Id.* In the latter scenario—which is precisely the situation here because no one is required to participate in the activity of offshore banking—the required records doctrine *would* apply.

Furthermore, in *Smith* the subpoena did not indicate that the records being sought related to a regulated activity, whereas in this case the subpoena so indicates. *See id.* (determining that the Required Records Doctrine did not apply in part because "[n]othing in the subpoena identifies the records sought as records required by the state's agricultural statutes to be kept"). Here, the subpoena explicitly requires the production of banking records required to be kept and maintained for inspection pursuant to regulations implemented through the BSA.

[16] Finally, M.H. argues that allowing the regulatory nature of a requirement to render it as having "public aspects" allows the exception to swallow the rule that "[t]he Government's anxiety to obtain information known to a private individual does not without more render that information public." *Marchetti,* 390 U.S. at 57, 88 S.Ct. 697. But, as stated above, a statute or regulation "directed at a selective group inherently suspect of criminal activities" fails to render the privilege against self-incrimination inapplicable. *Id.* Determining whether a regulation is essentially regulatory or criminal requires analysis that goes beyond the label Congress or an agency provides, thus safeguarding against the exception swallowing the rule. Furthermore, in this instance, ***1079** M.H. has not made a compelling argument that the information he is being asked to provide lacks "public aspects" despite its essentially regulatory nature. We therefore conclude that the records in question have public aspects.

IV

Because the records sought through the subpoena fall under the Required Records Doctrine, the Fifth Amendment privilege against self-incrimination is inapplicable, and M.H. may not invoke it to resist compliance with the subpoena's command. *See Doe M.D.,* 801 F.2d at 1167 ("Records that are required to be maintained by law are outside the scope of the privilege [against self-incrimination]."). Because M.H.'s Fifth Amendment privilege is not implicated, we need not address his request for immunity. *Bouknight,* 493 U.S. at 562, 110 S.Ct. 900 (declining to "define the precise limitations that may exist upon the State's ability to use the testimonial aspects of Bouknight's act of production in subsequent criminal proceedings").

The district court's order is AFFIRMED.

All Citations

648 F.3d 1067, 108 A.F.T.R.2d 2011-5880, 11 Cal. Daily Op. Serv. 10,616, 2011 Daily Journal D.A.R. 12,661

Footnotes

[1] The regulation cited in the subpoena, 31 C.F.R. § 103.32, has since been relocated to 31 C.F.R. § 1010.420. For ease of reference, this opinion will refer to the current citation.

[2] The regulation reads, in relevant part:

> Records of accounts required by [31 C.F.R. § 103.24 (relocated to 31 C.F.R. § 1010.350)] to be reported to the Commissioner of Internal Revenue shall be retained by each person having a financial interest in or signature or other authority over any such account. Such records shall contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period. Such records shall be retained for a period of 5 years and shall be kept at all times available for inspection as authorized by law.

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852 F.Supp.2d 1020
United States District Court,
N.D. Illinois,
Eastern Division.

In re: SPECIAL FEBRUARY 2011–1 GRAND JURY SUBPOENA DATED SEPTEMBER 12, 2011.

No. 11 GJ 792.
|
Nov. 22, 2011.

Synopsis
Background: Individual subpoenaed to testify and produce records before the grand jury moved to quash the subpoena.

[Holding:] The District Court, James F. Holderman, Chief Judge, held that the required records doctrine did not apply to preclude the individual's assertion of a Fifth Amendment privilege.

Motion granted.

***1020** *MEMORANDUM OPINION AND ORDER*

JAMES F. HOLDERMAN, Chief Judge:

The movant in this matter was personally subpoenaed to testify and produce records before the grand jury. He was told by the Government that he is a target of the grand jury's investigation (hereinafter referred to as “T.C.” for Target Citizen). ***1021** T.C. has moved to quash the subpoena based on his Fifth Amendment privilege against incrimination. The Government has opposed the motion. For the following reasons, the motion to quash is granted.

BACKGROUND

The grand jury as a part of its investigation of T.C. issued the subpoena dated September 12, 2011 that is the subject of T.C.'s motion. That subpoena in addition to seeking T.C.'s testimony[1] compels him to produce “any and all” of his foreign financial account records covering the time period from October 1, 2006, to the present. Under the regulations authorized by the Bank Secrecy Act (BSA), 31 U.S.C. §§ 5311–5332, any foreign financial account holder is required to keep records of his foreign financial accounts and to file annual reports with the IRS. The subpoena at issue specifically commands T.C. to appear and testify before the grand jury and bring with him the following:

> [a]ny and all records required to be maintained pursuant to 31 C.F.R. § 103.32 [subsequently relocated to 31 C.F.R. § 1010.420] relating to foreign financial accounts that you had/have a financial interest in, or signature authority over, including records reflecting the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during each specified year.
>
> The records that the subpoena compels contain information T.C. was required to report concerning his foreign financial accounts to the IRS annually for the years he held such accounts by filing Form TD F 90–22.1, the “Report of Foreign Bank and Financial Accounts” (FBAR). T.C. declined to provide that information on his 2009 and 2010 FBAR forms, citing his Fifth Amendment privilege against self-incrimination. It appears that T.C. did not file the form in 2006, 2007, or 2008. Transcript of Nov. 8, 2011 Hearing at 8:13–9:1 (under seal).

ANALYSIS

[1] The Fifth Amendment to the United States Constitution states that “[n]o person ... shall be compelled in any criminal case to be a witness against himself.” There is no dispute here that the contents of the subpoenaed documents enjoy no Fifth Amendment privilege. Because the foreign banks holding T.C.'s accounts created the documents that the government seeks, the documents do not include T.C.'s testimony, much less his compelled testimony. *See United States v. Hubbell,* 530 U.S. 27, 36, 120 S.Ct. 2037, 147 L.Ed.2d 24 (2000). Nonetheless, T.C.'s “act of producing documents in response to a subpoena may have a compelled testimonial aspect,” if producing the documents would require T.C. to “admit that the papers existed, were in [T.C.'s] possession or control, and were authentic.” *Id.* Here, T.C. contends, and the Government does not dispute, that producing the requested records would be an admission by T.C. that he has one or more foreign bank accounts and that he had knowledge of the account or accounts that he held during the period covered by the subpoena. That information incriminates T.C. if he failed to report those foreign accounts properly to the IRS or failed to pay the proper amount of tax due from the income generated by those foreign ***1022** accounts. *See* 26 U.S.C. § 7206(1); 31 U.S.C. § 5322; 31 C.F.R. § 1010.350(a).

[2] Even though T.C.'s act of production may be incriminating, the Government contends that the Fifth Amendment does not apply in this instance under the required records doctrine. That doctrine provides an exception to the Fifth Amendment privilege for "records which are required to be kept by law." *United States v. Lehman,* 887 F.2d 1328, 1332 (1989). The Supreme Court first recognized the required records doctrine in *Shapiro v. United States,* 335 U.S. 1, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948), a case requiring the production of a fruit wholesaler's price records required by law to be maintained and open to Government inspection. Because the Government had a legitimate regulatory interest in the price records (for the enforcement of emergency war-time price controls), the Supreme Court reasoned, "the privilege which exists as to private papers cannot be maintained in relation to 'records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of Governmental regulation, and the enforcement of restrictions validly established.' " *Id.* at 33, 68 S.Ct. 1375 (footnote omitted). The Supreme Court later interpreted *Shapiro* to establish a three-part test for the application of the required records doctrine: "first, the purpose of the compulsion must be 'essentially regulatory'; second, the records sought must contain the type of information that the regulated party would customarily keep; and third, the records must have 'public aspects' making them at least comparable to public documents." *Lehman,* 887 F.2d at 1332 (citing *Grosso v. United States,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968)).

The Ninth Circuit recently applied the three-part test to enforce a subpoena identical to the one in this case requesting foreign bank account records maintained under 31 C.F.R. § 1010.420. *In re M.H.,* 648 F.3d 1067, 1070 (9th Cir.2011). The Ninth Circuit applied the required records doctrine after concluding that all three prongs of the test were met. The Ninth Circuit reasoned, first, "[n]othing about having a foreign bank account on its own suggests a person is engaged in illegal activity," so the requirement to maintain records was "essentially regulatory," rather than criminal. *Id.* at 1074. Second, investors in foreign banks would typically keep basic information about their accounts, thus making the records "customarily kept." *Id.* at 1076. Finally, the Ninth Circuit held that "[w]here personal information is compelled in furtherance of a valid regulatory scheme ..., that information assumes a public aspect," and found the third prong was met as well. *Id.* at 1077. Consequently, the Ninth Circuit affirmed the district court's order requiring M.H.'s compliance with the subpoena.

The question here regarding the subpoena to T.C. is not as straightforward as the subpoena to M.H. The Seventh Circuit, unlike the Ninth, has recognized that the application of the required records doctrine has become more complex in the more than half a century since the Supreme Court decided *Shapiro.* To understand the complexity, one must recall that *Shapiro* was decided under the regime of *Boyd v. United States,* a nineteenth-century case which established the now-discredited rule prohibiting all compelled production of incriminating documents in private hands. 116 U.S. 616, 630, 6 S.Ct. 524, 29 L.Ed. 746 (1886). When that rule was the law of the land, there was a concern that the Government lacked the investigative tools necessary to enforce many of its legitimate regulatory regimes. *See* Richard A. Nagareda, ***1023** *Compulsion "To Be a Witness" and the Resurrection of* Boyd, 74 N.Y.U. L. Rev. 1575, 1643–44 (1999). The need for an exception to *Boyd* 's categorical rule was thus plain. Moreover, the rationale behind *Boyd* focused on an owner's right of privacy in his possessions.[2] It therefore made sense, at that time, to carve out the necessary exception by focusing on the attributes that distinguish "public" documents from "private." And indeed, the Supreme Court in *Shapiro* proceeded along precisely those lines when establishing the required records doctrine, stating that "there is an important difference in the constitutional protection afforded their possessors between papers exclusively private and documents having public aspects, a difference whose essence is that the latter papers, once they have been legally obtained, are available as evidence." *Shapiro,* 335 U.S. at 33–34, 68 S.Ct. 1375 (quotation marks and citation omitted). The three-part test distills the Supreme Court's reasoning in *Shapiro* by distinguishing public documents from the private property protected under *Boyd.*

The problem with the *Shapiro* three-part test today is that the *Boyd* principle no longer defines the parameters of the Supreme Court's application of the Fifth Amendment.[3] Instead of focusing on an individual's right to shield his private property from Government inquiry, the Supreme Court has recognized that the Fifth Amendment protects "a person only against being incriminated by his own compelled testimonial communications." *Fisher v. United States,* 425 U.S. 391, 409, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976); *see also id.* at 401, 96 S.Ct. 1569 ("We cannot cut the Fifth Amendment completely loose from the moorings of its language, and make it serve as a general protector of privacy—a word not mentioned in its text and a concept directly addressed in the Fourth Amendment. We adhere to the view that the Fifth Amendment protects against 'compelled self-incrimination, not (the disclosure of) private information.' " (citation omitted)). The Supreme Court's focus on whether a communication is "testimonial" led it to abandon the *Boyd* rule and to recognize that there is no privilege protecting the contents of documents, so long as their creation was the author's voluntary choice. *Id.* at 407–09, 96 S.Ct. 1569. In other words, when a person has already made an incriminating statement in a document, the mere production of the document does not require the producing person to restate the document's contents. Nonetheless, the Supreme Court has recognized that a document may still be protected from compelled production because the act of producing the document may ***1024** have testimonial aspects, such as an admission that the document is authentic. *United States v. Doe,* 465 U.S. 605, 612–13, 104 S.Ct. 1237, 79 L.Ed.2d 552 (1984).

In that context, the distinction between public and private documents that formed the foundation of *Shapiro* can no longer be the dominant rationale for the required records doctrine. *See* Alito, *supra* note 3, at 71–72 ("The required records rule ... also seems likely to be reexamined in light of *Fisher* and *Doe,* because this rule ... was developed without any consideration of the act of production."). Indeed, the Seventh Circuit in 1989 considered doing away with the doctrine because of *Fisher* and *Doe. See Lehman,* 887 F.2d at 1332. Although the Seventh Circuit retained the required records doctrine, it did so by articulating two new rationales for its existence in light of *Fisher* and *Doe.* First, the Seventh Circuit in *Smith v. Richert* tied the required records doctrine to *Doe* 's emphasis on the testimonial aspects of production, noting that if the law requires an individual to keep documents, "the only acknowledgment conveyed by [producing them] would be of the existence and applicability of the regulatory program that required him to maintain the records," an acknowledgment that is not incriminating. 35 F.3d 300, 302 (7th Cir.1994); *accord In re Grand Jury Subpoena Duces Tecum Served Upon Underhill,* 781 F.2d 64, 70 (6th Cir.1986) ("[B]ecause required records must have taken on a 'public aspect' and because the law requires that they be kept, an individual admits little of significance by producing them."); *see also Lehman,* 887 F.2d at 1332 (adopting the Sixth Circuit's reasoning in *Underhill*). The Seventh Circuit thereby established that in general, the production of required records will lack the testimonial significance that protects a subpoenaed witness's refusal to produce some documents under *Fisher* and *Doe.*

The second rationale squares the required records doctrine with *Fisher*'s focus on the voluntariness of the individual's testimony. One might assume that the maintenance and production of all "required" records would by definition be compelled and thus not voluntary. The Seventh Circuit reasoned, however, that so long as the individual has voluntarily chosen to enter a regulated field, the maintenance or production of any records under the compulsion of government regulation of that field is also voluntary. *See Smith,* 35 F.3d at 302–03 (explaining the voluntariness requirement and reasoning that it is met by "the individual who enters upon a regulated activity knowing that the maintenance of extensive records available for inspection by the regulatory agency is one of the conditions of engaging in the activity"); *Underhill,* 781 F.2d at 70 ("[I]f an individual chooses to begin or continue to do business in an area in which the government requires record keeping, he may be deemed to have waived any Fifth Amendment protection.").

Although the *Shapiro* three-part test remains viable after *Fisher* and *Doe, see Lehman,* 887 F.2d at 1333, one can discern from the Seventh Circuit's new rationales for the required records doctrine two additional factors that may make the required records exception inapplicable even when the three-part test is met. The first factor is whether the individual's compelled production of the subpoenaed records causes him to admit any incriminating fact beyond the mere existence and applicability of the regulatory program that requires the records' maintenance and production. The second factor is whether the individual claiming Fifth Amendment protection has voluntarily entered the field of regulation by the government so as to waive Fifth Amendment protection from any production that the government's regulatory scheme may require.

***1025** This latter factor is the main rationale behind the Seventh Circuit's decision that the required records doctrine does not cover individual taxpayers' domestic tax records. *See Smith,* 35 F.3d at 303 ("The decision to become a taxpayer cannot be thought voluntary in the same sense [as the decision to enter upon a regulated activity]. Almost anyone who works is a taxpayer, along with many who do not."). This factor does not present an obstacle to the application of the required records doctrine here, however. Only about half a million taxpayers choose to use foreign bank accounts each year, so the activity of foreign bank account usage lacks the near universality of the decision to earn sufficient income to become a taxpayer. *See In re M.H.,* 648 F.3d at 1074. Moreover, T.C.'s counsel conceded at the November 8, 2011 closed hearing on the motion to quash that T.C.'s decision to put funds in a foreign bank account was voluntary. Transcript of Nov. 8, 2011 Hearing at 6:6–10 (under seal).

Consequently, the issue to be decided regarding T.C.'s pending motion is whether T.C.'s compelled production of the subpoenaed records causes him to admit any incriminating fact beyond the mere existence and applicability of the regulatory program. On that point, this court finds that T.C.'s compelled production of the subpoenaed information would compel him to admit that he has an interest in one or more foreign bank accounts and that he is thus participating in the regulated activity.[4] As described above, that fact may incriminate him under 26 U.S.C. § 7206(1) and 31 U.S.C. § 5322.

In the typical required records case, of course, there is no danger that producing the required records will compel the individual engaging in the regulated activity to admit his participation in the regulated activity, for that fact is usually obvious. The individual's participation in the regulated activity is obvious because in the typical case, the individual engages in the regulated activity in public. In the *Shapiro* case itself, for example, the fruit wholesaler subject to the price controls conducted his business in public and with the public, so the Government already knew that he was, in fact, a fruit wholesaler subject to the regulations. The same could be said of all of the typical entities found to be subject to production under the required records doctrine. *See, e.g., In re Grand Jury Subpoena,* 21 F.3d 226 (8th Cir.1994) (regulation of an automobile dealer); *Lehman,* 887 F.2d at 1330 (cattle dealer); *Underhill,* 781 F.2d at 65 (automobile dealer); *United States v. Scherer,* 523 F.2d 371 (7th Cir.1975) (firearms dealer); *United States v. Rosenberg,* 515 F.2d 190, 199–200 (9th Cir.1975) (physician). In all of those cases, the very purpose of the regulations was to protect consumers and the public from the individuals engaged in domestic commercial activity in the public market.

[3] By contrast, the purpose of the BSA, according to its statutory declaration of purpose, is not to regulate a public market or to protect consumers, but rather to advance the Government's "criminal, tax, or regulatory investigations or proceedings," or to "protect against international terrorism." 31 U.S.C. § 5311. The people subject to BSA regulation have not ***1026** necessarily engaged in activities with the public or in the public sphere. An individual's voluntary decision to obtain a foreign bank account is private, unlike the voluntary decision to conduct business with the public in a regulated area. Without some disclosure by the individual such as the FBAR—which in this case T.C. has declined to fill out—the Government has no direct way to discover T.C.'s participation in the regulated activity.[5] Forcing T.C. to produce the foreign bank account records would compel him to admit that he has a foreign bank account, a compelled admission that the Fifth Amendment protects him from having to make.[6]

[4] **[5]** A bedrock principle of Fifth Amendment jurisprudence is that the Government cannot obtain access to information merely by expressing its "anxiety to obtain information known to a private individual," or even by "formaliz[ing] its demands in the attire of a statute." *Marchetti v. United States,* 390 U.S. 39, 57, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968). Thus, "a statute that required all Americans to keep a diary in which they recorded every arguably illegal act that they committed, or make a tape-recorded confession whenever they committed an illegal act, would not empower the authorities ... to compel the production of the diary or the tape." *Smith,* 35 F.3d at 303. The required records doctrine establishes a limited exception to that principle by allowing the government to compel the production of certain information merely by formally demanding the information in a statute. The required records doctrine only applies, however, in the limited case in which the individual's decision to participate in a regulated activity has already revealed the information that he seeks to protect under the Fifth Amendment. To expand the required records doctrine beyond that restricted class of cases would erode the protection that, in the words of Justice Joseph Story in his landmark *Commentaries on the Constitution,* "is of inestimable value." The origin of that protection, Justice Story reminded us, is to avoid the fate of countries in which, "not only are criminals compelled to give evidence against themselves, but are subjected to the rack or torture in order to procure a confession of guilt." 3 Joseph Story, Commentaries on the Constitution § 1782 (1833), *in* 5 The Founders' Constitution 295, 296 (Philip B. Kurland & Ralph Lerner eds., 1987). If such important protection can be eroded "*merely* because [records are] required to be kept by law ..., we are indeed living in glass houses." *Shapiro,* 335 U.S. at 50, 68 S.Ct. 1375 (Frankfurter, J., dissenting) (emphasis added). The Government must do more work than simply requiring T.C. to incriminate himself by producing his own files if it wishes to find evidence during this grand jury investigation that T.C. ***1027** has an incriminating interest in foreign bank accounts.

CONCLUSION

For the reasons stated above, T.C.'s motion to quash the subpoena is granted.

All Citations

852 F.Supp.2d 1020

Footnotes

[1] The Government in its Response stated it extended the date for T.C.'s compliance and stated, "His [T.C.'s] personal appearance was also tentatively excused in the event documents were produced assuming the documents were properly authenticated." (Govt. Resp. 1, fn. 1.)

[2] *See Boyd,* 116 U.S. at 627–28, 6 S.Ct. 524 (" 'Papers are the owner's goods and chattels; they are his dearest property, and are so far from enduring a seizure, that they will hardly bear an inspection ....' " (quoting *Entick v. Carrington and Three Other King's Messengers,* (1765) 95 Eng. Rep. 807 (K.B.); 19 How. St. Tr. 1029)); *see also Griswold v. Connecticut,* 381 U.S. 479, 484, 85 S.Ct. 1678, 14 L.Ed.2d 510 (1965) ("The Fourth and Fifth Amendments were described in *Boyd* as protection against all Governmental invasions 'of the sanctity of a man's home and the privacies of life.' " (citation omitted)); 3 Wayne LeFave et al., *Criminal Procedure* § 8.12(a) (3d ed. rev. 2010) ("*Boyd* relied on what has been described as a 'property oriented' view of the Fourth and Fifth Amendments, built upon the owner's right of privacy in the control of his lawfully held possessions. It recognized a special Fifth Amendment interest in the privacy of documents, viewing the forced production of their contents as equivalent to requiring a subpoenaed party to reveal that content through his testimony." (footnote omitted)).

[3] *See* Samuel A. Alito, Jr., *Documents and the Privilege Against Self–Incrimination,* 48 U. Pitt. L. Rev. 27, 39–40 (1986) ("*Boyd* 's property-based interpretation of the fourth amendment could not accommodate the needs of modern law enforcement or modern concepts of privacy."). *See generally* 1 Sara Sun Beale et al., *Grand Jury Law and Practice* § 6:14 (2d ed. 2008) (describing the erosion of *Boyd*).

[4] The court notes that this compelled self-incriminating admission is different from a non-self-incriminating admission that the regulatory program is applicable to taxpayers who have an interest in foreign bank accounts. The self-incriminating admission that the Fifth Amendment protects here is a compelled admission by T.C. to the grand jury that reveals he himself has an interest in a foreign bank account and is thus one of those taxpayers.

[5] If the Government could discover the information from a third-party or through other investigation, such as from a foreign bank, if any, in which T.C. has invested. The Government may argue that it is difficult to obtain the information from a third-party in this case, given that all of the relevant information is overseas and protected by foreign banks. The Government's difficulty in otherwise obtaining the subpoenaed information, however, is not a reason to eviscerate an individual's Fifth Amendment protection.

[6] The private nature of opening a foreign bank account also casts doubt on whether the account records meet the "public aspects" prong of the *Shapiro* three-part test. The Seventh Circuit has stated that records have "public aspects" if they "are usually known to the public in general rather than records which are essentially personal to the individual." *United States v. Campos–Serrano,* 430 F.2d 173, 176 (7th Cir.1970). The fact that an individual maintains a foreign bank account and the records thereof are not "usually known to the public in general."

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2015 WL 4275183
Only the Westlaw citation is currently available.
United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
Stephen M. KERR, Michael Quiel, Defendants.

No. CR–11–02385–PHX–JAT
|
Signed July 14, 2015
|
Filed July 15, 2015

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ORDER

JAMES A. TEILBORG, Senior District Judge

***1** Pending before the Court is Defendants' Joint Motion for New Trial or to Dismiss. (Doc. 454).

I. Background

On December 8, 2011, a grand jury indicted Michael Quiel ("Quiel") and Stephen Kerr ("Kerr") on a variety of crimes concerning failure to pay taxes on funds held in Swiss corporations. (Doc. 3). Each Defendant was charged with one count of Conspiracy to Defraud the United States, two counts of Willful Subscription to False Individual Income Tax Returns, and two counts of Willful Failure to File Reports of Foreign Bank and Financial Accounts ("FBAR"). (*Id.*).

Defendants were not alone in the indictment. Christopher Rusch ("Rusch"), Defendants' former attorney, was charged with one count of Conspiracy to Defraud the United States. (*Id.*). An additional charge of failure to file an FBAR was later added. (Doc. 331 at 1607). Rusch entered into a plea agreement, which compelled him to testify at the request of the United States. (Doc. 415).

A month-long jury trial began in early March. (Doc. 221); (Doc. 281). At trial, Rusch testified against Defendants. (Doc. 331). On direct examination, he admitted to engaging in illegal activity by improperly structuring the Swiss businesses controlled by Quiel and Kerr. (*Id.* at 1675). On cross-examination, Defendants introduced evidence to impeach Rusch. (Doc. 454 at 5); (Doc. 457 at 2).

Both Defendants were acquitted of Count One (Conspiracy to Defraud the United States). Kerr was found guilty of Counts Two & Three (Willful Subscription to False Individual Income Tax Returns for 2007 and 2008) and Counts Six & Seven (Willful Failure to File FBARs for 2007 and 2008). (Doc. 281). Quiel was found guilty of Counts Four & Five (Willful Subscription to False Individual Income Tax Returns for 2007 and 2008). (*Id.*). In addition, the jury hung as to Counts Eight & Nine (Willful Failure to File FBARs for 2007 and 2008). (*Id.*).

Following the verdict, Defendants were each sentenced to ten months in prison. (Doc. 373); (Doc. 376). Subsequently, Defendants moved for acquittal or alternatively a new trial. (Doc. 299); (Doc. 300). These motions were denied. (Doc. 345); (Doc. 346).

On appeal, the Ninth Circuit Court of Appeals affirmed the convictions. *United States v. Quiel,* 595 F. App'x 692 (9th Cir.2014), *cert. denied,* No. 14–1237, 2015 WL 1692989 (May 18, 2015). Now, Defendants request a new trial or alternatively an evidentiary hearing, in light of allegedly newly discovered evidence. (Doc. 454). Defendants have three different pieces of allegedly newly discovered evidence.

A. Rusch's Alleged Fraud

First, Defendants claim that evidence has emerged showing that Rusch engaged in fraudulent activities, before and during the trial, under the alias Christian Reeves. (*Id.* at 1–9). Defendants contend that examples of this fraud include Rusch: blogging as Reeves in early 2013, (*Id.* at 4); posting on ex-pat investing sites as Reeves starting in 2012, (*Id.* at 6); giving tax advice as Reeves, (*Id.*); podcasting as Reeves, (*Id.*); marketing himself as a rehabilitated lawyer, (*Id.*); and publishing an offshore tax guide after pleading guilty, but before trial, (*Id.*). Furthermore, Defendants allege that Rusch has admitted to being Reeves. (Doc. 459 at 3).

***2** Defendants argue that they could have used the evidence of Rusch's ongoing fraud to impeach his testimony at trial. (Doc. 454 at 13). Defendants further claim that if the Government was aware of Rusch's illegal activity, but did not disclose this information to Defendants, then a *Brady* violation has occurred, justifying a new trial. (*Id.* at 12–14).

Defendants further argue that even if the Government was not aware of this information, the newly discovered evidence, of its own force, justifies a new trial. (*Id.* at 14).

B. Rusch's Alleged Undisclosed Benefit

Second, Defendants allege that the Government has agreed "to look the other way while its witness commits additional crimes." (*Id.* at 10). Defendants claim that the Government has given Rusch a "fresh start" by allowing him to continue his allegedly fraudulent activity. (Doc. 458 at 7). Defendants argue that this "fresh start" is the product of an undisclosed agreement between Rusch and the Government. (*Id.* at 7) ("*Brady* and due process require that the Government turn over information about the full benefits and promises that the witness received for his co-operation, to include non-enforcement of civil penalties.") (citing *United States v. Shaffer,* 789 F.2d 682 (9th Cir.1986)).

C. Trial Exhibits 51 and 52

Third, Defendants allege that Pierre Gabris, a Swiss-national and alleged participant in the structuring of the Swiss accounts, would testify that "he did not prepare or send trial exhibits 51 and 52," which were offered into evidence on Rusch's re-direct. (*Id.* at 15). These exhibits contain emails originally sent from Gabris to Rusch, who forwarded them to Defendants, regarding accounting statements from Defendants' Swiss corporations. (Doc. 335 at 2533). Defendants argue that these allegedly forged documents provide further support for a new trial. (Doc. 454 at 15–16).

II. Applicable Legal Standards

Defendants claim that their newly discovered evidence satisfies the Rule 33 new trial test. (*Id.* at 14). This test requires Defendants to show: (1) that the evidence is newly discovered; (2) that Defendants' failure to discover the evidence sooner was not the result of a lack of diligence; (3) that the evidence is material; (4) that the evidence is neither cumulative nor merely impeaching; and (5) that a new trial would likely result in acquittal. *United States v. Kulczyk,* 931 F.2d 542, 548 (9th Cir.1991).

In addition, Defendants argue that they are due a new trial under *Brady v. Maryland.* (Doc. 454 at 12?14); *Brady v. Maryland,* 373 U.S. 83, 87 (1963). To prove a *Brady* violation, Defendants must show that: (1) the evidence is newly discovered; (2) the evidence was suppressed by the prosecution; and (3) the evidence was material. *United States v. Williams,* 547 F.3d 1187, 1202 (9th Cir.2008).

Finally, Defendants allege that trial exhibits 51 and 52 are forgeries. (Doc. 454 at 15). While Defendants assert that these forgeries entitle them to a new trial under *Brady,* this evidence is properly considered under *Napue v. Illinois,* because the evidence was not suppressed.[1] *Napue v. Illinois,* 360 U.S. 264 (1959). To establish a *Napue* violation, Defendants must prove that: (1) there was false evidence; (2) the prosecution knew, or should have known that the evidence was false; and (3) the evidence was material. *Towery v. Schriro,* 641 F.3d 300, 308 (9th Cir.2010) (citing *United States v. Zuno ? Arce,* 339 F.3d 886, 889 (9th Cir.2003)).

***3** Because both *Brady* and *Napue* violations are implicated by Defendants' allegations, the Court will use a two-step test described in further detail below, *see supra* Part II.D, to determine materiality.

Finally, to determine whether Defendants are entitled to an evidentiary hearing, the Court will presume that their allegations are true.

A. Rule 33 New Trial Test

Under Rule 33, a defendant may "move for a new trial on newly discovered evidence" within three years of the verdict. Fed.R.Crim.P. 33. The Court may "grant a new trial if the interest of justice so requires." *Id.* These motions "are not favored by the courts and should be viewed with great caution." *United States v. Marcello,* 568 F.Supp. 738, 740 (C.D.Cal.1983), *aff'd* 731 F.2d 1354 (9th

Cir.1984) (citing 3 Charles Alan Wright, *Federal Practice and Procedure: Criminal* § 557 (2d ed.1982)). To obtain a new trial, Defendants must satisfy each prong of a five-part test:

> (1) the evidence must be newly discovered;
>
> (2) the failure to discover the evidence sooner must not be the result of a lack of diligence on ... [Defendants'] part;
>
> (3) the evidence must be material to the issues at trial;
>
> (4) the evidence must be neither cumulative nor merely impeaching; and
>
> (5) the evidence must indicate that a new trial would probably result in acquittal.

United States v. Kulczyk, 931 F.2d 542, 548 (9th Cir.1991).

The materiality and probability prongs are essentially the same. *United States v. Krasny,* 607 F.2d 840, 845 n.3 (9th Cir.1979). Accordingly, they will be treated concurrently.

1. Newly Discovered

Rule 33 requires that evidence be newly discovered. *Kulczyk,* 931 F.2d at 548. Evidence is not newly discovered if it "was known to, or was in the possession of, the defense" before the trial concluded. *United States v. Hinkson,* 585 F.3d 1247, 1284 (9th Cir.2009) (*en banc*) (Fletcher, J., dissenting).

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

Defendants allege that they discovered Rusch's fraudulent activities performed under the Reeves alias after trial. (Doc. 454 at 4). Because Defendants allegedly learned of this information after trial, the newly discovered test is satisfied.

b. Trial Exhibits 51 and 52

Notwithstanding the Reeves allegation, Defendants do not allege when they learned that Gabris did not send the emails constituting trial exhibits 51 and 52. (*Id.* at 15). The heading above Defendants' claim reads: "The Discovery of Allegedly Forged Documents Further Provides the Basis for a New Trial." (*Id.*). This does not indicate when the discovery occurred. Additionally, the evidence allegedly arose from "conversations between Mr. Quiel's attorney, Mr. Gabris' attorney, and conversations between Mr. Gabris and Mr. Quiel outside the presence of Counsel"; there is no mention of when these conversations took place. (*Id.*). Furthermore, the Government noted the temporal-vacancy of the allegation, (Doc. 457 at 8), but Defendants failed to address this concern in their Reply, (Doc. 458).

Consequently, without a description of when this discovery was made, the Court cannot find a concrete allegation that the evidence is newly discovered. Therefore, because Defendants fail to meet their burden, the alleged evidence regarding trial exhibits 51 and 52 cannot be considered newly discovered.

2. Diligence

***4** "Due diligence means ordinary, rather than extraordinary, diligence." *United States v. Walker,* 546 F.Supp. 805, 811 (D.Haw.1982). The trial judge "has a large discretion in ... determining what diligence is necessary." *Prlia v. United States,* 279 F.2d 407, 408 (9th Cir.1960). In *United States v. Harrington,* the court found that the movant was not diligent in obtaining photographs of the crime scene and a map of the surrounding streets because this information "could have been obtained at any time." *United States v. Harrington,* 410 F.3d 598, 600 (9th Cir.2005).

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

While it is possible that the evidence of Rusch's alleged out-of-court activities could have been "discovered at any time" in the literal sense, this situation is distinguishable from *Harrington,* as the evidence in that case concerned the actual crime of which the defendant was convicted: selling LSD in that area. *Id.* In the present case, the proposed evidence concerns Rusch's conduct which was not associated with the activity of which Defendants were convicted. Therefore, an ordinarily-diligent defendant would not be expected to discover this evidence. Accordingly, Defendants' failure to discover this evidence in time for trial does not violate the diligence standard.

3. Cumulative/Impeachment Evidence

Generally, impeachment evidence does not justify a new trial. *United States v. Davis,* 960 F.2d 820, 825 (9th Cir.1992). Nevertheless, a new trial is warranted where "impeachment evidence [is] ... so powerful that, if it were to be believed by the trier of fact, it could render the witness' testimony totally incredible." *Id.* In these situations, the new evidence nullifies "an essential element of the government's case." *Id.*

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

While Defendants do describe Rusch's allegedly impeaching activity, they do not show how this evidence would negate an essential element of the Government's case. (Doc. 454). Therefore, because Defendants have not met their burden, their allegations do not warrant a new trial under Rule 33.

4. Probability of Acquittal and Materiality

Because Defendants claims do not satisfy the prior elements of this test, materiality and probability of acquittal will not be considered at this juncture.

B. *Napue* Test

Under *Napue,* "[t]he knowing use of false evidence by the state, or the failure to correct false evidence, may violate due process." *Towery v. Schriro,* 641 F.3d 300, 308 (9th Cir.2010) (citing *Napue v. Illinois,* 360 U.S. 264, 269 (1959)). To demonstrate a *Napue* violation, the movant must show that: "(1) the testimony (or evidence) was actually false, (2) the prosecution knew or should have known that the testimony was actually false, and (3) ... the false testimony was material." *Id.* (quoting *United States v. Zuno ? Arce,* 339 F.3d 886, 889 (9th Cir.2003)).

1. Falsity

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

Defendants do not allege that Rusch's illegal activity or the undisclosed leniency agreement caused false evidence or perjury to be introduced at trial. (Doc. 454). Therefore, these claims do not satisfy *Napue*.

b. Trial Exhibits 51 and 52

In contrast, Defendants do allege that trial exhibits 51 and 52 were falsified. (Doc. 454 at 15). Defendants claim that Gabris will testify that he did not send the emails to Rusch that constitute trial exhibits 51 and 52. (*Id.*). However, even if true, this does not establish that the evidence itself was false.

***5** Allegedly, trial exhibits 51 and 52 were used to " 'prove' distributions that were never made." (Doc. 454 at 15). Defendants claim that this evidence "supported the 'nominee theory' " of structuring, whereby an American impermissibly controls a foreign company through a nominee without paying taxes on funds held in that company. Defendants allege that had the jury known that the exhibits were falsified, they may have "acquitted Quiel on the tax charges." (*Id.* 16–17). Exhibit 51 is an email from Gabris to Rusch containing an accounting statement for the Swiss business accounts owned by Quiel. (Doc. 335 at 2534). This email was subsequently forwarded to Quiel. (*Id.*). Exhibit 52 was not mentioned after it was introduced into evidence. (*See id.*).

When the exhibits were introduced, defense counsel objected, arguing that "[t]hey're beyond the scope. And they're the hearsay statements of Mr. Pierre Gabris, who [defense counsel] will not have an opportunity to cross-examine." (Doc. 335 at 2534). In response, the prosecutor argued that during cross-examination Rusch was questioned "about providing information to the defendants. The implication was [that] he did not actually provide anything to defendants. These are being offered to rebut that. And they're not being offered for the truth of anything in the document, but just to their existence." (*Id.*). After hearing the explanation, the Court overruled the objection, and the evidence was admitted. (*Id.*).

Defendants do not contend that they were never forwarded the emails by Rusch. (*See* Doc. 454). Therefore, the evidence, which was used to establish that Rusch sent Quiel financial information regarding Quiel's Swiss accounts, is not changed by the fact that Gabris allegedly did not send the original emails to Rusch.

For evidence to be false under *Napue,* the falsity must be material to the purpose for which the evidence was used. *Cf. United States v. Vozzella,* 124 F.3d 389, 392 (2d Cir.1997) (emphasis added) (finding falsity where "records were known to be partially false and were presented to the jury in a fashion so highly misleading *as to amount to falsity regarding their veracity as a whole*."). Where evidence is partially false, but the false portion of the evidence has no bearing on the purpose for which the evidence is used, there is no risk that "a state has contrived a conviction through the pretense of a trial which in truth is but used as a means of depriving a defendant of liberty through a deliberate deception of court and jury." *Mooney v. Holohan,* 294 U.S. 103, 112 (1935). Consequently, insofar as trial exhibit 51 was used to support Rusch's testimony that he sent an email containing Swiss accounting statements to Quiel, the evidence was not false.

2. Knowledge and Materiality

Because Defendants fail to show that any of the allegedly newly discovered evidence was falsified, they fail to satisfy the *Napue* test. Therefore knowledge and materiality do not need to be considered.

C. *Brady* Test

Under *Brady,* "the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution." *Brady v. Maryland,* 373 U.S. 83, 87 (1963). For a *Brady* violation to occur, three elements must be present: "(1) the evidence at issue must be favorable to the accused, either because it is exculpatory, or because it is impeaching; (2) that evidence must have been suppressed by the State, either willfully or inadvertently; and (3) prejudice must have ensued." *United States v. Williams,* 547 F.3d 1187, 1202 (9th Cir.2008) (internal quotation marks omitted) (quoting *Strickler v. Greene,* 527 U.S. 263, 281?82 (1999)). The Defendants have the burden of establishing the presence of these elements. *United States v. Lopez,* 577 F.3d 1053, 1059 (9th Cir.2009).

1. Favorable Evidence

***6** Under *Brady,* newly discovered evidence that is favorable to the defense must be admissible, or must be able to impeach the Government's witness. *United States v. Kohring,* 637 F.3d 895, 903 (9th Cir.2010).

a. Rusch's Alleged Fraud

Defendants wish to introduce evidence allegedly showing that Rusch engaged in fraudulent activities before and during trial. (Doc. 454). This evidence is both admissible and useful for impeachment. Fed.R.Evid. 608 (allowing in extrinsic evidence on cross-examination if it is "probative of the character for truthfulness or untruthfulness of" the witness). Therefore, because the evidence is admissible as impeachment material, it is favorable under *Brady*.

b. Rusch's Alleged Undisclosed Benefit

Defendants further allege that the Government has made an undisclosed agreement for leniency with Rusch. (Doc. 458 at 7). Such evidence would be admissible at trial and would be useful for impeaching Rusch, therefore it is favorable under *Brady*.

c. Trial Exhibits 51 and 52

Finally, Defendants claim that trial exhibits 51 and 52 were forged, and thus constitute false evidence. (Doc. 454 at 15). Such evidence is favorable because either Gabris's testimony that he did not send the emails would be admissible or the emails themselves might be inadmissible.

2. Suppression

The Government must disclose any exculpatory evidence within its possession, regardless of whether Defendants requested such evidence. *Kyles v. Whitley,* 514 U.S. 419, 433 (1995) (citing *United States v. Bagley,* 473 U.S. 667, 682 (1985)). This duty applies even if those "acting on the government's behalf" have exculpatory evidence without the prosecutor's knowledge. *Id.* at 437. A prosecutor's failure to disclose an agreement with a coconspirator in exchange for their testimony at trial constitutes suppression under *Brady*. *Giglio v. United States,* 405 U.S. 150, 154?55 (1972).

a. Rusch's Alleged Fraud

Defendants assert that the Government may have known of Rusch's illegal activity, and that this information was not disclosed to Defendants. (Doc. 454 at 9–10). They claim that without an evidentiary hearing the Court cannot know whether the Government possessed, but did not disclose, this evidence. (*Id.*). If Defendants allegations are true, the suppression element of *Brady* is satisfied.

b. Rusch's Alleged Undisclosed Benefit

Furthermore, Defendants allege that the Government made an undisclosed agreement with Rusch to treat him with leniency after trial. (Doc. 458 at 7). Failure to disclose agreements of leniency satisfy the suppression prong of *Brady*. Therefore, if true, this allegation establishes suppression.

c. Trial Exhibits 51 and 52

Finally, Defendants allege that the Government may have known that trial exhibits 51 and 52 were forged, and that by not disclosing this information, the Government violated *Brady*. (Doc. 454 at 15–16). Defendants are not alleging that the Government suppressed the exhibits, by that the evidence was forged. Therefore, this evidence does not satisfy the suppression prong of *Brady*.

3. Materiality

Evidence is material "only if there is a reasonable probability that, had the evidence been disclosed to the defense, the result of the proceeding would have been different." *Bagley,* 463 U.S. at 682. The reasonable probability standard does not require the defendant to prove by a preponderance of the evidence that "disclosure of the suppressed evidence would have resulted ... in acquittal," but merely that suppression "undermines confidence in the outcome of the trial." *Kyles,* 514 U.S. at 434. The Court "may find a 'reasonable probability' even where the remaining evidence would have been sufficient to convict the defendant." *Jackson v. Brown,* 513 F.3d 1057, 1071 (9th Cir.2008) (citing *Strickler v. Greene,* 527 U.S. 263, 290 (1999)).

***7** Newly discovered impeachment evidence is merely cumulative, and does not violate *Brady,* where a witness's credibility was eroded by "significant impeachment evidence" at trial. *Morris v. Ylst,* 447 F.3d 735, 741 (9th Cir.2006); *accord United States v. Endicott,* 869 F.2d 452, 456 (9th Cir.1989) (holding that newly discovered impeachment evidence "does not warrant a new trial when the evidence would not have affected the jury's assessment of the witness' credibility and when the witness was subjected to vigorous cross-examination.") (citing *United States v. Steel,* 759 F.2d 706, 714 (9th Cir.1985)). However, "impeachment evidence ... [is] not 'merely cumulative' where the withheld evidence was of a different character than evidence already known to the defense." *United States v. Kohring,* 637 F.3d 895, 904 (9th Cir.2010) (quoting *Banks v. Dretke,* 540 U.S. 668, 702–03 (2004)).

Brady claims are considered "collectively, but ... [the Court] 'must first evaluate the tendency and force of each item of suppressed evidence and then evaluate its cumulative effect at the end of the discussion.' " Id. at 903 (quoting Barker v. Fleming, 423 F.3d 1085, 1094 (9th Cir.2005)).

a. Rusch's Alleged Fraud

First, Defendants claim that Rusch engaged in fraudulent activities before and during the trial without Defendants' knowledge. (Doc. 454 at 6–9). Allegedly, this evidence could have been used to impeach Rusch. (*Id.*) The

Government argues that Rusch was already subjected to significant impeachment evidence at trial, including Defendants: "pointing out inconsistencies in [Rusch's] prior statements," emphasizing Rusch's "motives as a cooperator," extracting "concessions concerning his violations of the ethical rules and rules of professional conduct," using "surreptitious recordings," and calling "a legal ethics expert." (Doc. 457 at 5). As such, the Government claims, further impeachment evidence would be merely cumulative. (*Id.*).

There is no proposed evidence indicating that any of Rusch's activities as Reeves before or during trial were criminal in nature. While Defendants argue that Rusch has committed a felony by practicing law as a disbarred attorney, and has committed fraud by holding himself out as a rehabilitated attorney, (Doc. 454 at 11), neither of these activities occurred before or during the trial. In fact, as Defendants note, Rusch was not prohibited from practicing law until June 21, 2013, (*Id.* at 6), while the verdict in this case was rendered on April 11, 2013, (Doc. 288); (Doc. 289). There is no indication that Rusch was doing anything more under the Reeve's pseudonym than what he was doing prior to his involvement with Defendants: providing tax advice for U.S. citizens seeking to do business and bank overseas. Done properly, this activity is not illegal.

Additionally, there is nothing inherently fraudulent with using a pseudonym. Therefore, it is not clear in what manner Defendants wish to use Rusch's activities before and during the trial as impeachment evidence. To the extent that they wish to reinforce his engagement with offshore tax schemes, such evidence would be merely cumulative, as he readily admitted to this sort of activity on direct. (Doc. 331 at 1613).

To the extent that Defendants allege that Rusch's engaged in post-trial illegal activity, such evidence is irrelevant for *Brady* purposes, because the Government did not possess, at or before trial, evidence it could suppress.

b. Rusch's Alleged Undisclosed Benefit

Second, Defendants allege that the Government has allowed Rusch to engage in illegal activity without consequence as the result of an undisclosed agreement that prompted Rusch's trial testimony. (Doc. 458 at 7). The Government argues that "at no time was the United States aware of Rusch's post-trial conduct except with regard to the information provided by the U.S. Probation Department." (Doc. 460 at 2). Given that the Government did not directly deny the existence of an agreement, it is possible that there was an agreement for leniency, even without the Government's present awareness of Rusch's post-trial activities. Therefore, taking this allegation as true, a material violation under *Brady* has occurred. *Brady*. *Giglio v. United States,* 405 U.S. 150, 155 (1972) (finding that an undisclosed agreement for leniency with an important witness violated *Brady*). However, as will be discussed below, Defendants offer no evidence that such an agreement actually exists.

D. *Brady*/*Napue* Two–Step Materiality

***8** While *Brady* and *Napue* both have their own tests, they each require materiality. If *Brady* and *Napue* violations are both alleged, their materiality should be considered collectively. *Jackson v. Brown,* 513 F.3d 1057, 1076 (9th Cir.2008). However, because *Napue* 's materiality test is easier to meet, *Napue* violations must be considered first, as not to "overweight" the *Brady* violations. *Id.* This process is performed in two steps.

First, the Court weighs the *Napue* violations and asks whether there is "any reasonable likelihood that the false testimony *could* have affected the judgment of the jury." *Id.* If the answer is yes, then reversal of judgment is the proper remedy. *Id.* If not, then the *Napue* and *Brady* violations are considered collectively. *Id.* Under this second test, the Court asks whether "there is a reasonable probability that, but for [the prosecutor's] unprofessional errors, the result of the proceeding *would* have been different." *Id.* If the answer to this question is yes, the remedy is generally a new trial. *Id.*

While both the allegedly forged trial exhibits and the allegations regarding Rusch engaging in fraud do not satisfy the *Napue* and *Brady* tests, the allegation regarding an undisclosed agreement satisfies *Brady*. No weight can be given to the allegations that do not satisfy either test. Therefore, the only question in this consideration is whether there is a reasonable probability that, but for the undisclosed agreement, the outcome of the trial would have been different. Because the Supreme Court has determined that the nondisclosure of an agreement for leniency with an important witness satisfies this test, *Giglio v. United States,* 405 U.S. 150 (1972), materiality under the dual *Brady*/*Giglio* test would be satisfied if Defendants' allegations are true. Again, however, Defendants offer no evidence that such an agreement actually exists.

III. Evidentiary Hearing

Generally, motions for a new trial are "decided solely upon affidavits." *United States v. Colacurcio,* 499 F.2d 1401, 1406 n.7 (9th Cir.1974). However, "[t]he decision on whether to hold a hearing or to proceed by affidavit is within the sound discretion of the trial court." *United States v. Nace,* 561 F.2d 763, 772 (9th Cir.1977). An evidentiary hearing should only be granted if the facts alleged, taken as true, would constitute grounds for a new trial. *See United States v. Scott,* 521 F.2d 1188, 1196 (9th Cir.1975) (finding that the trial judge did not abuse his discretion in denying an evidentiary hearing where "there was nothing to be gained by such a hearing."). "Evidentiary hearings ... are not meant to be 'fishing expeditions for ... [Defendants] to explore their case in search of its existence.' " *Morgan v. Gonzales,* 495 F.3d 1084, 1091 (9th Cir.2007) (quoting *Rich v. Calderon,* 187 F.3d 1064, 1067 (9th Cir.1999)).

Defendants provide no affidavit to bolster their allegation that the Government has made an undisclosed agreement with Rusch. (Doc. 454). On the other hand, the Government does not explicitly deny Defendants' allegations, but rather sidesteps the issue by stating that they have not monitored Rusch's post-trial conduct. (Doc. 460 at 1–2). The Government's statements do not preclude the existence of an undisclosed agreement.[2] However, ultimately, absent an affidavit, Defendants do nothing more than speculate.

***9** Defendants' failure to include an affidavit does not give the Court the choice between holding an evidentiary hearing or making a decision based upon affidavits; it leaves only one option. Allowing an evidentiary hearing in this case would encourage Defendants in the future, uncertain of their case for newly discovered evidence, to fail to include affidavits in an attempt to force the Court to allow an evidentiary hearing. The Court does not wish to create such an incentive. Therefore, Defendants' motion for an evidentiary hearing is denied, because on this record it would be nothing more than a fishing expedition.

Thus, although Defendants' claim that Rusch has an ongoing, undisclosed leniency agreement with the Government would entitle Defendants to relief, because Defendants offer no affidavit or other evidence showing that such an agreement exists, and the Government has effectively denied the existence of an agreement, the Court will not hold an evidentiary hearing or grant a new trial. Indeed, Defendants do not even suggest what witnesses they would call or what evidence they would produce at an evidentiary hearing that would substantiate the allegation that Rusch has an agreement with the Government beyond the plea agreement already disclosed. Thus, the Court will not allow a fishing expedition on this topic.

IV. Conclusion

A. Rusch's Alleged Fraud

First, this evidence does not satisfy the Rule 33 test, because it is impeachment evidence that does not negate an essential element of the Government's case.

Second, this Court already determined this evidence was immaterial under *Brady,* because there is no alleged evidence regarding Rusch's conduct, both before and during trial, that would constitute more than merely cumulative impeachment material.

Third, this evidence was determined to not satisfy the *Napue* test, because there is no allegation that this evidence resulted in false evidence or perjured testimony being introduced at trial.

B. Rusch's Alleged Undisclosed Benefit

First, this evidence fails the Rule 33 test because it is impeachment evidence which does not negate an essential element of the Government's case.

Second, this evidence, taken as true, satisfies the *Brady* test, because the existence of an undisclosed agreement is material under *Brady*. *Giglio v. United States,* 405 U.S. 150, 154–55 (1972). However, Defendants have offered no evidence beyond their speculation that any such agreement exists; therefore, Defendants are not entitled to relief as to this claim.

Third, this evidence fails the *Napue* test, because there is no allegation that this evidence resulted in false evidence or perjured testimony being introduced at trial.

C. Trial Exhibits 51 and 52

First, the allegations regarding trial exhibits 51 and 52 being forged do not satisfy the Rule 33 test, because there is no allegation that this evidence is newly discovered.

Second, this evidence does not satisfy the *Brady* test, because there is no allegation that this evidence was suppressed.

Third, this evidence does not satisfy the *Napue* test. This evidence was introduced for the purpose of supporting the proposition that Rusch sent an email containing financial statements to Quiel. For this purpose, the evidence was not false, and thus fails to satisfy the falsity prong of the *Napue* test.

Accordingly,

IT IS ORDERED that Defendants Joint Motion for New Trial or to Dismiss and Request for an Evidentiary Hearing, (Doc. 454), is denied.

All Citations

Not Reported in Fed. Supp., 2015 WL 4275183

Footnotes

[1] The Court notes that neither party cited the *Napue* test with regard to trial exhibits 51 and 52. While *Brady* and *Napue* violations can overlap, *see Giglio v. United States,* 405 U.S. 150 (1972) (finding both violations where the prosecution did not disclose an informant-witness's plea deal and did not correct the witness who committed perjury by denying the existence of a plea deal while testifying), the essence of Defendants' allegation is that this evidence was false; not that it was suppressed. Therefore, this evidence is properly considered under *Napue*; not *Brady*.

[2] Specifically, the Government does not expressly deny that the reason it has not monitored Rusch's post-trial activity is because of an undisclosed agreement to not monitor him and grant him leniency in his future dealings. For purposes of this order, the Court has interpreted the Government's statements as a denial of having any undisclosed agreement regarding future activities with Rusch. If the Government actually has any such agreement, and has artfully worded its representations to not directly address Defendants' allegations, the Government is ordered to correct the Court's interpretation immediately and the Court would deem any failure to correct the Court's understanding to be a fraud on the Court and a *Giglio* violation.

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2017 WL 4773358
United States District Court,
N.D. California.

John C. HOM, John C. Hom
& Associates, Inc., Plaintiffs,
v.
UNITED STATES of America, Defendant.

No. C 17-02525 WHA
|
Signed 09/22/2017

Attorneys and Law Firms

John C. Hom, San Rafael, CA, pro se.

Laura C. Beckerman, Robert Silverblatt, US Department of Justice, Washington, DC, for Defendant.

ORDER GRANTING MOTION TO DISMISS

William Alsup, United States District Judge

INTRODUCTION

***1** In this "re-filed" pro se action against the United States for unauthorized disclosures of plaintiffs' tax information, the United States moves to dismiss. The United State's motion to dismiss is **GRANTED**.

STATEMENT

Pro se plaintiffs John Hom and John C. Hom & Associates, Inc. "re-filed" this action for unauthorized disclosure of tax information in May 2017. The complaint in this action is a facsimile of a complaint plaintiffs filed in May 2013 (No. 13–cv–02243 WHA), which was dismissed in its entirety for failure to state a claim (*id.* Dkt. No. 19). Plaintiffs appealed that dismissal, and on appeal this Court's decision was affirmed (*id.* Dkt. No. 27).

Plaintiffs now re-file their complaint claiming that a change in law and the discovery of additional facts warrant re-examination of their claims. Defendant, the United States of America, moves to dismiss on the grounds that *res judicata* bars plaintiffs claims. For the reasons herein, the United State's motion is **GRANTED**.

ANALYSIS

1. *RES JUDICATA*.

Res judicata, also known as claim preclusion, bars litigation in a subsequent action of any claims that were raised or could have been raised in the prior action. *Owens v. Kaiser Found. Health Plan, Inc.*, 244 F.3d 708, 713 (9th Cir. 2001). *Res judicata* applies when there is: "(1) an identity of claims; (2) a final judgment on the merits; and (3) identity or privity between parties." *Stewart v. U.S. Bancorp*, 297 F.3d 953, 956 (9th Cir. 2002).

Here, all the requirements of *res judicata* are met. Plaintiffs are the same parties that filed the 2013 action against the same defendant, the United States. That action contained identical claims (No. 13–cv–02243 WHA, Dkt. No. 1). The action was dismissed in its entirety (*id.* Dkt. No. 19), and final judgment was entered for the United States (*id.* Dkt. No. 20). Plaintiffs then appealed, and our court of appeals affirmed the dismissal (*id.* Dkt. No. 27). Therefore, barring an exception, plaintiffs are bound by the earlier determination, and their claims must be dismissed.

Plaintiffs argue that *res judicata* does not apply here due to (1) a change in the law and (2) discovery of previously unavailable material facts (Opp. at 1). "[I]t is the general rule that *res judicata* is no defense where between the time of the first judgment and the second there has been an intervening decision or a change in the law creating an altered situation." *State Farm Mut. Auto. Ins. Co. v. Duel*, 324 U.S. 154, 162 (1945); *see also Clifton v. Attorney Gen. of State of Cal.*, 997 F.2d 660, 663 (9th Cir. 1993). No such rule applies to the discovery of new facts, however, and typically "An action that merely alleges new facts in support of a claim that has gone to judgment in a previous litigation will be subject to claim preclusion." *Gospel Missions of America v. City of Los Angeles*, 328 F.3d 548, 558 (9th Cir. 2003).

Here, there have been no relevant changes in the law. Plaintiffs argue that two decisions, *Taylor v. United States*, No. 14-12446 (11th Cir. 2013), and *United States v. Hom*, No. 14-16214 (9th Cir. 2016), have changed the law in such a way that plaintiffs' claims for unauthorized disclosure are now viable. As an initial matter, plaintiffs already presented *Taylor* to our court of appeals in a supplemental authority letter (No. 13-17195, Dkt. No. 24), and our court of appeals, with full notice of *Taylor*, affirmed the dismissal of plaintiffs' action. Plaintiffs now seek to overturn our court of appeals' affirmance by relying upon this same unpublished out-of-circuit 2013 decision. But *Taylor* does not lend support to plaintiffs' argument. There, the Eleventh Circuit held that an IRS agent's compliance with the Internal Revenue Manual is relevant to determination of whether he can invoke a good-faith defense in a wrongful disclosure action. *Taylor*, No. 14-12446 at 8. The good-faith exception, however, was not at issue in this action. Instead, the order dismissing plaintiffs' claims found that, under Section 6103 of Title 26 of the United States Code, the disclosures were lawful (*see* No. 13–cv–02243, Dkt. No. 19).

***2** Nor does our court of appeals' decision in plaintiff Hom's Foreign Bank Account Report ("FBAR") action, *United States v. Hom*, No. 14-16214 No. 14-16214, signal a change in the law. That action dealt with Hom's alleged failure to file his FBAR tax forms, which is irrelevant to this action, in which plaintiffs are alleging the IRS improperly disclosed their tax information.

Finally, even if plaintiffs could overcome a prior final determination by presenting new facts, they have failed to present any facts that have legal bearing on this action, or any potential to change the outcome here. Indeed, the primary "fact" that plaintiffs rely upon is the *Aloe Vera* decision, which the order dismissing plaintiffs' 2013 action addressed and distinguished (No. 13–cv–02243 WHA, Dkt. No. 19 at 3–4), and which our court of appeals likewise considered in affirming that order (*see* No. 13-17195, Dkt. No. 9). The March 2017 unpublished decision in *Aloe Vera*, No. 15-15672 Dkt. No. 11-1, which plaintiffs cite also lends no support. It is a narrow holding concerning a damages issue that has nothing to do with this action.

Plaintiffs are barred from re-litigating this action by the doctrine of *res judicata.* Their arguments have already been considered and rejected. Plaintiffs offer no grounds for granting them a second bite at the apple. Accordingly, their action is **DISMISSED**.

CONCLUSION

For the foregoing reasons, Plaintiffs' claims are barred by *res judicata.* Accordingly, the United State's motion to dismiss is **GRANTED**. Plaintiffs' action is **DISMISSED**. The Clerk **SHALL CLOSE THE FILE**.

IT IS SO ORDERED.

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United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
Stephen M. KERR, Michael Quiel, Defendants.

No. CR-11-02385-PHX-JAT
|
Signed 07/22/2016

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ORDER

James A. Teilborg, Senior United States District Judge

***1** On July 14, 2015, this Court issued an Order denying Defendant Kerr's and Defendant Quiel's (Defendants) motion for new trial. Defendants appealed that Order. Defendants now ask this Court to accept remand from the Court of Appeals to consider what Defendants claim is even more evidence in support of the previous motion for new trial (which itself was supplemented). The Court's prior Order stated as follows: [1]

> Pending before the Court is Defendants' Joint Motion for New Trial or to Dismiss. (Doc. 454).
>
> **I. Background**
>
> On December 8, 2011, a grand jury indicted Michael Quiel ("Quiel") and Stephen Kerr ("Kerr") on a variety of crimes concerning failure to pay taxes on funds held in Swiss corporations. (Doc. 3). Each Defendant was charged with one count of Conspiracy to Defraud the United States, two counts of Willful Subscription to False Individual Income Tax Returns, and two counts of Willful Failure to File Reports of Foreign Bank and Financial Accounts ("FBAR"). (*Id.*).

Defendants were not alone in the indictment. Christopher Rusch ("Rusch"), Defendants' former attorney, was charged with one count of Conspiracy to Defraud the United States. (*Id.*). An additional charge of failure to file an FBAR was later added. (Doc. 331 at 1607). Rusch entered into a plea agreement, which compelled him to testify at the request of the United States. (Doc. 415).

A month-long jury trial began in early March. (Doc. 221); (Doc. 281). At trial, Rusch testified against Defendants. (Doc. 331). On direct examination, he admitted to engaging in illegal activity by improperly structuring the Swiss businesses controlled by Quiel and Kerr. (*Id.* at 1675). On cross-examination, Defendants introduced evidence to impeach Rusch. (Doc. 454 at 5); (Doc. 457 at 2).

Both Defendants were acquitted of Count One (Conspiracy to Defraud the United States). Kerr was found guilty of Counts Two & Three (Willful Subscription to False Individual Income Tax Returns for 2007 and 2008) and Counts Six & Seven (Willful Failure to File FBARs for 2007 and 2008). (Doc. 281). Quiel was found guilty of Counts Four & Five (Willful Subscription to False Individual Income Tax Returns for 2007 and 2008). (*Id.*). In addition, the jury hung as to Counts Eight & Nine (Willful Failure to File FBARs for 2007 and 2008). (*Id.*).

Following the verdict, Defendants were each sentenced to ten months in prison. (Doc. 373); (Doc. 376). Subsequently, Defendants moved for acquittal or alternatively a new trial. (Doc. 299); (Doc. 300). These motions were denied. (Doc. 345); (Doc. 346).

On appeal, the Ninth Circuit Court of Appeals affirmed the convictions. *United States v. Quiel*, 595 Fed.Appx. 692 (9th Cir. 2014), *cert. denied*, No. 14—1237, 2015 WL 1692989 (May 18, 2015). Now, Defendants request a new trial or alternatively an evidentiary hearing, in light of allegedly newly discovered evidence. (Doc. 454). Defendants have three different pieces of allegedly newly discovered evidence.

A. Rusch's Alleged Fraud

***2** First, Defendants claim that evidence has emerged showing that Rusch engaged in fraudulent activities, before and during the trial, under the alias Christian Reeves. (*Id.* at 1—9). Defendants contend that examples of this fraud include Rusch: blogging as Reeves in early 2013, (*Id.* at 4); posting on ex-pat investing sites as Reeves starting in 2012, (*Id.* at 6); giving tax advice as Reeves, (*Id.*); podcasting as Reeves, (*Id.*); marketing himself as a rehabilitated lawyer, (*Id.*); and publishing an offshore tax guide after pleading guilty, but before trial, (*Id.*). Furthermore, Defendants allege that Rusch has admitted to being Reeves. (Doc. 459 at 3).

Defendants argue that they could have used the evidence of Rusch's ongoing fraud to impeach his testimony at trial. (Doc. 454 at 13). Defendants further claim that if the Government was aware of Rusch's illegal activity, but did not disclose this information to Defendants, then a *Brady* violation has occurred, justifying a new trial. (*Id.* at 12—14).

Defendants further argue that even if the Government was not aware of this information, the newly discovered evidence, of its own force, justifies a new trial. (*Id.* at 14).

B. Rusch's Alleged Undisclosed Benefit

Second, Defendants allege that the Government has agreed "to look the other way while its witness commits additional crimes." (*Id.* at 10). Defendants claim that the Government has given Rusch a "fresh start" by allowing him to continue his allegedly fraudulent activity. (Doc. 458 at 7). Defendants argue that this "fresh start" is the product of an undisclosed agreement between Rusch and the Government. (*Id.* at 7) ("*Brady* and due process require that the Government turn over information about the full benefits and promises that the witness received for his co-operation, to include non-enforcement of civil penalties.") (citing *United States v. Shaffer*, 789 F.2d 682 (9th Cir. 1986)).

C. Trial Exhibits 51 and 52

Third, Defendants allege that Pierre Gabris, a Swiss-national and alleged participant in the structuring of the Swiss accounts, would testify that "he did not prepare or send trial exhibits 51 and 52," which were offered into evidence on Rusch's re-direct. (*Id.* at 15). These exhibits contain emails originally sent from Gabris to Rusch, who forwarded them to Defendants, regarding accounting statements from Defendants' Swiss corporations. (Doc. 335 at 2533). Defendants argue that these allegedly forged documents provide further support for a new trial. (Doc. 454 at 15—16).

II. Applicable Legal Standards

Defendants claim that their newly discovered evidence satisfies the Rule 33 new trial test. (*Id.* at 14). This test requires Defendants to show: (1) that the evidence is newly discovered; (2) that Defendants' failure to discover the evidence sooner was not the result of a lack of diligence; (3) that the evidence is material; (4) that the evidence is neither cumulative nor merely impeaching; and (5) that a new trial would likely result in acquittal. *United States v. Kulczyk*, 931 F.2d 542, 548 (9th Cir. 1991).

In addition, Defendants argue that they are due a new trial under *Brady v. Maryland*. (Doc. 454 at 12—14); *Brady v. Maryland*, 373 U.S. 83, 87 (1963). To prove a *Brady* violation, Defendants must show that: (1) the evidence is newly discovered; (2) the evidence was suppressed by the prosecution; and (3) the evidence was material. *United States v. Williams*, 547 F.3d 1187, 1202 (9th Cir. 2008).

Finally, Defendants allege that trial exhibits 51 and 52 are forgeries. (Doc. 454 at 15). While Defendants assert that these forgeries entitle them to a new trial under *Brady*, this evidence is properly considered under *Napue v. Illinois*, because the evidence was not suppressed.[2] [footnote numbered 1 in the original order] *Napue v. Illinois*, 360 U.S. 264 (1959). To establish a *Napue* violation, Defendants must prove that: (1) there was false evidence; (2) the prosecution knew, or should have known that the evidence was false; and (3) the evidence was material. *Towery v. Schriro*, 641 F.3d 300, 308 (9th Cir. 2010) (citing *United States v. Zuno—Arce*, 339 F.3d 886, 889 (9th Cir. 2003)).

***3** Because both *Brady* and *Napue* violations are implicated by Defendants' allegations, the Court will use a two-step test described in further detail below, *see supra* Part II.D, to determine materiality.

Finally, to determine whether Defendants are entitled to an evidentiary hearing, the Court will presume that their allegations are true.

A. Rule 33 New Trial Test

Under Rule 33, a defendant may "move for a new trial on newly discovered evidence" within three years of the verdict. Fed. R. Crim. P. 33. The Court may "grant a new trial if the interest of justice so requires." *Id.* These motions "are not favored by the courts and should be viewed with great caution." *United States v. Marcello*, 568 F. Supp. 738, 740 (C.D. Cal. 1983), *aff'd* 731 F.2d 1354 (9th Cir. 1984) (citing 3 Charles Alan Wright, *Federal Practice and Procedure: Criminal* § 557 (2d ed. 1982)). To obtain a new trial, Defendants must satisfy each prong of a five-part test:

(1) the evidence must be newly discovered;

(2) the failure to discover the evidence sooner must not be the result of a lack of diligence on...[Defendants'] part;

(3) the evidence must be material to the issues at trial;

(4) the evidence must be neither cumulative nor merely impeaching; and

(5) the evidence must indicate that a new trial would probably result in acquittal.

United States v. Kulczyk, 931 F.2d 542, 548 (9th Cir. 1991).

The materiality and probability prongs are essentially the same. *United States v. Krasny*, 607 F.2d 840, 845 n.3 (9th Cir. 1979). Accordingly, they will be treated concurrently.

1. Newly Discovered

Rule 33requires that evidence be newly discovered. *Kulczyk*, 931 F.2d at 548. Evidence is not newly discovered if it "was known to, or was in the possession of, the defense" before the trial concluded. *United States v. Hinkson*, 585 F.3d 1247, 1284 (9th Cir. 2009) (*en banc*) (Fletcher, J., dissenting).

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

Defendants allege that they discovered Rusch's fraudulent activities performed under the Reeves alias after trial. (Doc. 454 at 4). Because Defendants allegedly learned of this information after trial, the newly discovered test is satisfied.

b. Trial Exhibits 51 and 52

Notwithstanding the Reeves allegation, Defendants do not allege when they learned that Gabris did not send the emails constituting trial exhibits 51 and 52. (*Id.* at 15). The heading above Defendants' claim reads: "The Discovery of Allegedly Forged Documents Further Provides the Basis for a New Trial." (*Id.*). This does not indicate when the discovery occurred. Additionally, the evidence allegedly arose from "conversations between Mr. Quiel's attorney, Mr. Gabris' attorney, and conversations between Mr. Gabris and Mr. Quiel outside the presence of Counsel"; there is no mention of when these conversations took place. (*Id.*). Furthermore, the Government noted the temporal-vacancy of the allegation, (Doc. 457 at 8), but Defendants failed to address this concern in their Reply, (Doc. 458).

Consequently, without a description of when this discovery was made, the Court cannot find a concrete allegation that the evidence is newly discovered. Therefore, because Defendants fail to meet their burden, the alleged evidence regarding trial exhibits 51 and 52 cannot be considered newly discovered.

2. Diligence

***4** "Due diligence means ordinary, rather than extraordinary, diligence." *United States v. Walker*, 546 F. Supp. 805, 811 (D. Haw. 1982). The trial judge "has a large discretion in...determining what diligence is necessary." *Prlia v. United States*, 279 F.2d 407, 408 (9th Cir. 1960). In *United States v. Harrington*, the court found that the movant was not diligent in obtaining photographs of the crime scene and a map of the surrounding streets because this information "could have been obtained at any time." *United States v. Harrington*, 410 F.3d 598, 600 (9th Cir. 2005).

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

While it is possible that the evidence of Rusch's alleged out-of-court activities could have been "discovered at any time" in the literal sense, this situation is distinguishable from *Harrington*, as the evidence in that case concerned the actual crime of which the defendant was convicted: selling LSD in that area. *Id.* In the present case, the proposed evidence concerns Rusch's conduct which was not associated with the activity of which Defendants were convicted. Therefore, an ordinarily-diligent defendant would not be expected to discover this evidence. Accordingly, Defendants' failure to discover this evidence in time for trial does not violate the diligence standard.

3. Cumulative/Impeachment Evidence

Generally, impeachment evidence does not justify a new trial. *United States v. Davis*, 960 F.2d 820, 825 (9th Cir. 1992). Nevertheless, a new trial is warranted where "impeachment evidence [is]...so powerful that, if it were to be believed by the trier of fact, it could render the witness' testimony totally incredible." *Id.* In these situations, the new evidence nullifies "an essential element of the government's case." *Id.*

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

While Defendants do describe Rusch's allegedly impeaching activity, they do not show how this evidence would negate an essential element of the Government's case. (Doc. 454). Therefore, because Defendants have not met their burden, their allegations do not warrant a new trial under Rule 33.

4. Probability of Acquittal and Materiality

Because Defendants claims do not satisfy the prior elements of this test, materiality and probability of acquittal will not be considered at this juncture.

B. *Napue* Test

Under *Napue*, "[t]he knowing use of false evidence by the state, or the failure to correct false evidence, may violate due process." *Towery v. Schriro*, 641 F.3d 300, 308 (9th Cir. 2010) (citing *Napue v. Illinois*, 360 U.S. 264, 269 (1959)). To demonstrate a *Napue* violation, the movant must show that: "(1) the testimony (or evidence) was actually false, (2) the prosecution knew or should have known that the testimony was actually false, and (3)...the false testimony was material." *Id.* (quoting *United States v. Zuno—Arce*, 339 F.3d 886, 889 (9th Cir. 2003)).

1. Falsity

a. Rusch's Alleged Fraud and Rusch's Alleged Undisclosed Benefit

Defendants do not allege that Rusch's illegal activity or the undisclosed leniency agreement caused false evidence or perjury to be introduced at trial. (Doc. 454). Therefore, these claims do not satisfy *Napue*.

b. Trial Exhibits 51 and 52

In contrast, Defendants do allege that trial exhibits 51 and 52 were falsified. (Doc. 454 at 15). Defendants claim that Gabris will testify that he did not send the emails to Rusch that constitute trial exhibits 51 and 52. (*Id.*). However, even if true, this does not establish that the evidence itself was false.

***5** Allegedly, trial exhibits 51 and 52 were used to " 'prove' distributions that were never made." (Doc. 454 at 15). Defendants claim that this evidence "supported the 'nominee theory' " of structuring, whereby an American impermissibly controls a foreign company through a nominee without paying taxes on funds held in that company. Defendants allege that had the jury known that the exhibits were falsified, they may have "acquitted Quiel on the tax charges." (*Id.* 16—17). Exhibit 51 is an email from Gabris to Rusch containing an accounting statement for the Swiss business accounts owned by Quiel. (Doc. 335 at 2534). This email was subsequently forwarded to Quiel. (*Id.*). Exhibit 52 was not mentioned after it was introduced into evidence. (*See id.*).

When the exhibits were introduced, defense counsel objected, arguing that "[t]hey're beyond the scope. And they're the hearsay statements of Mr. Pierre Gabris, who [defense counsel] will not have an opportunity to cross-examine." (Doc. 335 at 2534). In response, the prosecutor argued that during cross-examination Rusch was questioned "about providing information to the defendants. The implication was [that] he did not actually provide anything to defendants. These are being offered to rebut that. And they're not being offered for the truth of anything in the document, but just to their existence." (*Id.*). After hearing the explanation, the Court overruled the objection, and the evidence was admitted. (*Id.*).

Defendants do not contend that they were never forwarded the emails by Rusch. (*See* Doc. 454). Therefore, the evidence, which was used to establish that Rusch sent Quiel financial information regarding Quiel's Swiss accounts, is not changed by the fact that

Gabris allegedly did not send the original emails to Rusch.

For evidence to be false under *Napue*, the falsity must be material to the purpose for which the evidence was used. *Cf. United States v. Vozzella*, 124 F.3d 389, 392 (2d Cir. 1997) (emphasis added) (finding falsity where "records were known to be partially false and were presented to the jury in a fashion so highly misleading *as to amount to falsity regarding their veracity as a whole.*"). Where evidence is partially false, but the false portion of the evidence has no bearing on the purpose for which the evidence is used, there is no risk that "a state has contrived a conviction through the pretense of a trial which in truth is but used as a means of depriving a defendant of liberty through a deliberate deception of court and jury." *Mooney v. Holohan*, 294 U.S. 103, 112 (1935). Consequently, insofar as trial exhibit 51 was used to support Rusch's testimony that he sent an email containing Swiss accounting statements to Quiel, the evidence was not false.

2. Knowledge and Materiality

Because Defendants fail to show that any of the allegedly newly discovered evidence was falsified, they fail to satisfy the *Napue* test. Therefore knowledge and materiality do not need to be considered.

C. *Brady* Test

Under *Brady*, "the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution." *Brady v. Maryland*, 373 U.S. 83, 87 (1963). For a *Brady* violation to occur, three elements must be present: "(1) the evidence at issue must be favorable to the accused, either because it is exculpatory, or because it is impeaching; (2) that evidence must have been suppressed by the State, either willfully or inadvertently; and (3) prejudice must have ensued." *United States v. Williams*, 547 F.3d 1187, 1202 (9th Cir. 2008) (internal quotation marks omitted) (quoting *Strickler v. Greene*, 527 U.S. 263, 281—82 (1999)). The Defendants have the burden of establishing the presence of these elements. *United States v. Lopez*, 577 F.3d 1053, 1059 (9th Cir. 2009).

1. Favorable Evidence

***6** Under *Brady*, newly discovered evidence that is favorable to the defense must be admissible, or must be able to impeach the Government's witness. *United States v. Kohring*, 637 F.3d 895, 903 (9th Cir. 2010).

a. Rusch's Alleged Fraud

Defendants wish to introduce evidence allegedly showing that Rusch engaged in fraudulent activities before and during trial. (Doc. 454). This evidence is both admissible and useful for impeachment. Fed. R. Evid. 608 (allowing in extrinsic evidence on cross-examination if it is "probative of the character for truthfulness or untruthfulness of" the witness). Therefore, because the evidence is admissible as impeachment material, it is favorable under *Brady*.

b. Rusch's Alleged Undisclosed Benefit

Defendants further allege that the Government has made an undisclosed agreement for leniency with Rusch. (Doc. 458 at 7). Such evidence would be admissible at trial and would be useful for impeaching Rusch, therefore it is favorable under *Brady*.

c. Trial Exhibits 51 and 52

Finally, Defendants claim that trial exhibits 51 and 52 were forged, and thus constitute false evidence. (Doc. 454 at 15). Such evidence is favorable because either Gabris's testimony that he did not send the emails would be admissible or the emails themselves might be inadmissible.

2. Suppression

The Government must disclose any exculpatory evidence within its possession, regardless of whether Defendants requested such evidence. *Kyles v. Whitley*, 514 U.S. 419, 433 (1995) (citing *United States v. Bagley*, 473 U.S. 667, 682 (1985)). This duty applies even if those "acting on the government's behalf" have exculpatory evidence without the prosecutor's knowledge. *Id.* at 437. A prosecutor's failure to disclose an agreement with a coconspirator in exchange for their testimony at trial constitutes suppression under *Brady*. *Giglio v. United States*, 405 U.S. 150, 154—55 (1972).

a. Rusch's Alleged Fraud

Defendants assert that the Government may have known of Rusch's illegal activity, and that this information was not disclosed to Defendants. (Doc. 454 at 9—10). They claim that without an evidentiary hearing the Court cannot know whether the Government possessed, but did not disclose, this evidence. (*Id.*). If Defendants allegations are true, the suppression element of *Brady* is satisfied.

b. Rusch's Alleged Undisclosed Benefit

Furthermore, Defendants allege that the Government made an undisclosed agreement with Rusch to treat him with leniency after trial. (Doc. 458 at 7). Failure to disclose agreements of leniency satisfy the suppression prong of *Brady*. Therefore, if true, this allegation establishes suppression.

c. Trial Exhibits 51 and 52

Finally, Defendants allege that the Government may have known that trial exhibits 51 and 52 were forged, and that by not disclosing this information, the Government violated *Brady*. (Doc. 454 at 15—16). Defendants are not alleging that the Government suppressed the exhibits, by that the evidence was forged. Therefore, this evidence does not satisfy the suppression prong of *Brady*.

3. Materiality

Evidence is material "only if there is a reasonable probability that, had the evidence been disclosed to the defense, the result of the proceeding would have been different." *Bagley*, 463 U.S. at 682. The reasonable probability standard does not require the defendant to prove by a preponderance of the evidence that "disclosure of the suppressed evidence would have resulted...in acquittal," but merely that suppression "undermines confidence in the outcome of the trial." *Kyles*, 514 U.S. at 434. The Court "may find a 'reasonable probability' even where the remaining evidence would have been sufficient to convict the defendant." *Jackson v. Brown*, 513 F.3d 1057, 1071 (9th Cir. 2008) (citing *Strickler v. Greene*, 527 U.S. 263, 290 (1999)).

***7** Newly discovered impeachment evidence is merely cumulative, and does not violate *Brady*, where a witness's credibility was eroded by "significant impeachment evidence" at trial. *Morris v. Ylst*, 447 F.3d 735, 741 (9th Cir. 2006); *accord United States v. Endicott*, 869 F.2d 452, 456 (9th Cir. 1989) (holding that newly discovered impeachment evidence "does not warrant a new trial when the evidence would not have affected the jury's assessment of the witness' credibility and when the witness was subjected to vigorous cross-examination.") (citing *United States v. Steel*, 759 F.2d 706, 714 (9th Cir. 1985)). However, "impeachment evidence...[is] not 'merely cumulative' where the withheld evidence was of a different character than evidence already known to the defense." *United States v. Kohring*, 637 F.3d 895, 904 (9th Cir. 2010) (quoting *Banks v. Dretke*, 540 U.S. 668, 702—03 (2004)).

*Brady*claims are considered "collectively, but...[the Court] 'must first evaluate the tendency and force of each item of suppressed evidence and then evaluate its cumulative effect at the end of the discussion.' " *Id.* at 903 (quoting *Barker v. Fleming*, 423 F.3d 1085, 1094 (9th Cir. 2005)).

a. Rusch's Alleged Fraud

First, Defendants claim that Rusch engaged in fraudulent activities before and during the trial without Defendants' knowledge. (Doc. 454 at 6—9). Allegedly, this evidence could have been used to impeach Rusch. (*Id.*) The Government argues that Rusch was already subjected to significant impeachment evidence at trial, including Defendants: "pointing out inconsistencies in [Rusch's] prior statements," emphasizing Rusch's "motives as a cooperator," extracting "concessions concerning his violations of the ethical rules and rules of professional conduct," using "surreptitious recordings," and calling "a legal ethics expert." (Doc. 457 at 5). As such, the Government claims, further impeachment evidence would be merely cumulative. (*Id.*).

There is no proposed evidence indicating that any of Rusch's activities as Reeves before or during trial were criminal in nature. While Defendants argue that Rusch has committed a felony by practicing law as a disbarred attorney, and has committed fraud by holding himself out as a rehabilitated attorney, (Doc. 454 at 11), neither of these activities occurred before or during the trial. In fact, as Defendants note, Rusch was not prohibited from practicing law until June 21, 2013, (*Id.* at 6), while the verdict in this case was rendered on April 11, 2013, (Doc. 288); (Doc. 289). There is no indication that Rusch was doing anything more under the Reeve's pseudonym than what he was doing prior to his involvement with Defendants: providing tax advice for U.S. citizens seeking to do business and bank overseas. Done properly, this activity is not illegal.

Additionally, there is nothing inherently fraudulent with using a pseudonym. Therefore, it is not clear in what manner Defendants wish to use Rusch's activities before and during the trial as impeachment evidence. To the extent that they wish to reinforce his engagement with offshore tax schemes, such evidence would be merely cumulative, as he readily admitted to this sort of activity on direct. (Doc. 331 at 1613).

To the extent that Defendants allege that Rusch's engaged in post-trial illegal activity, such evidence is irrelevant for *Brady* purposes, because the Government did not possess, at or before trial, evidence it could suppress.

b. Rusch's Alleged Undisclosed Benefit

Second, Defendants allege that the Government has allowed Rusch to engage in illegal activity without consequence as the result of an undisclosed agreement that prompted Rusch's trial testimony. (Doc. 458 at 7). The Government argues that "at no time was the United States aware of Rusch's post-trial conduct except with regard to the information provided by the U.S. Probation Department." (Doc. 460 at 2). Given that the Government did not directly deny the existence of an agreement, it is possible that there was an agreement for leniency, even without the Government's present awareness of Rusch's post-trial activities. Therefore, taking this allegation as true, a material violation under *Brady* has occurred. *Brady*. *Giglio v. United States*, 405 U.S. 150, 155 (1972) (finding that an undisclosed agreement for leniency with an important witness violated *Brady*). However, as will be discussed below, Defendants offer no evidence that such an agreement actually exists.

D. *Brady/Napue* Two-Step Materiality

***8** While *Brady* and *Napue* both have their own tests, they each require materiality. If *Brady* and *Napue* violations are both alleged, their materiality should be considered collectively. *Jackson v. Brown*, 513 F.3d 1057, 1076 (9th Cir. 2008). However, because *Napue*'s materiality test is easier to meet, *Napue* violations must be considered first, as not to "overweight" the *Brady* violations. *Id.* This process is performed in two steps.

First, the Court weighs the *Napue* violations and asks whether there is "any reasonable likelihood that the false testimony *could* have affected the judgment of the jury." *Id.* If the answer is yes, then reversal of judgment is the proper remedy. *Id.* If not, then the *Napue* and *Brady* violations are considered collectively. *Id.* Under this second test, the Court asks whether "there is a reasonable probability that, but for [the prosecutor's] unprofessional errors, the result of the proceeding *would* have been different." *Id.* If the answer to this question is yes, the remedy is generally a new trial. *Id.*

While both the allegedly forged trial exhibits and the allegations regarding Rusch engaging in fraud do not satisfy the *Napue* and *Brady* tests, the allegation regarding an undisclosed agreement satisfies *Brady*. No weight can be given to the allegations that do not satisfy either test. Therefore, the only question in this consideration is whether there is a reasonable probability that, but for the undisclosed agreement, the outcome of the trial would have been different. Because the Supreme Court has determined that the nondisclosure of an agreement for leniency with an important witness satisfies this test, *Giglio v. United States*, 405 U.S. 150 (1972), materiality under the dual *Brady/Giglio* test would be satisfied if Defendants' allegations are true. Again, however, Defendants offer no evidence that such an agreement actually exists.

III. Evidentiary Hearing

Generally, motions for a new trial are "decided solely upon affidavits." *United States v. Colacurcio*, 499 F.2d 1401, 1406 n.7 (9th Cir. 1974). However, "[t]he decision on whether to hold a hearing or to proceed by affidavit is within the sound discretion of the trial court." *United States v. Nace*, 561 F.2d 763, 772 (9th Cir. 1977). An evidentiary hearing should only be granted if the facts alleged, taken as true, would constitute grounds for a new trial. *See United States v. Scott*, 521 F.2d 1188, 1196 (9th Cir. 1975) (finding that the trial judge did not abuse his discretion in denying an evidentiary hearing where "there was nothing to be gained by such a hearing."). "Evidentiary hearings...are not meant to be 'fishing expeditions for...[Defendants] to explore their case in search of its existence.' " *Morgan v. Gonzales*, 495 F.3d 1084, 1091 (9th Cir. 2007) (quoting *Rich v. Calderon*, 187 F.3d 1064, 1067 (9th Cir. 1999)).

Defendants provide no affidavit to bolster their allegation that the Government has made an undisclosed agreement with Rusch. (Doc. 454). On the other hand, the Government does not explicitly deny Defendants' allegations, but rather sidesteps the issue by stating that they have not monitored Rusch's post-trial conduct. (Doc. 460 at 1—2). The Government's statements do not preclude the existence of an undisclosed agreement. [3] [footnote numbered 2 in the original order] However, ultimately, absent an affidavit, Defendants do nothing more than speculate.

***9** Defendants' failure to include an affidavit does not give the Court the choice between holding an evidentiary hearing or making a decision based upon affidavits; it leaves only one option. Allowing an evidentiary hearing in this case would encourage Defendants in the future, uncertain of their case for newly discovered evidence, to fail to include affidavits in an attempt to force the Court to allow an evidentiary hearing. The Court does not wish to create such an incentive. Therefore, Defendants' motion for an evidentiary hearing is denied, because on this record it would be nothing more than a fishing expedition.

Thus, although Defendants' claim that Rusch has an ongoing, undisclosed leniency agreement with the Government would entitle Defendants to relief, because Defendants offer no affidavit or other evidence showing that such an agreement exists, and the Government has effectively denied the existence of an agreement, the Court will not hold an evidentiary hearing or grant a new trial. Indeed, Defendants do not even suggest what witnesses they would call or what evidence they would produce at an evidentiary hearing that would substantiate the allegation that Rusch has an agreement with the Government beyond the plea agreement already disclosed. Thus, the Court will not allow a fishing expedition on this topic.

IV. Conclusion

A. Rusch's Alleged Fraud

First, this evidence does not satisfy the Rule 33 test, because it is impeachment evidence that does not negate an essential element of the Government's case.

Second, this Court already determined this evidence was immaterial under *Brady*, because there is no alleged evidence regarding Rusch's conduct, both before and during trial, that would constitute more than merely cumulative impeachment material.

Third, this evidence was determined to not satisfy the *Napue* test, because there is no allegation that this evidence resulted in false evidence or perjured testimony being introduced at trial.

B. Rusch's Alleged Undisclosed Benefit

First, this evidence fails the Rule 33 test because it is impeachment evidence which does not negate an essential element of the Government's case.

Second, this evidence, taken as true, satisfies the *Brady* test, because the existence of an undisclosed agreement is material under *Brady*. *Giglio v. United States*, 405 U.S. 150, 154—55 (1972). However, Defendants have offered no evidence beyond their speculation that any such agreement exists; therefore, Defendants are not entitled to relief as to this claim.

Third, this evidence fails the *Napue* test, because there is no allegation that this evidence resulted in false evidence or perjured testimony being introduced at trial.

C. Trial Exhibits 51 and 52

First, the allegations regarding trial exhibits 51 and 52 being forged do not satisfy the Rule 33 test, because there is no allegation that this evidence is newly discovered.

Second, this evidence does not satisfy the *Brady* test, because there is no allegation that this evidence was suppressed.

Third, this evidence does not satisfy the *Napue* test. This evidence was introduced for the purpose of supporting the proposition that Rusch sent an email containing financial statements to Quiel. For this purpose, the evidence was not false, and thus fails to satisfy the falsity prong of the *Napue* test.

Accordingly,

IT IS ORDERED that Defendants Joint Motion for New Trial or to Dismiss and Request for an Evidentiary Hearing, (Doc. 454), is denied.

Doc. 463.

In their currently pending motion, Defendants seek remand for the Court to consider "new evidence and new argument." Doc. 471 at 9. Defendants recount the legal standard for receiving a new trial under Rule 33, *Napue*, and *Brady*. *Id.* at 10-12. However, Defendants fail to argue which (if any) of these tests their "new evidence" falls under. Nonetheless, the Court will consider the evidence under all 3 tests.

***10** Defendants' first piece of "new evidence" is the affidavit of Jerome Perucchi that was signed on June 4, 2015, as part of a civil lawsuit with Defendant Quiel. *Id.* at 12. As stated above, this Court issued its prior Order denying new trial on July 14, 2015; thus, the affidavit is not "newly discovered" for purposes of remand and could have been filed with the prior motion. Additionally, it fails to fall within the time limits of Rule 33.[4] As for *Napue* and *Brady*, it does not appear the government ever had access to Mr. Perucchi or his testimony; therefore Defendants have failed to show any knowledge on the part of the government. Accordingly, remand to consider this evidence is denied.[5]

Defendants' second piece of "new evidence" is further evidence that Defendant Rusch (acting under a pseudonym) is continuing to engage in the behavior that was the crime in Defendants' trial. *Id.* at 12-14. Even if Mr. Rusch is committing on-going, future criminal behavior, such behavior would not satisfy Rule 33, *Napue*, or *Brady* for purposes of Defendants being entitled to a new trial. Further, there is no evidence that the government has a secret immunity agreement with Mr. Rusch; and indeed the Government has now twice (Docs. 464 and 472) expressly denied the existence of any such agreement. Accordingly, remand to consider this evidence is denied.

Because the Court has addressed the only allegedly "new" evidence identified by Defendants and has denied remand to consider such evidence,

IT IS ORDERED that the Motion to Accept Remand to Consider New Evidence for a New Trial (Doc. 471) is denied.

Dated this 22nd day of July, 2016.

All Citations

Not Reported in Fed. Supp., 2016 WL 3947102

Footnotes

[1] The Court acknowledges that block quoting a 17-page Order is generally unnecessary. However, Defendants' currently pending request to accept remand retreads so much of the exact same ground, the totality of the prior order is relevant.

[2] The Court notes that neither party cited the *Napue* test with regard to trial exhibits 51 and 52. While *Brady* and *Napue* violations can overlap, *see Giglio v. United States*, 405 U.S. 150 (1972) (finding both violations where the prosecution did not disclose an informant-witness's plea deal and did not correct the witness who committed perjury by denying the existence of a plea deal while testifying), the essence of Defendants' allegation is that this evidence was false; not that it was suppressed. Therefore, this evidence is properly considered under *Napue*; not *Brady*.

[3] Specifically, the Government does not expressly deny that the reason it has not monitored Rusch's post-trial activity is because of an undisclosed agreement to not monitor him and grant him leniency in his future dealings. For purposes of this order, the Court has interpreted the Government's statements as a denial of having any undisclosed agreement regarding future activities with Rusch. If the Government actually has any such agreement, and has artfully worded its representations to not directly address Defendants' allegations, the Government is ordered to correct the Court's interpretation immediately and the Court would deem any failure to correct the Court's understanding to be a fraud on the Court and a *Giglio* violation.

[4] If the Court of Appeals remands this case at some point in the future, it is now more than three years since the April 11, 2013 verdict.

[5] Moreover, the Court has reviewed the affidavit (Doc. 471-2 at 2-5) and none of the allegations made by Defendants in their motion (specifically that Defendant Rusch forged Mr. Perucchi's signature) are in Mr. Perucchi's affidavit. Thus, Defendants have no admissible evidence in support of their allegations against Mr. Rusch.

End of Document

707 F.3d 1262
United States Court of Appeals,
Eleventh Circuit.

In re GRAND JURY PROCEEDINGS, NO. 4–10.

No. 12–13131.
|
Feb. 7, 2013.

Synopsis
Background: In grand jury proceedings, subpoena duces tecum was issued to target and his wife requiring them to produce records concerning their foreign financial accounts. After target and his wife refused to comply, asserting their Fifth Amendment privilege against self–incrimination, government moved to compel. The United States District Court for the Northern District of Georgia, No. 113E–1: GJ 4–10, Richard W. Story, J., granted motion. Target and his wife appealed.

Holdings: The Court of Appeals, Hull, Circuit Judge, held that:

[1] government's interest in subpoenaed records was “essentially regulatory”;

[2] target's and his wife's records were “customarily kept” in connection with regulation activity; and

[3] target's and his wife's records had “public aspects.”

Affirmed.

Attorneys and Law Firms

***1264** Frank Phillip Cihlar, Gregory Victor Davis, Alexander Patrick Robbins, U.S. Dept. of Justice, Tax Div., App. Sec., Washington, DC, Steven D. Grimberg, Lawrence R. Sommerfeld, Sally Yates, U.S. Attys., Atlanta, GA, for Plaintiff–Appellee.

Jerome J. Froelich, McKenney & Froelich, Atlanta, GA, for Defendants–Appellants.

Appeal from the United States District Court for the Northern District of Georgia.

Before HULL, WILSON and HILL, Circuit Judges.

Opinion

HULL, Circuit Judge:

This appeal concerns a grand jury investigation and the issuance of subpoenas *duces tecum* to a target (the “Target”) and his wife, which required the production of records concerning their foreign financial accounts. The Target and his wife refused to comply with the subpoenas by producing their records, asserting their Fifth Amendment privilege against self-incrimination. The government moved to compel, pointing out that the Supreme Court has recognized an exception (the “Required Records Exception”) to the self-incrimination privilege when certain records are kept pursuant to a valid regulatory scheme. *See Shapiro v. United States,* 335 U.S. 1, 32–33, 68 S.Ct. 1375, 1391–93, 92 L.Ed. 1787 (1948). The government contended that the foreign financial account records sought in this case fell within that Exception. The district court agreed, ruling that the Required Records Exception applied to the subpoenaed records, and therefore, the records were not subject to the Target and his wife's privilege against self-incrimination.

After review and oral argument, we join the three of our sister circuits that have ***1265** considered the same issue here about foreign financial account records and conclude that the subpoenaed records fall within the Required Records Exception. We thus affirm the district court's grant of the government's motion to compel.

I. BACKGROUND

The relevant facts are both brief and undisputed. The present appeal arises out of a grand jury investigation in the Northern District of Georgia, jointly conducted by the Internal Revenue Service (“IRS”), the U.S. Department of Justice Tax Division, and the U.S. Attorney's Office (collectively, the “government”). The government suspected that the Target, along with his wife, maintained foreign bank accounts both together and individually. For the years under investigation, the Target and his wife filed joint tax returns. Among other things, the government's investigation focused on the Target and his wife's failures to: (1) disclose on their tax returns their ownership of or income derived from their foreign accounts; and (2) file, with the U.S. Department of the Treasury, Forms TD F 90–22.1, Reports of Foreign Bank and Financial Accounts ("FBAR") for these alleged accounts. [1]

During the course of its investigation, on June 29, 2011, the grand jury, at the request of the U.S. Attorney, issued subpoenas *duces tecum* to both the Target and his wife. These subpoenas required the Target and his wife to produce any foreign financial account records that they were required to keep pursuant to the federal regulations governing offshore banking. Specifically, the subpoenas requested:

> [f]or the tax years 2006 to the present: any and all records required to be maintained pursuant to 31 C.F.R. § 103.32 relating to foreign financial accounts that you had/ have a financial interest in, or signature authority over, including records reflecting the name in which each such account is maintained, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during each specified year. [2]

The Target and his wife informed the government that they would not produce the subpoenaed records. Thereafter, on September 20, 2011, the government filed a motion seeking to compel their compliance with the subpoenas. In its motion, filed in the district court, the government argued that the Bank Secrecy Act ("BSA"), 31 U.S.C. § 5311 *et seq.,* and its implementing regulations, required the Target and his wife to keep the foreign financial account records sought by the subpoenas. Because the subpoenas were directed at only those records kept "within the requirements of [the] regulations," the Required Records Exception to the Fifth Amendment privilege against self-incrimination applied, such that the Target and his wife could not resist complying with the subpoenas on Fifth Amendment grounds. The government requested that the district court grant the motion to compel and enter an order directing the Target and his wife "to show cause why they should not be held in contempt for failing to comply with the subpoenas."

***1266** The Target and his wife filed a response to the government's motion to compel, arguing that the Required Records Exception did not apply to them based on the particular facts and circumstances of their case.

On November 7, 2011, the district court granted the government's motion to compel. In pertinent part, the district court found that the documents requested in the subpoenas fell within the Required Records Exception because: (1) federal law required the Target and his wife to maintain and make available for inspection records regarding their foreign financial accounts; (2) that recordkeeping requirement, imposed by federal statute and implemented by federal regulations, was part of a civil regulatory scheme that was " 'essentially regulatory' and not criminal in nature"; (3) the records were of the sort that "bank customers would customarily keep"; and (4) the records had "public aspects" because they contained information that federal law required the Target and his wife to maintain and make available for inspection by the IRS, as well as report to the Treasury Department. The district court ordered the Target and his wife to produce the subpoenaed foreign financial account records "or be subject to contempt."

The Target and his wife did not comply with the district court's order. On March 5, 2012, the government moved the district court to hold the Target and his wife in contempt, pursuant to 28 U.S.C. § 1826. The district court issued an order holding the Target and his wife in contempt for their failure to comply with the district court's earlier November 7 order. The district court, however, stayed the enforcement of its contempt order pending the outcome of any appeal. The Target and his wife timely appealed.

II. DISCUSSION

[1] **[2]** On appeal, the Target [3] argues that he properly invoked his Fifth Amendment privilege against self-incrimination, and that the district court erred in concluding that the Required Records Exception applied to the subpoenaed records. The Target also argues that because his act of producing the subpoenaed records could potentially be incriminating, his Fifth Amendment privilege against self-incrimination should apply to his act of production, as well as applying to the records themselves. [4]

Before discussing these privilege issues, we review the Bank Secrecy Act and its related regulations.

A. The Bank Secrecy Act

The Currency and Foreign Transactions Reporting Act of 1970, Pub.L. 91–508, 84 Stat. 1118 (1970), is generally referred to as the Bank Secrecy Act ("BSA"). The BSA's purpose is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings...." 31 U.S.C. § 5311. Section 241 of the BSA, codified at 31 U.S.C. § 5314, provides that the "Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to ***1267** keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency." *Id.* § 5314(a). In short, the Secretary of the Treasury *must* require U.S. citizens and residents, as well as any person doing business in the United States, to "keep records and file reports" regarding their foreign financial transactions and relationships. *See id.*

Pursuant to this Section 241 instruction, the Secretary of the Treasury has implemented regulations that require U.S. citizens, residents, and business entities to report their foreign financial accounts to the IRS. *See* 31 C.F.R. § 1010.350. Specifically, the reporting regulation requires that:

> Each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country *shall report such relationship to the Commissioner of Internal Revenue* for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. 5314 to be filed by such persons. The form prescribed under section 5314 is the Report of Foreign Bank and Financial Accounts (TD–F 90–22.1), or any successor form.

31 C.F.R. § 1010.350(a) (emphasis added).

A separate regulation mandates that those persons who are required to report foreign financial interests under § 1010.350 retain certain foreign financial records for at least five years, making them "available for inspection as authorized by law." *Id.* § 1010.420. These foreign financial records must contain (1) "the name in which each such account is maintained"; (2) "the number or other designation of such account"; (3) "the name and address of the foreign bank or other person with whom such account is maintained"; (4) "the type of such account"; and (5) "the maximum value of each such account during the reporting period." *Id.* [5]

The records named in the subpoenas here mirror the records that § 1010.420 requires persons maintaining foreign financial interests to keep and maintain for government inspection. The information contained in those subpoenaed records is also identical to information that persons subject to § 1010.420 annually report to the U.S. Department of the Treasury through FBAR, Form TD F 90–22.1. Thus, the records at issue contain information that the Target—if he has a foreign financial account and meets other qualifications specified in the BSA—must keep, report to the Treasury Department, and maintain for inspection.

The question here is whether records that federal law requires a person to keep and make available for inspection by the federal government can be subpoenaed by the government in a grand jury investigation when the holder of the records asserts his Fifth Amendment privilege against self-incrimination. We now turn to a discussion of the Fifth Amendment and the Required Records Exception to that ***1268** Amendment's privilege against self-incrimination.

B. The Fifth Amendment's Privilege against Self–Incrimination

The Fifth Amendment to the United States Constitution states that "[n]o person ... shall be compelled in any criminal case to be a witness against himself...." This provision applies "when the accused is compelled to make a [t]estimonial [c]ommunication that is incriminating." *Fisher v. United States,* 425 U.S. 391, 408, 96 S.Ct. 1569, 1579, 48 L.Ed.2d 39 (1976); *see also United States v. Doe,* 465 U.S. 605, 610, 104 S.Ct. 1237, 1241, 79 L.Ed.2d 552 (1984) ("[T]he Fifth Amendment protects [a] person ... from *compelled* self-incrimination.").

[3] Courts have interpreted broadly what constitutes a "testimonial communication." In *Fisher,* the Supreme Court stated that "[t]he act of producing evidence in response to a subpoena ... has communicative aspects of its own, wholly aside from the contents of the papers produced." 425 U.S. at 410, 96 S.Ct. at 1581; *see also Doe,* 465 U.S. at 612, 104 S.Ct. at 1242 ("A government subpoena compels the holder of the document to perform an act that may have testimonial aspects and an incriminating effect."). For instance, by complying with a subpoena, the subpoena recipient may "tacitly concede[ ] the existence of the papers demanded and their possession or control," as well as his "belief that the papers are those described in the subpoena." *Fisher,* 425 U.S. at 410, 96 S.Ct. at 1581; *see also Baltimore City Dep't of Soc. Servs. v. Bouknight,* 493 U.S. 549, 554–55, 110 S.Ct. 900, 904–05, 107 L.Ed.2d 992 (1990) ("[T]he act of complying with the government's demand testifies to the existence, possession, or authenticity of the things produced."). The issue then becomes whether the "tacit averments" made by producing the requested materials are both " 'testimonial' and 'incriminating' for purposes of applying the Fifth Amendment." *Fisher,* 425 U.S. at 410, 96 S.Ct. at 1581; *see also In re Three Grand Jury Subpoenas Duces Tecum Dated Jan. 29, 1999,* 191 F.3d 173, 178 (2d Cir.1999) ("[I]t is now settled that an individual may claim an act of production privilege to decline to produce documents, the contents of which are not privileged, where the act of production is, itself, (1) compelled, (2) testimonial, and (3) incriminating.").

C. The Required Records Exception

[4] Although the Fifth Amendment protects an individual against self-incrimination by barring the government from "compelling [him] to give 'testimony' that incriminates him," its protective shield is not absolute. *Fisher,* 425 U.S. at 409, 96 S.Ct. at 1580. In some instances, Congress may, without violating an individual's Fifth Amendment privilege, require that individual "to report information to the government," despite the fact that the information "may incriminate the individual." *United States v. Garcia–Cordero,* 610 F.3d 613, 616 (11th Cir.2010).

[5] **[6]** Of relevance to the present case, the Supreme Court has made clear that when the government is authorized to regulate an activity, an individual's Fifth Amendment privilege does not prevent the government from imposing recordkeeping, inspection, and reporting requirements as part of a valid regulatory scheme. *See Shapiro v. United States,* 335 U.S. 1, 32–33, 68 S.Ct. 1375, 1391–93, 92 L.Ed. 1787 (1948). Based on the Required Records Exception, the government may mandate the retention or inspection of records as "to public documents in public offices, [and] also [as] to records required by law to be kept in order that there may be suitable information of transactions which ***1269** are the appropriate subjects of governmental regulation, and the enforcement of restrictions validly established." *Id.* at 17, 68 S.Ct. at 1384 (quoting *Wilson v. United States,* 221 U.S. 361, 380, 31 S.Ct. 538, 544, 55 L.Ed. 771 (1911)).

The rationale underlying the Required Records Exception is "twofold." *In re Two Grand Jury Subpoenae Duces Tecum,* 793 F.2d 69, 73 (2d Cir.1986). First, *voluntary* participation in an activity that, by law or statute, mandates recordkeeping may be deemed a waiver of the act of production privilege because the "obligations to keep and produce the records are in a sense consented to as a condition of being able to carry on the regulated activity involved." *In re Grand Jury Proceedings* ("*McCoy & Sussman*"), 601 F.2d 162, 171 (5th Cir.1979). [6] Second, because such recordkeeping is done pursuant to legal mandate, "the mere response by production is no more a violation of the privilege against self-incrimination than requiring the creation of the record itself, for it is the record, presumably, that might incriminate [the recordholder]." *Id.*; *see also Two Grand Jury Subpoenae,* 793 F.2d at 73 ("[B]ecause the records must be kept by law, the record-holder 'admits' little in the way of control or authentication by producing them.").

[7] Building on *Shapiro,* the Supreme Court later articulated three "premises" or elements of the Required Records Exception in a pair of cases that dealt with whether the Exception applied to the payment of an excise tax on illegal gambling wagers. *See Grosso v. United States,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 713, 19 L.Ed.2d 906 (1968); *Marchetti v. United States,* 390 U.S. 39, 56–57, 88 S.Ct. 697, 707, 19 L.Ed.2d 889 (1968). The Supreme Court described the three "premises" as follows: (1) "the purposes of the United States' inquiry must be essentially regulatory"; (2) the "information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept"; and (3) "the records themselves must have assumed 'public aspects' which render them at least analogous to public documents." *Grosso,* 390 U.S. at 67–68, 88 S.Ct. at 713. Concluding that the Required Records Exception was inapplicable in *Grosso* and *Marchetti,* the Supreme Court stressed that any recordkeeping or inspection requirement under *Shapiro* must be directed at "an essentially non-criminal and regulatory area of inquiry," *Marchetti,* 390 U.S. at 57, 88 S.Ct. at 707, rather than "directed almost exclusively to individuals inherently suspect of criminal activities," *Grosso,* 390 U.S. at 68, 88 S.Ct. at 713.

In the nearly 45 years that have elapsed since the Supreme Court laid out the Required Records Exception's three "premises" in *Grosso* and *Marchetti,* many of our sister circuits have recognized and applied these "premises" as though they were elements of the Required Records Exception. *See, e.g., In re Grand Jury Subpoena,* 696 F.3d 428, 432–36 (5th Cir.2012); *In re Special Feb. 2011–1 Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d 903, 905–09 (7th Cir.2012), *petition for cert. filed,* 2013 WL 152456 (U.S. Jan. 9, 2013) (No. 12–853); *In re Grand Jury Investigation M.H.,* 648 F.3d 1067, 1071–79 (9th Cir.2011), *cert. denied,* ––– U.S. ––––, 133 S.Ct. 26, 183 L.Ed.2d 676 (2012); *In re Grand Jury Subpoena* ("*Spano*"), 21 F.3d 226, 228–30 (8th Cir.1994); *In re Grand Jury Subpoena Duces Tecum Served upon Underhill* ("*Underhill*"), 781 F.2d 64, 67–70 (6th Cir.1986); ***1270** *United States v. Dichne,* 612 F.2d 632, 638–41 (2d Cir.1979); *United States v. Webb,* 398 F.2d 553, 556 (4th Cir.1968).

Importantly here, in several of these cases—*In re M.H.* (9th Cir.), *Grand Jury Subpoena Dated Sept. 12, 2011* (7th Cir.), and *In re Grand Jury Subpoena* (5th Cir.)—our sister circuits upheld the application of the Required Records Exception to individuals who were served with subpoenas that sought the production of financial records required to be kept pursuant to the BSA and its implementing regulations. *In re Grand Jury Subpoena,* 696 F.3d at 430–31; *Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d at 909; *In re M.H.,* 648 F.3d at 1069; *see also Dichne,* 612 F.2d at 638–41 (applying the Required Records Exception to the BSA's currency reporting requirements).

D. Analysis—Application of the Required Records Exception

With this analytical framework in place, we now turn to our application of the Required Records Exception to the particular records at issue here. For the reasons set forth below, we conclude that the government has met its burden of proving that the foreign financial account documents sought from the Target, which the BSA and its implementing regulations require him to maintain, satisfy the "premises" of the Required Records Exception.[7] Because the Exception applies, both the documents themselves and the act of producing them fall outside the purview of the Fifth Amendment.

1. "Essentially Regulatory"

[8] The Target argues that the text of the BSA and its legislative history indicate Congress intended for the recordkeeping and reporting requirements imposed on foreign financial accountholders to aid law enforcement, and therefore, that the purpose of the Act is criminal in nature rather than "essentially regulatory." *Grosso,* 390 U.S. at 67–68, 88 S.Ct. at 713. He asserts that because the Act lists first among its purposes the gathering of information that has a "high degree of usefulness in *criminal,* tax, or regulatory investigations," 31 U.S.C. § 5311 (emphasis added), the Act's chief purpose is to fight crime.

[9] The Target also acknowledges, however, that the BSA has multiple purposes. That a statute relates both to criminal law and to civil regulatory matters does not strip the statute of its status as "essentially regulatory." *See Cal. Bankers Ass'n v. Shultz,* 416 U.S. 21, 76–77, 94 S.Ct. 1494, 1525, 39 L.Ed.2d 812 (1974); *In re Grand Jury Subpoena,* 696 F.3d at 434–35; *In re M.H.,* 648 F.3d at 1074. In *Shultz,* the Supreme Court observed that the goal of assisting in the enforcement of criminal laws was "undoubtedly prominant [sic] in the minds of the legislators," as they considered the Bank Secrecy Act. *Shultz,* 416 U.S. at 76–77, 94 S.Ct. at 1525. The Supreme Court further observed that ***1271** "Congress seems to have been equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported...." *Id.* at 76, 94 S.Ct. at 1525. The Supreme Court therefore concluded that "the fact that a legislative enactment manifests a concern for the enforcement of the criminal law does not cast any generalized pall of constitutional suspicion over it." *Id.* at 77, 94 S.Ct. at 1525.

Furthermore, the BSA also requires records to be kept "where [the records] have a high degree of usefulness in criminal, *tax, or regulatory investigations....*" 31 U.S.C. § 5311 (emphasis added). The House Report, that accompanied the Act, acknowledged that the Act's recordkeeping and reporting requirements not only would "aid duly constituted authorities in lawful investigations," but also would "facilitate the supervision of financial institutions properly subject to federal supervision" and would "provide for the collection of statistics necessary for the formulation of monetary and economic policy." H.R.Rep. No. 91–975 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4405. As the Fifth Circuit recently noted,

> the Treasury Department shares the information it collects pursuant to the Act's requirements with other agencies—including the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of Thrift Supervision—none of which are empowered to bring criminal prosecutions.

In re Grand Jury Subpoena, 696 F.3d at 434–35 (citing 31 U.S.C. § 5319; 31 C.F.R. § 1010.950(a)–(b)). Furthermore, violations of the BSA can be enforced by civil or criminal means, and Congress emphasized that the availability of civil sanctions is "of great importance in assuring compliance with regulations of the type contemplated by [the BSA]." H.R.Rep. No. 91–975, *reprinted in* 1970 U.S.C.C.A.N. 4394, 4405; *see* 31 U.S.C. §§ 5321(a)(3) and (d), 5322(a) and (b).

[10] Even ignoring the non-criminal purposes of the BSA, the question is not whether Congress was subjectively concerned about crime when enacting the BSA's recordkeeping and reporting provisions, but rather whether these requirements apply exclusively or almost exclusively to people engaged in criminal activity. *See Marchetti,* 390 U.S. at 57, 88 S.Ct. at 707. "Therefore, that Congress aimed to use the BSA as a tool to combat certain criminal activity is insufficient to render the BSA essentially criminal as opposed to essentially regulatory." *In re M.H.,* 648 F.3d at 1074.

In *Dichne,* the Second Circuit held that a similar recordkeeping and reporting requirement of the BSA was not subject to the Fifth Amendment's privilege against self-incrimination. 612 F.2d at 638–41. The provision at issue in *Dichne* required anyone exporting or importing monetary instruments worth more than $5,000 (now $10,000) to file a report with the Secretary of the Treasury. *See* 31 U.S.C. § 5316 (*previously codified at* 31 U.S.C. § 1101). The Second Circuit noted that because "the transportation of such amounts of currency is by no means an illegal act, the District Court was correct in its finding that the reporting requirement was not addressed to a highly selective group inherently suspect of criminal activities." *Dichne,* 612 F.2d at 639 (internal quotation marks omitted). The Second Circuit therefore held that "[i]n view of the lack of a direct linkage between the required disclosure and the potential criminal activity, and in view of the fact that the statute is not directed at an inherently suspect ***1272** group, ... the reporting requirement does not present such a substantial risk of incrimination so as to outweigh the governmental interest in requiring such a disclosure." *Id.* at 641 (internal quotation marks omitted). Consequently, activity required by the BSA statute was not subject to the Fifth Amendment's privilege against self-incrimination. *Id.*; *see also United States v. Sturman,* 951 F.2d 1466, 1487 (6th Cir.1991) ("The Bank Secrecy Act applies to all persons making foreign deposits, most of whom do so with legally obtained funds. The requirement is imposed in the banking regulatory field which is not infused with criminal statutes. In addition, the disclosures do not subject the defendant to a real danger of self-incrimination since the source of the funds is not disclosed.... Thus, the defendant has failed to show that the Bank Secrecy Act violated any individual right [that] ... *Grosso* seek[s] to protect.").

The BSA and its implementing regulations at issue here apply to a wide range of individuals. "There is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account," and "[n]othing about having a foreign bank account on its own suggests a person is engaged in illegal activity." *In re M.H.,* 648 F.3d at 1074. We agree with our three sister circuits that the recordkeeping requirements of the BSA, as implemented by 31 C.F.R. §§ 1010.350 and 1010.420, are essentially regulatory in nature, as they do not target inherently illegal activity or a group of persons inherently suspect of criminal activity. *See In re Grand Jury Subpoena,* 696 F.3d at 435 (holding that "[b]ecause the BSA's recordkeeping requirements serve purposes unrelated to criminal law enforcement and because the provisions do not exclusively target people engaged in criminal activity, we conclude that the requirements are 'essentially regulatory,' satisfying the [Required Records Exception]'s first prong"); *Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d at 909 (concluding that the first "premise" of the Required Records Exception, as it pertained to BSA records, was satisfied); *In re M.H.,* 648 F.3d at 1075 (holding that 31 C.F.R. § 1010.420 was "essentially regulatory" because the information sought was "not inherently criminal," and therefore, "being required to provide that information would generally not establish a significant link in a chain of evidence tending to prove guilt").

For these reasons, we conclude that the requested foreign financial account records satisfy the first "premise" of the Required Records Exception, as the government's interest is "essentially regulatory" in nature.

2. "Customarily Kept"

[11] The second "premise" of the Required Records Exception examines whether the records sought are of the type typically kept in connection with the regulated activity. *Grosso,* 390 U.S. at 68, 88 S.Ct. at 713; *Marchetti,* 390 U.S. at 57, 88 S.Ct. at 707. The Target argues that the foreign financial account records sought from him do not satisfy this "premise" because the records generally relate to "secret accounts of which records are normally not maintained."

The Ninth Circuit has held that the foreign financial account information required to be kept under 31 C.F.R. § 1010.420 is "basic account information that bank customers would customarily keep, in part because they must report it to the IRS every year as part of the IRS's regulation of offshore banking, and in part because they need the information to access their foreign bank accounts." *In re M.H.,* 648 F.3d at 1076. The Fifth Circuit has concluded similarly, stating that foreign financial account records are "customarily kept" in satisfaction of the Required ***1273** Records Exception's second "premise" where they "are of the same type that the witness must report annually to the IRS pursuant to the IRS's regulation of offshore banking: the name, number, and type of account(s), the name and address of the bank where an account is held, and the maximum value of the account...." *In re Grand Jury Subpoena,* 696 F.3d at 435; *see also Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d at 909 (concluding that the second prong of the Required Records Exception was met).

We agree. Simply put, the Target's argument that these records are not "customarily kept" is a non-starter. In addition to needing these foreign financial account records to comply with tax and Treasury Department reporting obligations, "the records sought are also of the same type that a reasonable account holder would keep in order to access his account." *Grand Jury Subpoena,* 696 F.3d at 435. We conclude that the subpoenaed foreign financial account records here are of a kind "customarily kept" in connection with the regulated activity of offshore banking, thereby satisfying the second "premise" of the Required Records Exception.

3. "Public Aspects"

[12] The third "premise" of the Required Records Exception requires that the requested records "have assumed 'public aspects' which render them at least analogous to public documents." *Grosso,* 390 U.S. at 68, 88 S.Ct. at 713. The Target asserts that an individual's personal financial records do not possess sufficient "public aspects" to satisfy this prong of the test.

[13] Generally, "[w]here personal information is compelled in furtherance of a valid regulatory scheme, as is the case here, that information assumes a public aspect." *In re M.H.,* 648 F.3d at 1077. The fact "that the records sought are typically considered private does not bar them from possessing the requisite public aspects." *In re Grand Jury Subpoena,* 696 F.3d at 436. As we concluded above, the BSA is a valid regulatory regime, and therefore, the information sought pursuant to the Act "assumes a public aspect." *In re M.H.,* 648 F.3d at 1077. The Fifth Circuit noted that "the Treasury Department shares the information it collects pursuant to the [Bank Secrecy] Act's record-keeping and reporting requirements with a number of other agencies. That this data sharing [serves] an important public purpose sufficient to imbue otherwise private foreign bank account records with 'public aspects' is not difficult to imagine." *In re Grand Jury Subpoena,* 696 F.3d at 436.

The fact that 31 C.F.R. § 1010.420 requires foreign accountholders to keep foreign financial account records, but to file only the TD F 90–22.1 FBAR form concerning those records with the Treasury Department, does not extinguish the public aspects of the records here. The Supreme Court has recognized that there is no material distinction between records required to be kept by law and those regularly or "easily accessed" by the government. *See Marchetti,* 390 U.S. at 56 n. 14, 88 S.Ct. at 706 n. 14 ("We perceive no meaningful difference between an obligation to maintain records for inspection, and such an obligation supplemented by a requirement that those records be filed periodically with officers of the United States.").

Thus, this Court finds that the Target's records sought here have "public aspects," satisfying the third and final "premise" of the Required Records Exception. *See Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d at 909 (concluding that respondent could not resist a subpoena on Fifth Amendment grounds because the requested ***1274** records met the three prongs of the Required Records Exception).[8]

E. The Act–of–Production Privilege

[14] We now address the Target's contention that the Required Records Exception is not applicable to a case such as this where the act of producing the records would be compelled, testimonial, and self-incriminating. We reject the Target's attempt to draw a distinction, for Fifth Amendment privilege purposes, between his act of producing the records and the records themselves. As the Seventh Circuit has persuasively stated,

> [o]ne of the rationales, if not the main rationale, behind the Required Records Doctrine is that the government or a regulatory agency should have the means, over an assertion of the Fifth Amendment Privilege, to inspect the records it requires an individual to keep *as a condition of voluntarily participating in that regulated activity*. That goal would be easily frustrated if the Required Records Doctrine were inapplicable whenever the act of production privilege was invoked.
>
> *The voluntary choice to engage in an activity that imposes record-keeping requirements under a valid civil regulatory scheme carries consequences, perhaps the most significant of which, is the possibility that those records might have to be turned over upon demand, notwithstanding any Fifth Amendment privilege*. That is true whether the privilege arises by virtue of the contents of the documents or [by the] act of producing them.

Grand Jury Subpoena Dated Sept. 12, 2011, 691 F.3d at 908–09 (citations omitted) (emphasis added).

Although the Supreme Court decided its "act-of-production" privilege cases *after* it decided *Shapiro, Grosso,* and *Marchetti,* it has since applied the rationale behind the Required Records Exception to negate a witness's act-of-production privilege. *See Bouknight,* 493 U.S. at 555–62, 110 S.Ct. at 905–09 (holding, in a case involving a mother's refusal, on Fifth Amendment grounds, to comply with a court order to turn her child over to a social services agency, "[e]ven assuming that this limited testimonial assertion is sufficiently incriminating and 'sufficiently testimonial for purposes of the privilege,' Bouknight may not invoke the privilege to resist the production order because she has assumed custodial duties related to production and because production is required as part of a noncriminal regulatory regime" (citation omitted)); *see also Spano,* 21 F.3d at 228–30 (holding that "the required records exception to the Fifth Amendment privilege will apply to the act of production by a sole proprietor even where the act of production could involve compelled testimonial self-incrimination"); *Underhill,* 781 F.2d at 70 ("In our view, in order to have meaning the required records exception must apply to the act of production as well ***1275** as the contents of documents to which the doctrine applies.").

Indeed, in *McCoy & Sussman,* our predecessor Court determined that the act-of-production privilege discussed in *Fisher* was "not directed at the production of 'required records,' " and that "[t]he proper designation by the government of certain records to be kept by an individual necessarily implies an obligation to produce them." 601 F.2d at 170–71. The Court added that the "obligation to keep and produce the records are in a sense consented to as a condition of being able to carry on the regulated activity involved." *Id.* at 171. Further, "[i]n this respect, the mere response by production is no more a violation of the privilege against self-incrimination than requiring the creation of the record itself, for it is the record, presumably, that might incriminate." *Id.*[9]

We likewise reject the Target's assertion that the resolution of this question is controlled by our decision in *United States v. Argomaniz,* 925 F.2d 1349 (11th Cir.1991). In *Argomaniz,* this Court concluded that a criminal defendant was entitled to invoke his Fifth Amendment privilege against self-incrimination as it pertained to his act of producing incriminating business records to the IRS. 925 F.2d at 1355–56. However, the *Argomaniz* Court did not address the Required Records Exception as it pertained to the defendant's assertion of privilege, and there is no indication that the records sought by the IRS in *Argomaniz* were records that the defendant was required by federal law to maintain, present for inspection, or file pursuant to a valid exercise of congressional authority. Accordingly, *Argomaniz* is materially distinguishable from the present case.

In sum, to the extent that the Required Records Exception operates to extinguish the Target's Fifth Amendment privilege against self-incrimination, it necessarily extinguishes this privilege as to both the act of producing the records and the records themselves.

III. CONCLUSION

For the reasons stated above, and after oral argument and our review of the record in the present case, we affirm the district court's order granting the government's motion to compel the Target and his wife to comply with the subpoenas *duces tecum* for their foreign financial account records. [10]

AFFIRMED.

All Citations

707 F.3d 1262, 111 A.F.T.R.2d 2013-794, 2013-1 USTC P 50,182, 23 Fla. L. Weekly Fed. C 1864

Footnotes

[1] “Each United States person” must file an FBAR form if that person has a financial interest in, or signature authority over, any financial account or other financial interest maintained in a foreign country. *See* 31 U.S.C. § 5314; 31 C.F.R. §§ 1010.350, 1010.420.

[2] On March 31, 2011, 31 C.F.R. § 103.32 became 31 C.F.R. § 1010.420. *Compare* 31 C.F.R. § 103.32 (2010) *with id.* § 1010.420 (2011); *see also* Transfer and Reorganization of Bank Secrecy Act Regulations, 75 Fed.Reg. 65806–01 (Oct. 26, 2010).

[3] Although both the Target and his wife received identical subpoenas and both are appealing the district court's contempt order, we refer to the Target as a singular entity in our discussion, for ease of reference.

[4] “We review the district court's findings of relevant facts for clear error, ... and review the district court's application of the Fifth Amendment privilege *de novo*.” *In re Grand Jury Subpoena Duces Tecum Dated Mar. 25, 2011,* 670 F.3d 1335, 1338 (11th Cir.2012) (citations omitted). In the present case, because the issue on appeal is solely a legal one, our review is *de novo. Id.*

[5] We note that the Target has raised no challenge to the constitutionality or legality of either the Bank Secrecy Act or its implementing regulations. And it is plainly within Congress's power to regulate foreign financial transactions undertaken by U.S. citizens and residents by mandating that such financial activity be reported yearly to the federal government. *See* U.S. CONST. art. I, § 8, cl. 3 (vesting Congress with the authority “[t]o regulate Commerce with foreign Nations”); *Cal. Bankers Ass'n v. Shultz,* 416 U.S. 21, 59, 94 S.Ct. 1494, 1516, 39 L.Ed.2d 812 (1974) (upholding the constitutionality of the Bank Secrecy Act, noting that “[t]he plenary authority of Congress to regulate foreign commerce, and to delegate significant portions of this power to the Executive, is well established”).

[6] In *Bonner v. City of Prichard,* 661 F.2d 1206, 1209 (11th Cir.1981) (en banc), we adopted as binding precedent all decisions of the former Fifth Circuit handed down prior to October 1, 1981.

[7] Our predecessor Court, the Fifth Circuit, applied the first and third “premises”—the “essentially regulatory” and “public aspects” elements—but did not explicitly mention the “customarily kept” element. *See McCoy & Sussman,* 601 F.2d at 167–71; *cf. Garcia–Cordero,* 610 F.3d at 616–18 (discussing and applying the “regulatory regime exception” to the Fifth Amendment, in a case that did not involve physical records, without mention of a “customarily kept” element). In light of this precedent, the government encourages us to apply only the first and third “premises” in the present case. We need not decide if the second “premise” or element applies because, like the Fifth Circuit in its more recent decision, even if we were to “assume, for purposes of decision, that all three prongs of the test set forth in *Grosso* apply,” we would nevertheless “conclude that all three requirements are met in this case.” *In re Grand Jury Subpoena,* 696 F.3d at 433–34 (quoting *In re M.H.,* 648 F.3d at 1073).

8 We also reject the Target's argument that the Required Records Exception is only triggered where there is some level of licensure or heightened government regulation at issue. We agree with the government's position that it is up to Congress to determine the appropriate level of regulation that should accompany its mandate that certain records be kept. We note that the Fifth Circuit recently arrived at the same conclusion, holding that "[i]f the witness's argument were correct, then Congress would be prohibited from imposing the least regulatory burden necessary; it would instead be required to supplement a reporting or recordkeeping scheme with additional and unnecessary 'substantive restrictions' for the sole purpose of upholding its record keeping and reporting requirements," and thus, "adopting a rule that the legitimacy of a recordkeeping requirement depends on Congress first enacting substantive restrictions would lead to absurd results." *In re Grand Jury Subpoena,* 696 F.3d at 436 (internal quotations omitted).

9 McCoy was the sole proprietor and operator of a customshouse brokerage office. *McCoy & Sussman,* 601 F.2d at 166. Representatives of the U.S. Customs Service sought to inspect McCoy's records "in accordance with regulations [19 C.F.R. §§ 111.21 *et seq.*] requiring customshouse brokers to maintain records of their business and allow access to them." *Id.* McCoy refused to permit the inspection. *Id.* As part of a grand jury investigation, McCoy was later served with a subpoena *duces tecum* requiring the production of certain records. *Id.* McCoy contended that "even if the subpoena were limited to 'required records,' he would be privileged from producing the records because the mere act of producing them would be, in effect, testimonial." *Id.* at 170. This Court rejected that contention as to "required records." *Id.* at 170–71.

10 In this appeal, the government has never sought any oral testimony from the Target or his wife, and thus this case involves *only* records and the *act* of producing those records.

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2017 WL 4417826
United States District Court,
N.D. Illinois, Eastern Division.

UNITED STATES of America, Plaintiff,
v.
Jung Joo PARK, Charles C. Park, James Park,
Nina Park, and John Doe, as representative
of the estate of Que Te Park, Defendants.

No. 16 C 10787
|
Signed 10/05/2017

Attorneys and Law Firms

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Kevin K. McCormick, Dewald Law Group PC, Arlington Heights, IL, for Defendants.

MEMORANDUM OPINION AND ORDER

HON. JORGE L. ALONSO, United States District Judge

***1** Plaintiff, the United States of America, brings this action to collect a tax penalty assessed against Que Te Park, who is now deceased, from his surviving family members or estate. His children, defendants Charles C. Park, James Park, and Nina Park have moved to dismiss the claims against them. The motion to dismiss is granted, with leave to file an amended complaint by November 7, 2017.

BACKGROUND

On June 10, 2010, Que Te Park ("Mr. Park"), then living in Inverness, Illinois, filed an amended Report of Foreign Bank and Financial Accounts ("FBAR") for the 2008 tax year, disclosing for the first time numerous foreign bank accounts in which he held (substantially) more than $10,000. Based on the amended report, the United States government assessed a tax penalty against Mr. Park of nearly $4 million. *See* 31 U.S.C. § 5314.

According to the allegations of the complaint, Mr. Park died on July 12, 2012. Subsequently, his wife, defendant Jung Joo Park ("Mrs. Park"), informed the Internal Revenue Service that Mr. Park's estate was not probated. The government alleges, however, "upon information and belief," that Mr. Park held assets that included, but were not limited to, "Korean bank accounts," "Korean real property," and "certain other inheritance documents" (2d Am. Compl. ¶ 45, ECF No. 25), and that some or all of these assets were transferred to Mrs. Park and Mr. Park's children, defendants Charles Park, James Park, and Nina Park (hereinafter, "the Park children"), pursuant to South Korean probate proceedings. (*See id.* ¶¶ 46-48.)

In particular, the government alleges that Mr. Park had previously placed assets in a revocable trust named the Que Te Declaration of Trust ("the Trust"). He settled and notarized the Trust in DuPage County, Illinois, in January 2007. Mr. Park was both the grantor and the original trustee of the Trust. By its own terms, the Trust became irrevocable on Mr. Park's death. The Trust names Mrs. Park as the successor trustee; it also names the Park children as successor co-trustees, but only "[i]n the event [Mrs. Park] is unwilling and unable to act as Successor Trustee" at the time of Mr. Park's death or incapacity. (*Id.*, Ex. 1, Trust, Article Fifth, Section 8, ECF No. 25-1.) Upon Mr. Park's death, the terms of the Trust required the trustee to divide the Trust assets into two separate trusts. First, the trustee is required to set up a "Marital Trust" for the benefit of Mrs. Park. (*Id.* ¶ 28.) Mrs. Park is empowered, independently of her role as trustee, to distribute any part of the Marital Trust "principal" to any of Mr. Park's "descendants and their respective spouses" or to charity. Second, the trustee is to use the Trust's remaining assets to set up a "Family Trust" for the benefit of Mrs. Park during her lifetime, but, after her death, to be divided and distributed to Mr. Park's descendants. (*Id.* ¶ 29; *id.*, Ex. 1, Article Fourth).

The government's complaint consists of seven counts: Count I, to reduce the 2008 FBAR civil penalties to judgment; Count II, liability of the Trust for the 2008 FBAR penalties; Count III, for Illinois common-law transferee liability against Mrs. Park and the Park children; Count IV, fiduciary liability against Mrs. Park as trustee of the Trust and *de facto* representative of Mr. Park's estate; Count V, to set aside fraudulent transfers of Trust assets to Mrs. Park and the Park children; Count VI, to set aside fraudulent transfers of other assets held by

Mr. Park to Mrs. Park and the Park children; and Count VII, for an accounting of transfers of Trust assets and other assets owned by Mr. Park. The Park children move to dismiss the claims against them, which are alleged in Counts III, V, VI and VII. [1]

ANALYSIS

***2** "A motion under Rule 12(b)(6) tests whether the complaint states a claim on which relief may be granted." *Richards v. Mitcheff*, 696 F.3d 635, 637 (7th Cir. 2012). Under Rule 8(a)(2), a complaint must include "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). The short and plain statement under Rule 8(a)(2) must " 'give the defendant fair notice of what the claim is and the grounds upon which it rests.' " *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957) (ellipsis omitted)).

Under federal notice-pleading standards, a complaint's "[f]actual allegations must be enough to raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555. Stated differently, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (citing *Twombly*, 550 U.S. at 556). "In reviewing the sufficiency of a complaint under the plausibility standard, [courts must] accept the well-pleaded facts in the complaint as true, but [they] 'need[ ] not accept as true legal conclusions, or threadbare recitals of the elements of a cause of action, supported by mere conclusory statements.' " *Alam v. Miller Brewing Co.*, 709 F.3d 662, 665-66 (7th Cir. 2013) (quoting *Brooks v. Ross*, 578 F.3d 574, 581 (7th Cir. 2009)).

Additionally, any claims of or including acts of fraud must comply with Federal Rule of Civil Procedure 9(b), which requires the pleading party to "state with particularity the circumstances constituting fraud." *United States ex rel. Presser v. Acacia Mental Health Clinic, LLC*, 836 F.3d 770, 775 (7th Cir. 2016). Although fraudulent or deceptive intent "may be alleged generally," Rule 9(b) requires a plaintiff to describe the "circumstances" of the alleged fraudulent activity with "particularity" by including such information as the "the identity of the person who made the misrepresentation, the time, place and content of the misrepresentation, and the method by which the misrepresentation was communicated," *Windy City Metal Fabricators & Supply, Inc. v. CIT Tech. Fin. Servs., Inc.*, 536 F.3d 663, 668 (7th Cir. 2008), or, to put it differently, by providing the "who, what, where, when and how" of the alleged fraudulent conduct. *See Bank of Am., Nat'l Ass'n, v. Knight*, 725 F.3d 815, 818 (7th Cir. 2013).

The Park children argue that Counts III, V, and VI fail to state a claim; the government's claims are barred by the statute of limitations; Illinois law does not govern the Trust; the fraud counts are not pleaded with particularity; and the government has not stated a claim for accounting.

Some of the Park children's arguments can be dispatched quickly. First, whether the statute of limitations bars a claim is an affirmative defense that the Court resolves on a motion to dismiss only if it is clear on the face of the complaint that the plaintiff's claims are time-barred. In this case, it is not clear on the face of the government's complaint that its claims are time-barred; and in any case, as the government argues without reply from the Park children, " '[i]t is well settled that the United States is not bound by state statutes of limitation ... in enforcing its rights' " in proceedings it institutes to collect taxes, even those involving state fraudulent transfer law. *United States v. Hoyt*, 524 F. Supp. 2d 638, 641 (D. Md. 2007) (quoting *United States v. Summerlin,* 310 U.S. 414, 416 (1940)). Second, the Park children argue that Illinois law does not govern the Trust because, by its own terms, the Trust is governed by the law of the jurisdiction where "the Trust property shall ... have its situs for administration," (Trust, Article Ninth, ECF No. 25-1), and to the extent the complaint sheds any light on where Trust property has its "situs for administration," it appears to be in South Korea. This argument is not squarely, fully briefed by the parties, and in any case, it is not clear on the face of the pleadings where the Trust property is held, so the issue cannot be resolved on a motion to dismiss. These arguments for dismissing the Second Amended Complaint are unpersuasive.

***3** That leaves the argument that the government has not met its pleading burden. In particular, the Park children argue that the heightened pleading standard of Rule 9(b) applies to the government's claims against them because they sound in fraud, and, according to the Park children, the government has not met its burden to state the "circumstances constituting fraud" with "particularity."

The government's claims under the Illinois Uniform Fraudulent Transfer Act ("IUFTA"), 740 ILCS 160/5, in Counts V and VI must be pleaded with particularity under Rule 9(b). *See Gen. Elec. Capital Corp. v. Lease Resolution Corp.*, 128 F.3d 1074, 1079-80 (7th Cir. 1997). To plead a "constructive fraud" or "fraud in law" claim under the IUFTA, as the government seeks to do in this case, the government must plead the following elements:

> 1) an allegation of jurisdiction, 2) a statement of the date and the conditions under which [the transferor's obligation to the plaintiff arose], 3) a statement that the [transferor] owes the plaintiff the amount, 4) a description of the events surrounding the [transferor's] conveyance of all of his property to the transfer recipient for the purpose of defrauding and for delaying the collection of payment by the plaintiff, and 5) the plaintiff's demand of the court.

Id. Courts in this district have interpreted the fourth element to require the complaint to allege "what (or how much) was transferred, when the transfer was made, how it was made, who made it, who received it, and under what circumstances." *See In re Life Fund 5.1 LLC*, No. 09 B 32672, 2010 WL 2650024, at *3 (Bankr. N.D. Ill. June 30, 2010); *Handler v. Heidenry*, No. 11 C 4494, 2012 WL 2396615, at *5 (N.D. Ill. June 25, 2012) (quoting *In re Life Fund 5.1*); *True Line Contracting & Remodeling Servs., Inc. v. Sheraton Peoria Hotel, LLC*, No. CV 15-1013, 2015 WL 5179561, at *3 (C.D. Ill. Sept. 4, 2015) (quoting *Handler*). Other district courts have similarly required plaintiffs purporting to assert claims of fraudulent transfers under other states' versions of the Uniform Fraudulent Transfer Act or similar laws to make particularized allegations of the circumstances of the allegedly fraudulent transfers. *See, e.g., Screen Capital Int'l Corp. v. Library Asset Acquisition Co.*, 510 B.R. 248, 258-59 (C.D. Cal. 2014); *Heartland Payment Sys., Inc. v. Hickory Mist Luxury Cabin Rentals, LLC*, No. 3:11-CV-350, 2011 WL 6122371, at *5 (E.D. Tenn. Dec. 8, 2011); *Kranz v. Koenig*, 240 F.R.D. 453, 456 (D. Minn. 2007); *cf. Skyline Potato Co. v. Tan-O-On Mktg., Inc.*, 879 F. Supp. 2d 1228, 1257-58 (D.N.M. 2012). The government has not come close to describing with particularity the precise circumstances of the alleged transfers in the way that these decisions have required. The complaint contains no particularized description of the events surrounding the conveyance of Mr. Park's assets or the Trust to the Park children; in fact, it makes no particularized allegations of any such conveyance or conveyances at all. Particularized facts concerning "what (or how much) was transferred, when the transfer was made, how it was made, who made it, who received it, and under what circumstances," are largely missing; the government only pleads who received the alleged transfers (the Park children). The government has not met its pleading burden under Rule 9(b) on Counts V and VI.

The government argues that, Rule 9(b) notwithstanding, it has stated a valid claim for transferee liability in Count III under Illinois common law. (*See* Opp'n Br. at 5-6 (citing *Berliant v. C.I.R.*, 729 F.2d 496, 500 (7th Cir. 1984)) (" 'It is an established doctrine of equity that creditors ... may pursue assets into the hands of distributees, where distribution has been made without discharging their debts.' ") (quoting *Union Tr. Co. v. Shoemaker*, 101 N.E. 1050, 1053 (Ill. 1913)).) According to the government, that claim need not comply with Rule 9(b). Even if the government is correct in that regard, it still fails to meet its burden under the more liberal pleading standard of Rule 8 because it pleads no details of any particular transfers of assets from Mr. Park or the Trust to the Park children. Indeed, according to the complaint, the government appears to have no basis for alleging any such transfers ever occurred other than "information and belief." (2d Am. Compl. ¶¶ 46, 48.) Under such circumstances, the Court is "unable to infer any more than the possibility of misconduct." *Simonian v. Edgecraft Corp.*, No. 10 C 1263, 2010 WL 3781262, at *3 (N.D. Ill. Sept. 20, 2010) (citing *Iqbal*, 558 U.S. at 678 ("Where a complaint pleads facts that are merely consistent with a defendant's liability, it stops short of the line between possibility and plausibility of entitlement to relief.")); *see Screen Capital Int'l Corp.*, 510 B.R. at 259 ("Even under Rule 8, the [complaint] fails to properly allege what—if any—[property] rights ... were transferred ... to or for the benefit of [defendant], and thus what each [party] seeks to recover *from* [defendant]. Without properly alleging an underlying transfer, [plaintiff] cannot bring a claim for avoidance and recovery of a constructively fraudulent transfer under Rule 8.”). Notably, by the terms of the Trust, it is Mrs. Park who is the primary trustee and beneficiary of the Trust during her lifetime, not the Park children. There is no more than the possibility that assets of Mr. Park or the Trust were transferred to the Park children or that they exercised control over them. In other words, the factual allegations do not “raise a right to relief above the speculative level,” *Twombly*, 550 U.S. at 555, and the government provides nothing more than “[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, [which] do not suffice,” *Iqbal*, 556 U.S. at 678, to state a claim that can survive a motion to dismiss. For these reasons, the government fails to state a claim for common-law transferee liability against the Park children.

***4** The government’s claim for an accounting is similarly inadequate. According to the allegations of the complaint and the arguments in the government’s response brief, the accounting claim against the Park children is premised on the allegations that the Park children received property or assets of Mr. Park or the Trust.[2] (*See* Opp'n Br. at 13-15, ECF No. 30 (citing 2d Am. Compl. ¶¶ 97-98).) As explained above, even assuming that the more liberal *Twombly*/*Iqbal* plausibility standard of Rule 8 applies, these allegations are essentially speculative and do not meet the *Twombly*/*Iqbal* standard.

CONCLUSION

For the reasons set forth above, the Court grants the Park children’s motion to dismiss the claims against them [27]. The claims against the Park children should be dismissed without prejudice, with leave to file an amended complaint by November 7, 2017.

SO ORDERED.

All Citations

Slip Copy, 2017 WL 4417826, 120 A.F.T.R.2d 2017-6074, 2018-1 USTC P 50,106

Footnotes

[1] The government correctly states in its opposition brief that the Park children’s motion to dismiss was not timely filed. However, the Park children explain in reply that counsel was confused about whether the government had filed the Second Amended Complaint in lieu of a brief in response to the Park children’s then-pending motion to dismiss an earlier version of the complaint, with the expectation that the Second Amended Complaint mooted the pending motion to dismiss, or whether the government intended to proceed with briefing the issues raised in the pending motion to dismiss. Based on this confusion, the Court excuses the Park children’s untimely motion.

[2] The Court notes that the government has sued the Park children not only individually but also as “Successor Co-Trustees” of the Trust. However, the government apparently does not base its accounting claim against the Park children on their status as such, nor could it, because “[i]f, under the terms of the trust instrument, the successor trustee does not become a trustee until after the death of a predecessor trustee, a court cannot hold him or her liable for an accounting until after the predecessor’s death.” 35 Ill. Law and Prac. Trs. § 125 (citing *Landau v. Landau*, 101 N.E.2d 103, 107 (Ill. 1951)). Under the terms of the Trust, Mrs. Park was to succeed Mr. Park as trustee, and the Park children did not become “successor co-trustees” upon his death unless Mrs. Park was “unwilling and unable to act as Successor Trustee.” (*See* 2d Am. Compl., Ex. 1, Trust, Article Fifth, Section 8.) The government apparently recognizes as much in its complaint, stating that the Park children are sued in their capacity as successor co-trustees only “in the event that Mrs. Park has resigned as trustee.” (*Id.* ¶¶ 9-11.) But the government provides no grounds for any suspicion that she has done so or that, having done so, she has appointed the Park children as her successors (indeed, to the contrary, its claim for breach of fiduciary duty against the trustee of the Trust names only Mrs. Park as a defendant).

End of Document

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Only the Westlaw citation is currently available.
United States District Court,
E.D. California.

Nadia ROBERTS, et al., Plaintiffs,
v.
UBS AG, et al., Defendants.

No. CV F 12–0724 LJO SKO.
|
Jan. 30, 2013.

ORDER ON DEFENDANT UBS AG'S F.R.Civ.P. 12 MOTION TO DISMISS (Doc. 26.)

LAWRENCE J. O'NEILL, District Judge.

INTRODUCTION

***1** Defendant UBS AG seeks to dismiss as improperly pled and legally barred plaintiffs'[1] fraud, breach of fiduciary duties, malpractice and related claims arising from tax penalties plaintiffs incurred in connection with foreign investments and tax shelters with defendant UBS AG. Plaintiffs filed no timely papers to oppose UBS AG's F.R.Civ.P. 12(b)(6) motion to dismiss. This Court considered UBS AG's motion to dismiss on the record without a hearing, pursuant to Local Rule 230(c). For the reasons discussed below, this Court DISMISSES plaintiffs' claims subject to the UBS AG's motion to dismiss.

BACKGROUND[2]

Summary

UBS AG is a Swiss corporation and provides global financial services, including banking, securities, trading, brokerage and wealth management services. The FAC also names as defendants four individuals associated with UBS AG, three Swiss business entities, two private Swiss banks, and a Bermuda corporation. The individual plaintiffs are residents of California, Texas, Washington and New York and are former UBS AG clients. The FAC alleges that UBS AG defendants[3] induced plaintiffs "to conceal offshore assets from the U.S. Government using a variety of means, disguises, schemes, tactics, and covers" and "engaged in unlawful trading of U.S. securities" to result in plaintiffs' failure to pay U.S. taxes on their UBS AG investments. The FAC alleges that each plaintiff "faced criminal investigation relating to the shell company structure set up and carried out by Defendants" and "agreed to pay millions of dollars in tax penalties, plus interest, on top of related costs and professional fees." UBS AG challenges the FAC's multiple tort and related claims as lacking sufficient facts and as barred by plaintiffs' own conduct.

IRS Foreign Account And Trust Reporting

Internal Revenue Service ("IRS") Form 1040, Schedule B, Line 7a ("Line 7a") asks: "did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account located in a foreign country?" Schedule B indicates that if a taxpayer has a foreign account, the taxpayer generally must identify the account's location and complete IRS Form TD F 90–22.1 known as the Report of Foreign Bank and Financial Accounts ("FBAR"). FBAR instructions require a taxpayer to file a FBAR if the taxpayer has more than $10,000 in foreign accounts and to disclose maximum account values and financial institutions holding accounts.

UBS AG's Scheme

In 2001, the U.S. Treasury required UBS AG to enter into a Qualified Intermediary ("QI") Agreement to require UBS AG clients to complete Internal Revenue Service ("IRS") forms to identify beneficial account owners believed or known to be U.S. citizens or residents.[4] UBS AG developed a plan "to manipulate its U.S. customers such that UBS would avoid its own compliance with the QI Agreement while also misleading its customers regarding taxes and reporting" in that UBS AG "advised the use of third party trust entities" which "did not comply with its advisement-disclosure-withholding duties under the QI Agreement" and "encouraged inherited offshore accounts to remain in said offshore accounts and concealed the QI Agreement requirements." UBS

AG contracted professional service firms "to create the appearance of legality and independent recommendation and counsel in order to perpetrate their unlawful scheme to avoid the terms of the QI Agreement."

***2** UBS AG feigned compliance with the IRS and QI Agreement but "failed to disclose this illegal activity to Plaintiffs or any of its other U.S. clients." UBS AG "schemed to defraud U.S. authorities and solicited, offered, and induced U.S. clients to conceal offshore assets," "anticipated and planned to retaliate against their own clients by creating or positing evidence contrary to the truth should UBS AG clients come forward to the IRS," and "failed to disclose this illegal activity to Plaintiffs."

Execution Of The Scheme As To Plaintiffs

The Roberts

The Roberts are married. In 2004, Sean Roberts ("Mr.Roberts") owned a UBS AG account in the Isle of Mann and UBS AG banker Claude Ullman convinced Mr. Roberts to transfer his account to UBS AG's Swiss location. UBS AG engaged defendant Beda Singenberger ("Mr.Singenberger") to create a third-party trust for Mr. Roberts but neither UBS AG nor Mr. Singenberger "advised plaintiffs of the illegal nature of said third party trust and/or plaintiffs' reporting requirements." UBS AG failed to advise the Roberts of the QI Agreement, that their accounts violated the QI Agreement, and that the Roberts "needed to take steps to advise the IRS and mitigate their damages." In February 2009, UBS AG sent information to the IRS about the Roberts but delayed until November 2009 to advise the Roberts of an amnesty Voluntary Disclosure program.

In June 2011, the Roberts entered into plea agreements to plead guilty to filing a false tax return.

The Gubsers

The Gubsers were married during 1978–2008 and held a Swiss UBS AG account which they allowed to sit and which experienced income growth during 2004–2009. UBS AG never advised the Gubsers that they were subject to the QI Agreement. In December 2010, the Gubsers "realized that they may be subject to prosecution by the IRS for failing to declare a 40–year old account originating in Switzerland." The Gubsers participated in the Voluntary Disclosure program.

Dr. Ginzburg

In 2000, UBS AG banker Gian Gisler ("Mr.Gisler") advised Dr. Ginzburg to change the structure of Dr. Ginzburg's UBS AG funds. UBS AG representatives advised Dr. Ginzburg to close a Liechtenstein-based trust structure in favor of a Hong Kong-based trust, that Dr. Ginzburg "would not have to pay any taxes on any capital gains or dividends until the funds were repatriated" to Dr. Ginzburg's country of future domicile, the United States or Israel, and that he would pay only taxes on possible capital gains and dividends when he repatriated the funds. Dr. Ginzburg was never informed of the QI Agreement, and in November 2008, UBS AG froze his accounts to prevent him to mitigate market losses. UBS AG representatives refused to disclose information about Dr. Ginzburg's accounts and liquidated the stock portfolio at 2009 levels to result in a $1.5 million loss.

In July 2011, Dr. Ginzburg pled guilty to criminal tax fraud.

Mr. Eisenberg

***3** Mr. Eisenberg held a UBS AG account in the Grand Caymans and during a vacation there, entered a UBS AG branch to inquire about the account. He was informed that his account was on the "abandoned accounts" list and transferred to Switzerland. Mr. Eisenberg traveled to Switzerland and defendant Hansredi Schumacher ("Mr.Schumacher") advised Mr. Eisenberg to set up a trust. Mr. Eisenberg permitted Mr. Schumacher to set up a Liechtenstein account and was advised "that he would not be required to disclose his account because of the trust formation." In 2010, Mr. Eisenberg discovered that UBS AG double charged fees during the account's life.

UBS AG failed to advise Mr. Eisenberg of the QI Agreement, the need to report his account for taxes, and release by UBS AG of his name to the United States to preclude Mr. Eisenberg to correct defects or seek voluntary disclosure. The IRS prosecuted Mr. Eisenberg who entered into a December 2010 agreement to plead guilty to filing a false tax return and paid $2.5 million penalties on a $65,000 tax bill.

Mr. Chernick

Mr. Chernick succeeded in manufacturing toys with his Shumba corporation. In 2000, UBS AG executive director Phillip Bigger ("Mr.Bigger") recommended to move Mr. Chernick's Cayman Islands account to UBS AG's Hong Kong office, and Mr. Chernick opened up UBS AG Hong Kong accounts. Mr. Chernick was advised to hold U.S. securities in the Hong Kong accounts "without disclosing that Chernick would have to report such holdings to the U.S. or otherwise advising him of the QI Agreement terms." In 2002, defendant Matthias Rickenbach with UBS AG's authorization "caused the setup of a sham entity to hold Shumba and Simba." In 2006, Mr. Bigger caused Mr. Chernick to close his Shumba account at the UBS Hong Kong office and transferred the account's assets, including U.S. securities, to a UBS AG Zurich account. UBS AG failed to inform Mr. Chernick of the QI Agreement requirements to file IRS forms or UBS AG withholding of taxes.

Mr. Chernick entered into a July 2009 agreement to plead guilty to filing a false tax return.

Common Claims

As to all plaintiffs, the FAC alleges that:

1. UBS AG "regularly traded securities on behalf of Plaintiffs" and misrepresented "proper licensure to make each transaction illegally prior to and at the time of each transaction";

2. UBS AG defendants "repeatedly assured Plaintiffs that the management scheme and structure of their investments had been reviewed by UBS AG attorneys and were authorized by and in compliance with U.S. reporting laws"; and

3. UBS AG defendants "regularly met with Plaintiffs" but failed to advise of "the illegality of UBS AG's scheme, any problems related to the tax and investment advice, and/or the likelihood that each Plaintiff would be subject to tax penalties, interest, and criminal investigation as a result of UBS AG's scheme, all the while continuing to manage Plaintiffs' respective funds in accordance with the scheme."

Criminal Prosecution Of UBS AG

***4** In November 2008, the United States government filed indictments against UBS AG executives, managers and bankers. On February 18, 2009, UBS AG and the United States government entered into a Deferred Prosecution Agreement ("DPA") by which UBS AG admitted that during 2000–2007, UBS AG "participated in a scheme to defraud the United States and its agency, the IRS by actively assisting or otherwise facilitating a number of United States individual taxpayers in establishing accounts at UBS in a manner designed to conceal the United States taxpayers' ownership or beneficial interest in these accounts." On August 12, 2009, the United States government and UBS AG reached an agreement in principle by which 4,450 UBS AG clients would be revealed.

DISCUSSION

F.R.Civ.P. 12(b)(6) Motion To Dismiss Standards

The FAC alleges 20 tort and related claims which UBS AG contends are precluded by plaintiffs' "own tax fraud" in that all plaintiffs but the Gubsers have pled guilty to criminal tax fraud by knowingly filing false returns and concealing income. UBS AG faults plaintiffs' failure to disclose their foreign accounts on tax returns to render the FAC's claims based on an "implausible premise that UB S somehow caused them to reasonably believe they could legally lie to the IRS, keep secret their foreign accounts from the IRS, and fail to pay taxes."

"When a federal court reviews the sufficiency of a complaint, before the reception of any evidence either by affidavit or admissions, its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheurer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974); *Gilligan v. Jamco Development Corp.,* 108 F.3d 246,249 (9th Cir.1997). A

F.R.Civ.P. 12(b)(6) dismissal is proper where there is either a "lack of a cognizable legal theory" or "the absence of sufficient facts alleged under a cognizable legal theory." *Balisteri v. Pacifica Police Dept.,* 901 F.2d 696, 699 (9th Cir.1990); *Graehling v. Village of Lombard, Ill.,* 58 F.3d 295, 297 (7th Cir.1995). A F.R.Civ.P. 12(b)(6) motion "tests the legal sufficiency of a claim." *Navarro v. Block,* 250 F.3d 729, 732 (9th Cir.2001).

In addressing dismissal, a court must: (1) construe the complaint in the light most favorable to the plaintiff; (2) accept all well-pleaded factual allegations as true; and (3) determine whether plaintiff can prove any set of facts to support a claim that would merit relief. *Cahill v. Liberty Mut. Ins. Co.,* 80 F.3d 336, 337–338 (9th Cir.1996). Nonetheless, a court is not required "to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *In re Gilead Sciences Securities Litig.,* 536 F.3d 1049, 1055 (9th Cir.2008) (citation omitted). A court "need not assume the truth of legal conclusions cast in the form of factual allegations," *U.S. ex rel. Chunie v. Ringrose,* 788 F.2d 638, 643, n. 2 (9th Cir.1986), and must not "assume that the [plaintiff] can prove facts that it has not alleged or that the defendants have violated ... laws in ways that have not been alleged." *Associated General Contractors of California, Inc. v. California State Council of Carpenters,* 459 U.S. 519, 526, 103 S.Ct. 897, 74 L.Ed.2d 723 (1983). A court need not permit an attempt to amend if "it is clear that the complaint could not be saved by an amendment." *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.,* 416 F.3d 940, 946 (9th Cir.2005).

***5** A plaintiff is obliged "to provide the 'grounds' of his 'entitlement to relief' [which] requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Bell Atl. Corp. v. Twombly,* 550 U.S. 554,550 U.S. 544, 127 S.Ct. 1955, 1964–65, 167 L.Ed.2d 929 (2007) (internal citations omitted). Moreover, a court "will dismiss any claim that, even when construed in the light most favorable to plaintiff, fails to plead sufficiently all required elements of a cause of action." *Student Loan Marketing Ass'n v. Hanes,* 181 F.R.D. 629, 634 (S.D.Cal.1998). In practice, a complaint "must contain either direct or inferential allegations respecting all the material elements necessary to sustain recovery under some viable legal theory." *Twombly,* 550 U.S. at 562, 127 S.Ct. at 1969 (quoting *Car Carriers, Inc. v. Ford Motor Co.,* 745 F.2d 1101, 1106 (7th Cir.1984)).

In *Ashcroft v. Iqbal,* 556 U.S. 662, 129 S.Ct. 1937,1949, 173 L.Ed.2d 868 (2009), the U.S. Supreme Court explained:

> ... a complaint must contain sufficient factual matter, accepted as true, to "state a claim to relief that is plausible on its face." ... A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.... The plausibility standard is not akin to a "probability requirement," but it asks for more than a sheer possibility that a defendant has acted unlawfully. (Citations omitted.)

After discussing *Iqbal,* the Ninth Circuit summarized: "In sum, for a complaint to survive [dismissal], the non-conclusory 'factual content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief ." *Moss v. U.S. Secret Service,* 572 F.3d 962, 989 (9h Cir.2009) (quoting *Iqbal,* 556 U.S. 662, 129 S.Ct. at 1949, 173 L.Ed.2d 868).

The U.S. Supreme Court applies a "two-prong approach" to address dismissal:

> First, the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.... Second, only a complaint that states a plausible claim for relief survives a motion to dismiss.... Determining whether a complaint states a plausible claim for relief will ... be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.... But where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged—but it has not "show[n]"-"that the pleader is entitled to relief." Fed. Rule Civ. Proc. 8(a)(2).
>
> In keeping with these principles a court considering a motion to dismiss can choose to begin by identifying pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth. While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations. When there are well-pleaded factual

> allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief.

***6** *Iqbal,* 556 U.S. 662, 129 S.Ct. at 1949–1950, 173 L.Ed.2d 868.

A plaintiff suing multiple defendants "must allege the basis of his claim against each defendant to satisfy Federal Rule of Civil Procedure 8(a)(2), which requires a short and plain statement of the claim to put defendants on sufficient notice of the allegations against them." *Gauvin v. Trombatore,* 682 F.Supp. 1067, 1071 (N.D.Cal.1988). "Specific identification of the parties to the activities alleged by the plaintiffs is required in this action to enable the defendant to plead intelligently." *Van Dyke Ford, Inc. v. Ford Motor Co.,* 399 F.Supp. 277, 284 (D.Wis.1975).

With these standards in mind, this Court turns to UBS AG's challenges the FAC claims.

Fraud

The FAC's (first) fraudulent misrepresentation and concealment and (third) negligent misrepresentation claims allege that to induce plaintiffs to transfer their account investments to UBS AG and to pay hundreds of thousands of dollars in fees, UBS AG and other defendants misrepresented that the formation and form of shell corporations "were permitted by the IRS" and concealed from plaintiffs that "they not only owed taxes on their investments with the IRS but would face criminal investigation for the management structure of their respective accounts." The FAC's (second) constructive fraud claim alleges that UBS AG and other defendants breached duties owed to plaintiffs by forming shell corporations "with the representation that said formations were permitted by the IRS," failing "to report each Plaintiff's information to the IRS or to withhold taxes pursuant to the QI agreement," providing "erroneous tax opinions," and concealing that each plaintiff "would face criminal investigation."

Bar Of Plaintiffs' Own Fraud

UBS AG initially challenges the complaint's fraud claims as barred by plaintiffs' own fraud. UBS AG points to *Olenicoff v. UBS AG,* 2012 WL 1192911, at *1 (C.D.Cal.2012), where the plaintiff pursued claims against UBS AG after the plaintiff pled guilty to knowingly and willfully failing to disclose off-shore accounts on his tax returns. The fellow district judge in *Olenicoff,* 2012 WL 1192911, at *1, observed:

> To defend itself, UBS is forced to strenuously insist that its prior guilty plea only admitted to assisting willing clients with tax fraud, not forcing unsuspecting clients into tax evasion. While its argument is ironic, UBS is right. Even assuming that UBS gave [plaintiff] fraudulent tax advice, that makes UBS a co-conspirator, not a defendant in this litigation.

UBS AG argues that plaintiffs must bear responsibility for their own fraud and related actions in absence of FAC allegations that they misinterpreted or did not know of Line 7a or that UBS AG prepared their tax returns, advised them how to answer tax return questions, or represented that plaintiffs could legally deny existence of their UBS AG accounts.

Fraud Elements

UBS AG further challenges the FAC's absence of facts to support fraud elements.

***7** The elements of a California fraud claim are: (1) misrepresentation (false representation, concealment or nondisclosure); (2) knowledge of the falsity (or "scienter"); (3) intent to defraud, i.e., to induce reliance; (4) justifiable reliance; and (5) resulting damage. *Lazar v. Superior Court,* 12 Cal.4th 631, 638, 49 Cal.Rptr.2d 377, 909 P.2d 981 (1996). The same elements comprise a cause of action for negligent misrepresentation, except there is no requirement of intent to induce reliance. *Caldo v. Owens–Illinois, Inc.,* 125 Cal.App.4th 513, 519, 23 Cal.Rtpr.3d 1 (2004).

"[T]o establish a cause of action for fraud a plaintiff must plead and prove in full, factually and specifically, all of the elements of the cause of action." *Conrad v. Bank of America,* 45 Cal.App.4th 133, 156, 53 Cal.Rptr.2d 336

(1996). There must be a showing "that the defendant thereby intended to induce the plaintiff to act to his detriment in reliance upon the false representation" and "that the plaintiff actually and justifiably relied upon the defendant's misrepresentation in acting to his detriment." *Conrad,* 45 Cal.App.4th at 157, 53 Cal.Rptr.2d 336; *see Grant Thornton LLP v. Prospect High Income Fund,* 314 S.W.3d 913, 923 (Tex.2010) ("Both fraud and negligent misrepresentation require that the plaintiff show actual and justifiable reliance"); *J.A.O. Acquisition Corp. v. Stavitsky,* 8 N.Y.3d 144, 148, 831 N.Y.S.2d 364, 863 N.E.2d 585 (N.Y.2007); *Lawyers Title Ins. Corp. v. Baik,* 147 Wash.2d 536, 624, 55 P.3d 619 (Wash.2002). "The absence of any one of these required elements will preclude recovery." *Wilhelm v. Pray, Price, Williams & Russell,* 186 Cal.App.3d 1324, 1332, 231 Cal.Rptr. 355 (1986).

UBS AG faults the FAC's absence of facts to support plaintiffs' actual and justifiable reliance on UBS AG's misrepresentations or omissions. UBS AG argues that fraud claims based on an "omission" theory fail in that Line 7a seeks an unequivocal disclosure ("did you have a financial interest in or signature authority over a financial account ... located in a foreign country?").

UBS AG attacks an affirmatively misrepresented tax-reporting theory in that there is no justifiable reliance if a plaintiff unreasonably fails to conduct an independent inquiry that would have uncovered the truth or disregards known and obvious risks. *See Cameron v. Cameron,* 88 Cal.App.2d 585, 594, 199 P.2d 443 (1948) ("If [one] becomes aware of facts that tend to arouse his suspicion, or if he has reason to believe that any representations made to him are false or only half true, it is his legal duty to complete his investigation and he has no right to rely on statements of the other contracting party.") UBS AG contends that given clarity of disclosure required by IRS tax forms, plaintiffs could not have justifiably relied on UBS AG's alleged statements suggesting otherwise.

UBS AG points to the absence of allegations that UBS AG informed plaintiffs to deny that they held interests in foreign accounts or not to file Schedule B's and FBARs. UBS AG continues that an account holder is unable to claim that UBS AG caused the account holder's tax fraud when he/she declared under penalty of perjury for years that he/she "had no interest in foreign accounts despite knowing that he or she did."

Particularity Pleading Standard

***8** UBS AG faults the FAC's absence of specific allegations to support fraud-based claims.

F.R.Civ.P. 9(b) requires a party to "state with particularity the circumstances constituting fraud." [5] In the Ninth Circuit, "claims for fraud and negligent misrepresentation must meet Rule 9(b)'s particularity requirements." *Neilson v. Union Bank of California, N.A.,* 290 F.Supp.2d 1101, 1141 (C.D.Cal.2003). A court may dismiss a claim grounded in fraud when its allegations fail to satisfy F.R.Civ.P. 9(b)'s heightened pleading requirements. *Vess,* 317 F.3d at 1107. [6] A motion to dismiss a claim "grounded in fraud" under F.R.Civ.P. 9(b) for failure to plead with particularity is the "functional equivalent" of a F.R.Civ.P. 12(b)(6) motion to dismiss for failure to state a claim. *Vess,* 317 F.3d at 1107. As a counter-balance, F.R.Civ.P. 8(a)(2) requires from a pleading "a short and plain statement of the claim showing that the pleader is entitled to relief."

F.R.Civ.P. 9(b)'s heightened pleading standard "is not an invitation to disregard Rule 8's requirement of simplicity, directness, and clarity" and "has among its purposes the avoidance of unnecessary discovery." *McHenry v. Renne,* 84 F.3d 1172,1178 (9th Cir.1996). F.R.Civ.P 9(b) requires "specific" allegations of fraud "to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Semegen v. Weidner,* 780 F.2d 727, 731 (9th Cir.1985). "A pleading is sufficient under Rule 9(b) if it identifies the circumstances constituting fraud so that the defendant can prepare an adequate answer from the allegations." *Neubronner v. Milken,* 6 F.3d 666, 671–672 (9th Cir.1993) (internal quotations omitted; citing *Gottreich v. San Francisco Investment Corp.,* 552 F.2d 866, 866 (9th Cir.1997)). The Ninth Circuit has explained:

> Rule 9(b) requires particularized allegations of the circumstances *constituting* fraud. The time, place and content of an alleged misrepresentation may identify the statement or the omission complained of, but these circumstances do not "constitute" fraud. The statement in question must be false to be fraudulent. Accordingly, our cases have consistently required that circumstances indicating falseness be set forth.... [W]e [have] observed

> that plaintiff must include statements regarding the time, place, and *nature* of the alleged fraudulent activities, and that "mere conclusory allegations of fraud are insufficient." ... The plaintiff must set forth what is false or misleading about a statement, and why it is false. In other words, the plaintiff must set forth an explanation as to why the statement or omission complained of was false or misleading....
>
> In certain cases, to be sure, the requisite particularity might be supplied with great simplicity.

In Re Glenfed, Inc. Securities Litigation, 42 F.3d 1541, 1547–1548 (9th Cir.1994) (en banc) (italics in original) *superseded by statute on other grounds as stated in Marksman Partners, L.P. v. Chantal Pharm. Corp.,* 927 F.Supp. 1297 (C.D.Cal.1996); *see Cooper v. Pickett,* 137 F.3d 616, 627 (9th Cir.1997) (fraud allegations must be accompanied by "the who, what, when, where, and how" of the misconduct charged); *see Neubronner,* 6 F.3d at 672 ("The complaint must specify facts as the times, dates, places, benefits received and other details of the alleged fraudulent activity."); *Schreiber Distributing Co. v. Serv–Well Furniture Co., Inc.,* 806 F.2d 1393, 1401 (1986) ("the pleader must state the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation").

***9** In a fraud action against a corporation, a plaintiff must "allege the names of the persons who made the allegedly fraudulent representations, their authority to speak, to whom they spoke, what they said or wrote, and when it was said or written." *Tarmann v. State Farm Mut. Auto. Ins. Co.,* 2 Cal.App.4th 153, 157, 2 Cal.Rptr.2d 861 (1991).

F.R.Civ.P. 9(b) "does not allow a complaint to merely lump multiple defendants together but 'require[s] plaintiffs to differentiate their allegations when suing more than one defendant ... and inform each defendant separately of the allegations surrounding his alleged participation in the fraud.' " *Swartz v. KPMG LLP,* 476 F.3d 756, 764–765 (9th Cir.2007) (quoting *Haskin v. R.J. Reynolds Tobacco Co.,* 995 F.Supp. 1437, 1439 (M.D.Fla.1998)). In the context of a fraud suit involving multiple defendants, a plaintiff must, at a minimum, "identif[y] the role of [each] defendant[ ] in the alleged fraudulent scheme." *Moore v. Kayport Package Express, Inc.,* 885 F.2d 531, 541 (9th Cir.1989). "To state a claim of fraudulent conduct, which carries substantial reputational costs, plaintiffs must provide each and every defendant with enough information to enable them 'to know what misrepresentations are attributable to them and what fraudulent conduct they are charged with.' " *Pegasus Holdings v. Veterinary Centers of America, Inc.,* 38 F.Supp.2d 1158, 1163 (C.D.Cal.1998) (quoting *In re Worlds of Wonder Sec. Litig.,* 694 F.Supp. 1427, 1433 (N.D.Cal.1988)).

UBS AG argues that FAC's detailed allegations are limited to statements republished from UBS AG 2002, 2004 and 2006 publications and as to those statements, there is no clarity that "plaintiffs were exposed to these statements, or how those plaintiffs were affected."

UBS AG raises valid, unopposed attacks on the FAC's fraud claims. The FAC fails to address plaintiffs' own fraudulent misreporting of taxes and its impact on their fraud claims against UBS AG. The FAC fails to satisfy F.R.Civ.P. 9(b) particularity requirements. The FAC's bulk and verbosity do not equate to specific allegations of fraud attributed to identified defendants. The FAC lumps multiple defendants and offers little clarity as to the description and source of affirmative misrepresentations or concealments. A further FAC failing is the lack of sufficient facts to support reliance elements especially considering the obvious risk of failing to report income to the IRS. The FAC's fraudulent misrepresentation and concealment and negligent misrepresentation claims are subject to dismissal with leave to amend.

Breach Of Fiduciary Duty

The FAC's (six) breach of fiduciary duty and (ninth) professional malpractice claims accuse UBS AG and other defendants of fiduciary breaches by, among other things:

1. Soliciting and manipulating plaintiffs to transfer assets to and maintain accounts with UBS AG;

2. Failing to disclose and comply with the QI Agreement and other disclosure and tax requirements;

***10** 3. Failing to ensure that plaintiffs' UBS AG transactions complied with law;

4. Advising plaintiffs that their UBS AG transactions were legitimate and complied with tax law;

5. Promoting and selling unregistered and ineffective tax shelters; and

6. Improperly managing plaintiffs' assets.

UBS AG argues that fiduciary-based fraud, negligence and breach claims fail in the absence of an actionable duty to impose on UBS AG. UBS AG contends initially that as a bank, it owed no fiduciary duty to plaintiffs.

Elements

"The elements of a cause of action for negligence are (1) a legal duty to use reasonable care, (2) breach of that duty, and (3) proximate [or legal] cause between the breach and (4) the plaintiff's injury." *Mendoza v. City of Los Angeles,* 66 Cal.App.4th 1333, 1339, 78 Cal.Rptr.2d 525 (1998) (citation omitted).

"The elements of a cause of action for breach of fiduciary duty are: (1) the existence of a fiduciary duty; (2) a breach of the fiduciary duty; and (3) resulting damage. *Pellegrini v. Weiss,* 165 Cal.App.4th 515, 524, 81 Cal.Rptr.3d 387 (2008).

In *Salahutdin v. Valley of California, Inc.,* 24 Cal.App.4th 555, 562, 29 Cal.Rptr.2d 463 (1994), the California Court of Appeal explained constructive fraud:

> Constructive fraud is a unique species of fraud applicable only to a fiduciary or confidential relationship.... [A]s a general principle constructive fraud comprises any act, omission or concealment involving a breach of legal or equitable duty, trust or confidence which results in damage to another even though the conduct is not otherwise fraudulent. Most acts by an agent in breach of his fiduciary duties constitute constructive fraud. The failure of the fiduciary to disclose a material fact to his principal which might affect the fiduciary's motives or the principal's decision, which is known (or should be known) to the fiduciary, may constitute constructive fraud. Also, a careless misstatement may constitute constructive fraud even though there is no fraudulent intent. (Citation and internal punctuation omitted).

Account Management

UBS AG argues that fiduciary-based claims founded on mismanagement of plaintiffs' accounts fail in the absence of a subject fiduciary duty to impose on UBS AG.

A fiduciary relationship arises "between parties to a transaction wherein one of the parties is ... duty bound to act with the utmost good faith for the benefit of the other party." *Herbert v. Lankershim,* 9 Cal.2d 409, 483, 71 P.2d 220 (1937). A fiduciary relationship "ordinarily arises where a confidence is reposed by one person in the integrity of another, and in such a relation the party in whom the confidence is reposed, if he voluntarily accepts or assumes to accept the confidence, can take no advantage from his acts relating to the interest of the other party without the latter's knowledge or consent." *Herbert,* 9 Cal.2d at 483, 71 P.2d 220.

***11** Nonetheless "no fiduciary relationship is established merely because 'the parties reposed trust and confidence in each other.' " *Girard v. Delta Towers Joint Venture,* 20 Cal.App.4th 1741, 1749, 26 Cal.Rptr.2d 102 (1993) (quoting *Worldvision Enterprises, Inc. v. American Broadcasting Companies, Inc.,* 142 Cal.App.3d 589, 595, 191 Cal.Rptr. 148 (1983)). To be charged with a fiduciary obligation, a person must knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law. *City of Hope Nat. Medical Center v. Genentech, Inc.,* 43 Cal.4th 375, 385, 75 Cal.Rptr.3d 333, 181 P.3d 142 (2008).

"California courts have not extended the 'special relationship' doctrine to include ordinary commercial contractual relationships" *Martin v. U–Haul Co. Of Fresno,* 204 Cal.App.3d 396, 412, 251 Cal.Rptr. 17 (1988) (citations omitted). The "relationship between a bank and its depositor is not fiduciary in character." *Das v. Bank of America, N.A.,* 186 Cal.App.4th 727, 741, 112

Cal.Rptr.3d 439 (2010). "[U]nder ordinary circumstances the relationship between a bank and its depositor is that of debtor-creditor, and is not a fiduciary one." *Lawrence v. Bank of America,* 163 Cal.App.3d 431, 437, 209 Cal.Rptr. 541 (1985); *see Bennice v. Lakeshore Sav. & Loan Ass'n,* 254 A.D.2d 731, 732, 677 N.Y.S.2d 842 (1998) ("Absent the existence of a special relationship of trust and confidence, a bank has no duty to inform a customer or depositor of the tax consequences of a transaction"); *Tokarz v. Frontier Federal Sav. and Loan Ass'n,* 33 Wash.App. 456, 459, 656 P.2d 1089 (1982); *Jockusch v. Towsey,* 51 Tex. 129, 131 (1879).

Tax Advice

UBS AG further challenges fiduciary-based claims in the absence of FAC allegations that plaintiffs "yielded control over tax matters to UBS" or delegated "total control over tax reporting to UBS." UBS AG further notes that the FAC does not allege that UBS AG advised plaintiffs "not to resort to other tax accountants."

UBS AG faults "tax adviser" claims a inadequately pled in that the fraud, negligence and fiduciary claims turn on a relationship triggering a duty to disclose, but the QI Agreement is between UBS AG and the IRS, not plaintiffs, and thus generates UBS AG duties to the IRS, not to plaintiffs. UBS AG notes that the QI Agreement requires it to collect information about account holders, not to provide information to account holders. *Thomas v. UBS AG,* 2012 WL 2396866, at * 5 (N.D.Ill.2012) ("UBS's obligations under the QI Agreement run to the IRS, not the Plaintiffs. Therefore, Plaintiffs' allegation that UBS had a duty to Plaintiffs is not plausible"). UBS AG continues that QI Agreement never altered plaintiffs' disclosure requirements "on the IRS's crystal-clear tax forms."

The FAC lacks facts to support fiduciary-based claims. The FAC reveals a banking-investment or commercial relationship among UBS AG and plaintiffs. Certainly, no fiduciary relationship could arise from arrangements to conceal income and avoid taxes. No facts are apparent to warrant an attempt to amend fiduciary-based claims which are subject to dismissal with prejudice. Nonetheless, facts may exist to attempt to support claims based on general negligence or malpractice to the extent UBS AG owed such duties to plaintiffs. As such, the FAC's general negligence or malpractice based claims are subject to dismissal with leave to amend.

Securities Fraud

***12** The FAC's (fourth) securities fraud claim accuses UBS AG and other defendants of violating Section 10(b) of the Securities and Exchange Act, 15 U.S.C. § 78j (b), and its Rule 10b–5, 17 C.F.R. § 240.10b–5. The FAC's (fifth) securities fraud claim accuses UBS AG and other defendants of violation of California Corporations Code sections 25401 ("section 25401") and 25501 ("section 25501") based on misrepresentations and concealments that:

1. UBS AG and/or its third-party affiliates would prepare proper and legal documentation to form IRS-permissible shell corporations;

2. Ownership of UBS AG accounts "would be fully compliant with all U.S. reporting requirements"; and

3. Defendants would report all income and accounts required by the IRS "to ensure each Plaintiff would comply with all U.S. tax reporting requirements."

UBS AG faults the securities fraud claims in absence of FAC allegations of "purchase or sale of any securities by plaintiffs from UBS AG." A federal securities fraud claim requires an untrue statement or omission of material fact "in connection with the purchase or sale of any security." *Basic Inc. v. Levinson,* 485 U.S. 224, 231, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). To support a California securities fraud claim, a plaintiff must allege that there was an "offer to sell a security in this state or buy or offer to buy a security." *Goodworth Holdings Inc. v. Suh,* 239 F.Supp.2d 947, 962 (N.D.Cal.2002).

UBS AG criticizes the FAC's failure to identify "a single purchase or sale of a security that is connected to the alleged fraudulent statements by UBS AG." UBS AG challenges the FAC's failure "to identify even one security that was purchased or sold through their UBS accounts." To satisfy the "in connection with the purchase or sale of any security" requirement, "the misrepresentation or omission must pertain to the securities themselves; allegations of fraud merely involving securities are not sufficient." *Bissell v. Merrill Lynch & Co., Inc.,* 937 F.Supp. 237, 242 (S.D.N.Y.1996). "[U]nless the alleged fraud concerns the value of the securities bought or sold, or the consideration received in return, such fraud is not 'in connection with' the purchase or sale of a security." *Bissell,* 937 F.Supp. at 242.

UBS AG further faults absence of allegations of plaintiffs' damage "by any alleged misstatement regarding regulatory licenses" given the there are no claims that plaintiffs "were denied a rightful interest in any securities that UBS offered, or purported to offer, but was not legally able to facilitate." UBS AG notes the absence of facts to connect unspecified licenses to plaintiffs' truthful completion of their tax returns.

Turning to the California securities fraud claim, UBS AG further faults the absence of facts of "privity between the purchaser and seller of the security." Section 25401 "requires plaintiff to demonstrate privity with each defendant." *Goodworth Holdings Inc. v. Suh,* 239 F.Supp.2d 947, 963 (N.D.Cal.2002). Section 25501 provides that any person who violates section 25401 "shall be liable to the person who purchases a security from him." *Apollo Capital Fund, LLC v. Roth Capital Partners, LLC,* 158 Cal.App.4th 226, 252–253, 70 Cal.Rptr.3d 199 (2007). "Section 25501 on its face requires privity between the plaintiff and the defendant." *Apollo Capital,* 158 Cal.App.4th at 253, 70 Cal.Rptr.3d 199; *see California Amplifier, Inc. v. RLI Ins. Co.,* 94 Cal.App.4th 102, 109, 113 Cal.Rptr.2d 915 (2001) (Section 25501 "retain[s] the privity requirement from common law fraud"); *Admiralty v. Jones,* 677 F.2d 1289,1296 (9th Cir.1982) (under section 25501, "liability was limited to actual sellers" and seller's attorney "was not the literal seller, as required by this section").

***13** The FAC's securities fraud claims fail in the absence of facts of sales between UBS AG and plaintiffs. The FAC focuses on alleged exorbitant fees charged by UBS AG but identifies no specific securities transactions involving UBS AG as a party. At best, the FAC hints to fraud involving securities, not pertaining to the securities themselves. No facts are apparent to warrant an attempt to amend securities fraud claims which are subject to dismissal with prejudice.

RICO[7]

The FAC's (seventh) RICO claim alleges UBS AG's and other defendants' violation of 18 U.S.C. § 1962(c) ("section 1962(c)") based on predicate acts of:

1. "Embezzlement by the UBS AG Defendants and the third party affiliates who set up improper trusts ... and who further took money from Plaintiffs under false pretenses between 2008 and 2010";

2. "Fraudulent misrepresentation and concealment by ... individuals on behalf of UB S AG ... between 2000 and 2010 relating to fund management, tax legalities, liabilities, and filing requirements, privacy, quality of securities, true price of securities, misappropriation of funds, and true use of assets"; and

3. "Securities fraud ... between 2000 and 2010, including intentional statutory and governmental violations of selling securities without proper licensure, and ignoring nonlicensure of employees and third party securities promoters."

The FAC's (eighth) RICO conspiracy claim alleges UBS AG and other defendants conspired jointly to violate section 1962(c) through a pattern of racketeering and in turn to violate 18 U.S.C. § 1962(d) ("section 1962(d)").

Section 1962(c) and (d) provide:

> (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.
>
> (d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

A violation of § 1962(c) "requires (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. The plaintiff must, of course, allege each of these elements to state a claim." *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 496, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985).

Subsection (5) of 18 U.S.C. § 1961("section 1961") defines "pattern of racketeering activity" to require "at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity." Section 1961 "does not so much define a pattern of racketeering activity as state a minimum necessary condition for the existence of such a pattern." *H.J., Inc. v. Northwest Bell Telephone Co.,* 492 U.S. 229, 237, 109 S.Ct. 2893, 106 L.Ed.2d 195 (1989). Section 1961(5) "says of the phrase 'pattern of racketeering activity' only that it 'requires at least two acts of racketeering activity, one of which occurred after [October 15, 1970,] and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity.' It thus places an outer limit on the concept of a pattern of racketeering activity that is broad indeed." *H.J., Inc.,* 492 U.S. at 237, 109 S.Ct. 2893, 106 L.Ed.2d 195. "Section 1961(5) concerns only the minimum *number* of predicates necessary to establish a pattern; and it assumes that there is something to a RICO pattern *beyond* simply the number of predicate acts involved." *H.J., Inc.,* 492 U.S. at 238, 109 S.Ct. at 2900 (italics in original).

***14** UBS AG faults the FAC's failure to allege "any predicate acts that would form the basis" for the FAC's RICO claims. UBS AG notes that securities fraud fails to support a RICO claim and points to 18 U.S.C. § 1964(c): "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962." "In 1995, Congress amended the RICO statute to eliminate securities fraud as a predicate act upon which to base a RICO claim.... The rule that a plaintiff cannot assert a RICO claim based on predicate acts that sound in securities fraud is applicable even if, as is the case here, the claim is plead as a matter of mail fraud or wire fraud." *Swartz v. KPMG, LLC,* 401 F.Supp.2d 1146, 1151 (W.D.Wash.2004).

UBS AG argues that a RICO claim based on other fraud as predicate acts fails in the absence of "the particular contents of the alleged fraudulent representations." UBS AG contends that the FAC lacks allegations of UBS AG's embezzlement.

The Ninth Circuit applies F.R.Civ.P. 9(b) particularity requirements to RICO claims under 18 U.S.C. § 1962. *Moore v. Kayport Package Exp., Inc.,* 885 F.2d 531, 541 (9th Cir.1989); *Alan Neuman Prods., Inc. v. Albright,* 862 F.2d 1388, 1392–93 (9th Cir.1988) ("The allegations of predicate acts in the complaint concerning those elements of RICO are entirely general; no specifics of time, place, or nature of the alleged communications are pleaded. This is a fatal defect under Fed.R.Civ.P. 9(b), which requires that circumstances constituting fraud be stated with particularity."); *Schreiber Distrib. Co. v. ServWell Furniture Co. .,* 806 F.2d 1393, 1401 (9th Cir.1986) ("We have interpreted Rule 9(b) to mean that the pleader must state the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation.")

"The mere assertion of a RICO claim consequently has an almost inevitable stigmatizing effect on those named as defendants. In fairness to innocent parties, courts should strive to flush out frivolous RICO allegations at an early stage of the litigation." *Figueroa Ruiz v. Alegria,* 896 F.2d 645, 650 (1st Cir.1990).

"The particularity requirements of Rule 9(b) apply to allegations of mail fraud, 18 U.S.C. § 1341, and wire fraud, 18 U.S.C. § 1343, when used as predicate acts for a RICO claim." *Murr Plumbing, Inc. v. Scherer Bros. Financial Services Co.,* 48 F.3d 1066, 1069 (8th Cir.1995).

UBS AG faults the RICO conspiracy claim's absence of "allegations of coordination or organization among UBS AG and other Defendants who are alleged to have 'continued' some sort of scheme during the years after plaintiffs closed their UBS accounts in June 2005."

The FAC's RICO claims fail. Securities fraud fails to serve as a predicate act for a RICO claim. The FAC's RICO claims based on predicate acts of securities fraud are subject to dismissal with prejudice. RICO claims based on other predicate acts fail in absence of particularity to satisfy F.R.Civ.P. 9(b), similar to the FAC's fraud claims. Although the FAC offers little to support a potential RICO claim, out of an abundance of caution, the RICO claims, based on predicate acts other than securities fraud, are dismissed with leave to amend.

Disgorgement

***15** The FAC's (tenth) disgorgement claim alleges that UBS AG and other defendants charged for "management" services which "were not customary, but were excessive, especially in light of the alleged scheme" and UBS AG's and other defendants' lacking licenses "to conduct any of the transactions, give advice, sell, and/or invest" plaintiffs' assets." The disgorgement claim seeks "all fees, profits, commissions, received by Defendants either directly from each Plaintiff or from any and all other Defendants and/or third parties, in the preparation of and formation of business entities, and 'salaries' obtained from entities" using plaintiffs' assets.

Disgorgement is an "equitable remedy designed to deprive a wrongdoer of his unjust enrichment." *SEC v. First City Fin. Corp. .,* 890 F.2d 1215, 1231 (D.C.Cir.1989). UBS AG contends that the FAC is unable to allege a claim for disgorgement, which is a remedy, "not a claim in itself." *S.E.C. v. FirstJersey Securities, Inc.,* 101 F.3d 1450,1478 (2nd Cir.1996). *Moorehead v. Deutsche Bank AG,* 2011 WL 4496221, at *3, n. 1 (N.D.Ill.2011) ("Defendants correctly argue that 'disgorgement' is a remedy rather than an independent cause of action"); *In re Wiand,* 2007 WL 963162, at * 15 (M.D.Fla.2007) (disgorgement claim failed "as a matter of law because disgorgement is not an independent cause of action. It may be a remedy for a viable cause of action at common law or, in some circumstances, is provided as a statutory remedy for certain claims").

UBS AG argues that equitable grounds do not support disgorgement in that UBS AG disgorged profits with its DPA settlement with the United States government.

Nothing supports disgorgement as a separate claim to subject the FAC's (tenth) disgorgement claim to dismissal with prejudice.

Civil Conspiracy

The FAC's (eleventh) civil conspiracy claim alleges that UBS AG and other defendants engaged in civil conspiracies to misrepresent to plaintiffs "the true nature of the investment scheme to defraud each Plaintiff into paying unnecessary and excessive fees for a fraudulent product and fraudulent services and to convert assets from each Plaintiff."

UBS AG faults a civil conspiracy claim as not actionable. "[C]ivil conspiracy is not an independent tort." *Kidron v. Movie Acquisition Corp.,* 40 Cal.App.4th 1571, 1581, 47 Cal.Rptr.2d 752 (1995); *see Four Bros. Boat Works, Inc. v. Tesoro Petroleum Companies, Inc.,* 217 S.W.3d 653, 668 (2006) ("There is no independent liability for civil conspiracy"); *Hoeffner v. Orrick, Herrington & Sutcliffe LLP,* 85 A.D.3d 457, 924 N.Y.S.2d 376, 377 (App.Div.2011) ("it is well settled that New York does not recognize an independent civil tort of conspiracy"). "Conspiracy is not a cause of action, but a legal doctrine that imposes liability on persons who, although not actually committing a tort themselves, share with the immediate tortfeasors a common plan or design in its perpetration." *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.,* 7 Cal.4th 503, 510–511, 28 Cal.Rptr.2d 475, 869 P.2d 454 (1994) (citing *Wyatt v. Union Mortgage Co.,* 24 Cal.3d 773, 784,157 Cal.Rptr. 392, 598 P.2d 45 (1979)). "Standing alone, a conspiracy does no harm and engenders no tort liability. It must be activated by the commission of an actual tort." *Applied Equipment,* 7 Cal.4th at 511, 28 Cal.Rptr.2d 475, 869 P.2d 454. "The essence of the claim is that it is merely a mechanism for imposing vicarious liability; it is not itself a substantive basis for liability." *Berg & Berg Enterprises, LLC v. Sherwood Partners, Inc.,* 131 Cal.App.4th 802, 823, 32 Cal.Rptr.3d 325 (2005).

***16** Nothing supports civil conspiracy as a separate claim to subject the FAC's (eleventh) civil conspiracy claim to dismissal with prejudice.

Accounting

The FAC's (nineteenth) accounting claim alleges that UBS AG and other defendants "have received money, a portion of which is still due to each Plaintiff," but the amount of money due cannot be ascertained and/or verified without an accounting."

UBS AG argues that accounting is not an actionable claim.

An accounting cause of action is equitable and may be sought where the accounts are so complicated that an ordinary legal action demanding a fixed sum is impracticable. *Civic Western Corp. v. Zila Industries, Inc.,* 66 Cal.App.3d 1, 14, 135 Cal.Rptr. 915 (1977). A suit for an accounting will not lie where it appears from the complaint that none is necessary or that there is an adequate remedy at law. *Civic Western,* 66 Cal.App.3d at 14, 135 Cal.Rptr. 915. An accounting will not be accorded with respect to a sum that a plaintiff seeks to recover and alleges in his complaint to be a sum certain. *Civic Western,* 66 Cal.App.3d at 14, 135 Cal.Rptr. 915. Moreover, an accounting claim "need only state facts showing the existence of the relationship which requires an accounting and the statement that some balance is due the plaintiff." *Brea v. McGlashan,* 3 Cal.App.2d 454, 460, 39 P.2d 877 (1934).

"A right to an accounting is derivative; it must be based on other claims." *Janis v. California State Lottery Com.,* 68 Cal.App.4th 824, 833–834, 80 Cal.Rptr.2d 549 (1998). Moreover, as an equitable matter, an accounting frequently "presents a fiduciary relation between the parties in the nature of a trust which brings it especially within equitable remedies." *Kritzer v. Lancaster,* 96 Cal.App.2d 1, 6, 214 P.2d 407 (1950).

The FAC lacks facts to support an accounting, especially given dismissal of fiduciary-based claims. There are no facts to support complicated accounts, and presumably plaintiffs have the ability to ascertain what they allegedly paid to UBS AG. Nothing suggests that a remedy at law will not address the matters raised by the accounting claim, which is subject to dismissal with prejudice.

Declaratory Relief

The FAC's (twentieth) declaratory relief claim seeks judicial determinations that UBS AG and other defendants are "legally responsible" for interest and penalties assessed by taxing authorities and plaintiffs' professional fees and costs in connection with investigations and audits. The declaratory relief claim further seeks judicial determination that agreements "entered into with Defendants are void and unenforceable."

The Declaratory Judgment Act ("DJA"), 28 U.S.C. §§ 2201, 2202, provides in pertinent part:

> In a case of actual controversy within its jurisdiction ... any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

***17** 28 U.S.C. § 2201(a).

The DJA's operation "is procedural only." *Aetna Life Ins. Co. of Hartford, Conn. v. Haworth,* 300 U.S. 227, 240, 57 S.Ct. 461, 463, 81 L.Ed. 617 (1937). "A declaratory judgment is not a theory of recovery." *Commercial Union Ins. Co. v. Walbrook Ins. Co., Ltd.,* 41 F.3d 764, 775 (1st Cir.1994). The DJA "merely offers an *additional remedy* to litigants." *Nat'l Union Fire Ins. Co. v. Karp,* 108 F.3d 17, 21 (2nd Cir.1997) (italics in original). A DJA action requires a district court to "inquire whether there is a case of actual controversy within its jurisdiction." *American States Ins. Co. v. Kearns,* 15 F.3d 142, 143 (9th Cir.1994).

Declaratory relief is appropriate "(1) when the judgment will serve a useful purpose in clarifying and settling the legal relations in issue, and (2) when it will terminate and afford relief from the uncertainty, insecurity, and controversy giving rise to the proceeding." *Bilbrey by Bilbrey v. Brown,* 738 F.2d 1462, 1470 (9th Cir.1984).

As to a controversy to invoke declaratory relief, the question is whether there is a "substantial controversy, between parties having adverse legal rights, or sufficient immediacy and reality to warrant the issuance of a declaratory judgment." *Maryland Cas. Co. v. Pacific Coal & Oil Co.,* 312 U.S. 270, 273, 61 S.Ct. 510, 512, 85 L.Ed. 826 (1941). The U.S. Supreme Court has further explained:

> A justiciable controversy is thus distinguished from a difference or dispute of a hypothetical or abstract character; from one that is academic or moot.... The controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests.... It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character,

> as distinguished from an opinion advising what the law would be upon a hypothetical state of facts.

Haworth, 300 U.S. at 240–241, 57 S.Ct. at 464 (citations omitted).

A declaratory relief action "brings to the present a litigable controversy, which otherwise might only be tried in the future." *Societe de Conditionnement v. Hunter Eng. Co., Inc.,* 655 F.2d 938, 943 (9th Cir.1981). As an equitable remedy, declaratory relief is "dependent upon a substantive basis for liability" and has "no separate viability" if all other causes of action are barred. *Glue–Fold, Inc. v. Slautterback Corp.,* 82 Cal.App.4th 1018, 1023, n. 3, 98 Cal.Rptr.2d 661 (2000).

The FAC fails to support a declaratory relief claim given dismissal of other claims subject to UBS AG's motion to dismiss. The FAC fails to substantiate an independent claim for declaratory relief, and such claim is subject to dismissal with leave to amend.

Breach Of Contract

The FAC's (sixteenth) breach of contract claim alleges that plaintiffs "entered into implied, oral and written contracts with Defendants to provide [them] with professionally competent investment advisory and execution services, tax and legal advice and services, and accounting services." The breach of contract claim further alleges that UBS AG and other defendants "breached their contracts by, among other things, providing each Plaintiff with advice, opinions, recommendations, representations, instructions, and services that Defendants either knew or reasonably should have known to be wrong" and charging plaintiffs "fees, costs, and expenses that were not chargeable or agreed to by each Plaintiff."

***18** "The standard elements of a claim for breach of contract are: (1) the contract, (2) plaintiff's performance or excuse for nonperformance, (3) defendant's breach, and (4) damage to plaintiff therefrom." *Wall Street Network, Ltd. v. New York Times Co.,* 164 Cal.App.4th 1171, 1178, 80 Cal.Rptr.3d 6 (2008). "To form a contract, an 'offer must be sufficiently definite ... that the performance promised is reasonably certain.' " *Alexander v.Codemasters Group Limited,* 104 Cal.App.4th 129, 141, 127 Cal.Rptr.2d 145. 127 Cal.Rptr.2d 145 (2002).

Essential elements to contract existence are: (1) "[p]arties capable of contracting;" (2) "[t]heir consent;" (3) a "lawful object;" and (4) a "sufficient cause or consideration." Cal. Civ.Code, § 1550.

"A written contract may be pleaded either by its terms —set out verbatim in the complaint or a copy of the contract attached to the complaint and incorporated therein by reference—or by its legal effect. In order to plead a contract by its legal effect, plaintiff must allege the substance of its relevant terms." *McKell v. Washington Mutual, Inc.,* 142 Cal.App.4th 1457, 1489, 49 Cal.Rptr.3d 227 (2006) (internal citations omitted).

UBS AG characterizes the FAC "as too vague and indefinite, and therefore unenforceable, for plaintiff's failure to allege, in nonconclusory language, as required, the essential terms of the parties' purported contract, including the specific provisions of the contract upon which liability is predicated." *Sud v. Sud,* 211 A.D.2d 423, 621 N.Y.S.2d 37, 38 (App.Div.1995); *Bissessur v. Indiana University Bd. of Trustees,* 581 F.3d 599, 603 (7th Cir.2009) ("A plaintiff may not escape dismissal on a contract claim, for example, by stating that he had a contract with the defendant, gave the defendant consideration, and the defendant breached the contract. What was the contract? The promises made? The consideration? The nature of the breach?").

UBS AG is correct that the FAC's purported breach of contract claims are vague and conclusory. The FAC fails to identify sufficiently precise contract terms, their breach, who breached them, and how they were breached. The FAC fails to identify sufficiently plaintiffs' consideration to support breach of contract claims to warrant dismissal of the breach of contract claim with leave to amend.

Conversion

The FAC's (seventeenth) conversion claim alleges that UBS AG and other defendants "wrongfully interfered with each Plaintiff's interests in his investment assets by":

1. Charging "thousands of dollars in excessive and unauthorized fees";

2. Creating "unnecessary 'shell' corporations and/or charg[ing] unnecessary transaction fees and referral fees;" and

3. Wrongfully freezing "accounts and otherwise charg[ing] improper 'fees' upon closing each Plaintiff's account and transferring the funds back to each Plaintiff."

"Conversion is the wrongful exercise of dominion over the property of another." *Oakdale Village Group v. Fong,* 43 Cal.App.4th 539, 543, 50 Cal.Rptr.2d 810 (1996). "To establish conversion, a plaintiff must show: (1) the plaintiff's ownership or right to possession to the property at the time of conversion; (2) the defendant's conversion by a wrongful act; and (3) damages." *Oakdale Village Group,* 43 Cal.App.4th at 543–544, 50 Cal.Rptr.2d 810. "Money cannot be the subject of a cause of action for conversion unless there is a specific, identifiable sum involved, such as where an agent accepts a sum of money to be paid to another and fails to make the payment." *McKell v. Washington Mut., Inc.,* 142 Cal.App.4th 1457, 1491, 49 Cal.Rptr.3d 227 (2006). "A specific and identified amount of money can form the basis of a conversion claim, but when the money is not identified and not specific, the action is to be considered as one upon contract or for debt and not for conversion." *Ross v. U.S. Bank Nat. Ass'n,* 542 F.Supp.2d 1014, 1024 (N.D.Cal.2008) (internal quotation omitted).

***19** UBS AG faults the absence of FAC allegations that UBS AG retained, controlled or applied to its use property. UBS AG criticizes the FAC's allegation of "excessive fees" charged rather than a specific converted sum.

The FAC lacks sufficient specificity to support a conversion claim. The alleged funds converted are not a specific, identifiable sum to warrant dismissal of the conversion claim with leave to amend.

CONCLUSION AND ORDER

For the reasons discussed above, this Court:

1. DISMISSES with leave to amend the FAC's (first) fraudulent misrepresentation and concealment and (third) negligent misrepresentation claims;

2. DISMISSES with prejudice the FAC's claims arising from an alleged fiduciary relationship among UBS AG and plaintiffs but DISMISSES with leave to amend claims arising from general negligence or malpractice;

3. DISMISSES with prejudice the FAC's (fourth and fifth) securities fraud claims;

4. DISMISSES with prejudice the FAC's (seventh and eighth) RICO claims based on predicate acts of securities fraud but DISMISSES with leave to amend RICO claims based on predicate acts other than securities fraud;

5. DISMISSES with prejudice the FAC's (tenth) disgorgement claim;

6. DISMISSES with prejudice the FAC's (eleventh) civil conspiracy claim;

7. DISMISSES with prejudice the FAC's (nineteenth) accounting claim;

8. DISMISSES with leave to amend the FAC's (twentieth) declaratory relief claim;

9. DISMISSES with leave to amend the FAC's (sixteenth) breach of contract claim;

10. DISMISSES with leave to amend the FAC's (seventeenth) conversion claim;

11. ORDERS plaintiffs, no later than February 21, 2013, to file and serve either: (a) a second amended complaint, excluding claims dismissed with prejudice; or (b) a statement that plaintiffs do not seek to pursue claims in this action; and

12. ORDERS UBS AG, no than March 14, 2013, to file and serve a response to the second amended complaint.

If plaintiffs proceed with this action, this Court ADMONISHES plaintiffs to file a clear, concise second amended complaint to comply with F.R.Civ.P. 8(b)'s requirement to state "a short and plain statement of the claim" and F.R.Civ.P. 8(d)(1)'s requirement that "[e]ach allegation must be simple, concise, and direct." [8] This requirement "applies to good claims as well as bad, and is the basis for dismissal independent of Rule 12(b)(6)." *McHenry v. Renne,* 84 F.3d 1172, 1179 (9h

Cir.1996). "Something labeled a complaint but written more as a press release, prolix in evidentiary detail, yet without simplicity, conciseness and clarity as to whom plaintiffs are suing for what wrongs, fails to perform the essential functions of a complaint." *McHenry,* 84 F.3d at 1180. "Prolix, confusing complaints ... impose unfair burdens on litigants and judges." *McHenry,* 84 F.3d at 1179. This Court FURTHER ADMONISHES plaintiffs that failure to file a second amended complaint with requisite simplicity, conciseness and directness will serve as grounds to dismiss its claims. This Court FURTHER ADMONISHES plaintiffs not to attempt to replead or purse claims dismissed with prejudice or for which there are insufficient supporting facts and that this Court will grant plaintiffs no further attempts to plead claims.

***20** IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2013 WL 394701

Footnotes

[1] Plaintiffs are Nadia and Sean Roberts (the "Roberts"), Bernhard and Heidi Gubser (the "Gubsers"), Anton Ginzburg, M.D. ("Dr.Ginzburg"), Aurther Joel Eisenberg ("Mr.Eisenberg"), Jeffrey Chernick ("Mr.Chernick") and Mr. Chernick's Liberian corporation Shumba and Hong Kong corporation Simba, and these plaintiffs will be referred to collectively as "plaintiffs."

[2] The factual recitation summarizes plaintiffs' operative First Amended Complaint ("FAC") and is derived from other matters which this Court may consider.

[3] The FAC does not specifically identify the "UB S AG defendants" but they are presumably the 11 identified defendants.

[4] UBS AG notes that the IRS established the QI Program to require financial institutions to identify and withhold tax on U.S. source income paid to foreign bank accounts, including income generated by U.S. securities, real estate and other investments. UBS AG further notes that the QI Agreement "does not create a reporting requirement toward accountholders."

[5] F.R.Civ.P. 9(b)'s particularity requirement applies to state law causes of action: "[W]hile a federal court will examine state law to determine whether the elements of fraud have been pled sufficiently to state a cause of action, the Rule 9(b) requirement that the *circumstances* of the fraud must be stated with particularity is a federally imposed rule." *Vess v. Ciba–Geigy Corp. USA,* 317 F.3d 1097, 1103 (9th Cir.2003) (quoting *Hayduk v. Lanna,* 775 F.2d 441, 443 (1st Cir.1995) (italics in original)).

[6] "In some cases, the plaintiff may allege a unified course of fraudulent conduct and rely entirely on that course of conduct as the basis of a claim. In that event, the claim is said to be 'grounded in fraud' or to 'sound in fraud,' and the pleading of that claim as a whole must satisfy the particularity requirement of Rule 9(b)." *Vess,* 317 F.3d at 1103–1104.

[7] RICO refers to the Racketeer and Corrupt Practices Act ("RICO"), 18 U.S.C. §§ 1961, et seq.

[8] This Court contemplated setting a page limit for plaintiffs' second amended complaint. Given dismissal of several claims and this Court's requirements of simplicity, conciseness and clarity, this Court sees no reason why the second amended complaint should exceed 40 pages.

End of Document

709 Fed.Appx. 431
This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 9th Cir. Rule 36-3.
United States Court of Appeals, Ninth Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
Stephen KERR and Michael
Quiel, Defendants–Appellants.

No. 15–10393
|
Submitted August 18, 2017 [**]
San Francisco, California
|
SEPTEMBER 27, 2017

Synopsis

Background: After their convictions of subscription to a false tax return, and willful failure to file reports of foreign bank and financial accounts (FBARs) were affirmed on direct appeal, 595 Fed.Appx. 692, defendants filed motion for new trial based on newly discovered evidence. The United States District Court for the District of Arizona, No. 2:11–cr–02385–JAT–1, James A. Teilborg, J., 2015 WL 4275183, denied motion. Defendants appealed.

Holdings: The Court of Appeals held that:

[1] evidence showing the falsity of two trial exhibits was not "newly discovered," as required to support motion for new trial;

[2] evidence of defendants' attorney's fraudulent behavior and undisclosed agreement with Government did not constitute "newly discovered evidence";

[3] defendants' conclusory and speculative assertions were insufficient to support new trial based on knowing introduction of perjured testimony; and

[4] defendants failed to establish *Brady* violation.

Affirmed.

Appeal from the United States District Court for the District of Arizona, James A. Teilborg, District Judge, Presiding, D.C. No. 2:11–cr–02385–JAT–1

Attorneys and Law Firms

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Michael Kimerer, Esquire, Rhonda Elaine Neff, Esquire, Kimerer & Derrick, PC, Phoenix, AZ, Alan Stuart Richey, Port Hadlock, WA, for Defendants–Appellants.

Before: RAWLINSON and NGUYEN, Circuit Judges, and VANCE, [***] District Judge.

MEMORANDUM [*]

Stephen Kerr and Michael Quiel were convicted of willful subscription to a false tax return in violation of 26 U.S.C. § 7206(1). Kerr was also convicted of willful failure to file reports of foreign bank and financial accounts (FBARs) in violation of 31 U.S.C. §§ 5314 and 5322(a). This Court affirmed defendants' convictions on direct appeal. *See United States v. Quiel*, 595 Fed.Appx. 692 (9th Cir. 2014). Defendants now appeal the district court's denial of their motion for a new trial or, alternatively, for an evidentiary hearing. This motion was based on allegations that (1) defendants' lawyer, Christopher Rusch, had ***433** engaged in criminal and fraudulent behavior before, during, and after the trial, in part by blogging and podcasting under the pseudonym "Christian Reeves"; (2) the Government had an undisclosed agreement with Rusch that allowed Rusch to commit illegal acts without fear of prosecution in exchange for his testimony against defendants; and (3) Exhibits 51 and 52, introduced at trial, were forged. Defendants also appeal the district court's denial of their motion to accept a limited remand. We affirm.

[1] 1. We generally review the denial of a new trial motion, made based on newly discovered evidence, for abuse of discretion. *United States v. Hinkson*, 585 F.3d 1247, 1259

(9th Cir. 2009). In order to obtain a new trial under Rule 33, the defendant must establish that:

> (1) the evidence [is] newly discovered; (2) the failure to discover the evidence sooner [was not] the result of a lack of diligence on the defendant's part; (3) the evidence [is] material to the issues at trial; (4) the evidence [is] neither cumulative nor merely impeaching; and (5) the evidence ... indicate[s] that a new trial would probably result in acquittal.

United States v. Harrington, 410 F.3d 598, 601 (9th Cir. 2005) (quoting *United States v. Kulczyk*, 931 F.2d 542, 548 (9th Cir. 1991)). As an initial matter, the district court did not err in refusing to consider certain audio recordings, which were introduced to establish Reeves as Rusch's alter ego, because the court presumed the truth of this allegation. Additionally, contrary to defendants' assertions, the court did in fact consider the emails allegedly sent by Rusch. Further, the district court correctly held that evidence showing the falsity of Exhibits 51 and 52 did not satisfy Rule 33 because defendants failed to meet their burden of establishing when this evidence was discovered.

[2] Defendants also argue that the district court erred in finding that evidence relating to Rusch's fraudulent behavior and undisclosed agreement with the Government would be cumulative and merely impeaching. Ordinarily, newly discovered evidence that merely impeaches a witness will not warrant a new trial. *See, e.g.*, *United States v. Davis*, 960 F.2d 820, 825 (9th Cir. 1992). But impeachment evidence may require a new trial when it "refute[s] an essential element of the government's case," or it is "so powerful that, if it were to be believed by the trier of fact, it could render the witness' testimony totally incredible." *Id.* At trial, the jury heard testimony that Rusch committed a tax felony, had substantial tax debt, violated his fiduciary duties to his clients, misused his client trust fund account, falsely notarized a document, and violated the ethical rules of the California Bar. We agree with the district court that any additional evidence that Rusch engaged in other fraudulent behavior of the same nature would be cumulative of this impeachment evidence. Relatedly, defendants assert that additional evidence of Rusch's fraudulent behavior negates their *mens rea.* But this Court has already found that there was sufficient evidence for the jury to find the requisite willfulness, even without Rusch's testimony. *See Quiel*, 595 Fed.Appx. at 694. The district court did not abuse its discretion in denying defendants' new trial motion under Rule 33.

[3] **2.** We review *de novo* the district court's denial of a new trial motion based on an alleged *Napue* violation. *United States v. Rodriguez*, 766 F.3d 970, 980 (9th Cir. 2014). To prevail on a *Napue* claim, "the defendant must show that (1) the testimony was actually false, (2) the prosecution knew or should have known that the testimony was actually false, and (3) ... the false testimony was material." ***434** *Id.* at 990 (citation omitted). Defendants argue that the Government's failure to disclose Rusch's fraudulent behavior and pseudonym led to the introduction of perjury, and that Exhibits 51 and 52 were false. But defendants fail to show that either Rusch's testimony or the exhibits were actually false, or that the Government knew or should have known of their falsity. Defendants' conclusory and speculative assertions fail to make out a *Napue* claim. *See United States v. Aichele*, 941 F.2d 761, 766 (9th Cir. 1991).

[4] **3.** We also review the district court's denial of a new trial motion "*de novo* when the asserted basis for a new trial is a *Brady* violation." *United States v. Pelisamen*, 641 F.3d 399, 408 (9th Cir. 2011). "A *Brady* violation has occurred if: (1) the government willfully or inadvertently suppressed; (2) evidence favorable to the accused; and (3) prejudiced ensued." *Id.* (citing *Strickler v. Greene*, 527 U.S. 263, 281–82, 119 S.Ct. 1936, 144 L.Ed.2d 286 (1999)). First, defendants have not produced any evidence suggesting that Exhibits 51 and 52 were forged and have failed to bear their burden "of producing some evidence to support an inference that the government possessed or knew about the *Brady* material." *Id.* at 408 (citation and internal quotation marks omitted). Second, information about Rusch's pseudonym and fraudulent behavior, which the Government allegedly suppressed, is merely cumulative impeachment evidence, and therefore cannot give rise to a *Brady* violation. *See United States v. Kohring*, 637 F.3d 895, 902 (9th Cir. 2011). Finally, defendants assert that the Government failed to disclose the existence of a leniency agreement with Rusch. Although the prosecution's failure to disclose an agreement with a coconspirator in exchange for his testimony at trial constitutes suppression under *Brady*, *see*

Giglio v. United States, 405 U.S. 150, 154–55, 92 S.Ct. 763, 31 L.Ed.2d 104 (1972), defendants merely speculate about the possibility of an undisclosed agreement, *see Runningeagle v. Ryan*, 686 F.3d 758, 769–70 (9th Cir. 2012). The district court did not err in denying the new trial motion based on alleged *Brady* violations.

4. This Court reviews a district court's denial of a post-verdict evidentiary hearing for abuse of discretion. *United States v. Saya*, 247 F.3d 929, 934 (9th Cir. 2001). First, the district court presumed that Rusch used a pseudonym, so there was no need for an evidentiary hearing to establish that. *See United States v. Scott,* 521 F.2d 1188, 1196 (9th Cir. 1975). Second, considering the conclusory nature of defendants' allegations as to the falsity of Exhibits 51 and 52, the court did not abuse its discretion in declining to hold an evidentiary hearing to establish their falsity. *See United States v. Zuno–Arce*, 209 F.3d 1095, 1102–03 (9th Cir. 2000), *overruled on other grounds by Valerio v. Crawford*, 306 F.3d 742 (9th Cir. 2002). Finally, the district court was not obligated to hold an evidentiary hearing to entertain pure speculation about an undisclosed agreement between the Government and Rusch. *See United States v. Mincoff*, 574 F.3d 1186, 1199–1200 (9th Cir. 2009). Thus, the district court did not abuse its discretion in denying defendants' request for an evidentiary hearing.

5. Because the denial of defendants' motion to accept remand is essentially the denial of a motion for an indicative ruling, the Court reviews it for abuse of discretion. *See Jackson v. Allstate Ins. Co.*, 785 F.3d 1193, 1206 (8th Cir. 2015). Defendants moved the district court to accept remand to consider additional new evidence. None of this new evidence warrants relief under Rule 33, *Napue*, or *Brady.* Thus, the district court did not abuse its discretion in ***435** denying defendants' motion to accept a limited remand.

AFFIRMED.

James A. Teilborg, District Judge, Presiding
I concur in the result.

All Citations

709 Fed.Appx. 431, 120 A.F.T.R.2d 2017-6066

Footnotes

** The panel unanimously concludes this case is suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2).

*** The Honorable Sarah S. Vance, United States District Judge for the Eastern District of Louisiana, sitting by designation.

* This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36–3.

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2017 WL 3232578
United States District Court, N.D. California.

UNITED STATES of America, Plaintiff,
v.
Lawrence Y. LUI, Defendant.

Case No. 16-cv-00969-JST
|
Signed 07/31/2017

Attorneys and Law Firms

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ORDER GRANTING SUMMONSES IN PART, GRANTING MOTION TO QUASH AND DENYING MOTION TO DISMISS DOCUMENT SUMMONS

Re: ECF Nos. 32, 45, 59, 82

JON S. TIGAR, United States District Judge

***1** Before the Court is the United States' Verified Petition to Enforce Internal Revenue Service Summons ("the Petition") against Respondent Lawrence Lui. ECF No. 1. The Court will grant the petition in part and deny it in part.

I. FACTUAL AND PROCEDURAL BACKGROUND

The Petition arises from an Internal Revenue Service ("IRS") investigation into the tax liabilities of Lawrence Y. Lui ("Lui") and Gorretti L. Lui for the years of 2005 to 2012. ECF No. 1 at ¶ 3. On July 8, 2014, Revenue Agent Meiling Yang, a former Revenue Agent, served Petitioner with a summons related to the alleged tax liabilities. Id. ¶ 7. Agent Yang interviewed Lui pursuant to the summons on August 4, 2014. Id. ¶¶ 9-10. Lui refused to provide testimony, citing his Fifth Amendment privilege against self-incrimination, as well as other privileges. Id. ¶ 10. On July 29, 2015, Agent Lee served Lui with another summons for documents related to the alleged tax liabilities. Id. ¶ 11. The Government sought to compel the production of documents related to Wealth Grand Limited, a Hong Kong company ("WG"), Netfinity Assets Corporation, a British Virgin Islands company ("Netfinity"), and Jatur Sdn. Bhd., a Malaysian company ("Jatur"). ECF No. 1-3 at 7.

Agent Lee interviewed Lui pursuant to the second summons on August 28, 2015. ECF No. 1 at ¶ 14. Lui provided some responsive documents, but failed to provide all responsive documents or to provide testimony. Id.

Seeking a court order compelling Lui's cooperation with the summons, the Government filed the instant Petition on behalf of the IRS on February 26, 2016. ECF No. 1. On March 15, 2016, this Court found that the Government had established a prima facie case and ordered Lui to show cause as to why he should not be compelled to produce the requested documents and testimony. ECF No. 6. The parties subsequently submitted briefing. ECF Nos. 21-1, 33, 43, 47.[1] The Government also moved to quash Lui's requests for admissions and documents. ECF Nos. 32, 38, 45, 51, 61. Lui moved to dismiss the record summons portion of the Government's complaint. ECF Nos. 59, 61, 62. The Court held a hearing on the order to show cause, as well as the other motions as they relate to the substance of the order to show cause on December 15, 2016. The Court ultimately ordered re-briefing on the order to show cause. ECF No. 73. Lui retained new counsel, ECF Nos. 75, 80, and submitted an Amended Memorandum of Points and Authorities opposing the Governments' summonses. ECF No. 82. The Government filed a new reply. ECF No. 84. Lui filed a sur-reply. ECF No. 88. The Court now considers all of the motions.

II. LEGAL STANDARD

The IRS has authority to examine books and witnesses pursuant to a summons under 26 U.S.C. § 7602(a). "If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data." 26 U.S.C. § 7604.

***2** The specific legal procedure governing the court's inquiry is well-established. See United States v. Powell, 379 U.S. 48 (1964); United States v. Clarke, 134 S. Ct. 2361 (2014). First, the United States must outline its prima facie case. See Crystal v. United States, 172 F.3d 1141 (9th Cir. 1999). To do so, the United States must show that "(1) the investigation will be conducted for a legitimate purpose; (2) the material being sought is relevant to that purpose; (3) the information sought is not already in the IRS's possession; and (4) the IRS complied with all the administrative steps required by the Internal Revenue Code." Id. at 1143-44 (citing Powell, 379 U.S. at 57-58). "The government's burden is a slight one, and may be satisfied by a declaration from the investigating agent that the Powell requirements have been met." United States v. Dynavac, Inc., 6 F.3d 11407, 1414 (9th Cir. 1993). "The burden is minimal because the statute must be read broadly in order to ensure that the enforcement powers of the IRS are not unduly restricted." Crystal, 172 F.3d at 1144 (internal quotation omitted).

Once the Government meets its initial burden, the burden shifts to the respondent. Id. "[T]hose opposing enforcement of a summons ... bear the burden to disprove the actual existence of a valid civil tax determination or collection purpose by the [IRS].... [T]his burden is a heavy one." Id. at 1144 (internal quotation omitted). Established grounds for challenging the summons include demonstrating "failure to satisfy the Powell requirements." United States v. Jose, 131 F.3d 1325, 1328 (9th Cir. 1997) (en banc). Abuse of process, such as bad faith use of the procedure to harass or pressure the taxpayer regarding other disputes, is also recognized as grounds to invalidate the summons. Powell, 379 U.S. at 58. The Government also may not seek enforcement of a summons when it has already decided to recommend the matter for prosecution. See United States v. LaSalle National Bank, 437 U.S. 298, 314 (1978). "[T]he dispositive question in each case is whether the Service is pursuing the authorized purposes in good faith." Crystal, 172 F.3d at 1144-45 (internal quotation omitted).

III. DISCUSSION

This Court previously found that the Government had established a prima facie case under Powell based upon its initial Petition and accompanying Declaration. ECF No. 6 at 1. The Government demonstrated through Agent Lee's declarations and the supporting documents that the investigation's purpose is to seek Lui's testimony and records regarding tax liabilities. ECF No. 1 at ¶ 3. The declarations of Agent Lee and the supporting documents establish that the material sought is relevant to the investigation's purpose. ECF No. 1 at ¶¶ 3, 4, 6, 8, 12. The declarations assert that the IRS does not presently possess the records sought. Id. at ¶ 6. The Government contends there has been no referral to the Department of Justice for criminal prosecution of the matters described in the summons. Id. at ¶ 17. Finally, the Government asserts that it has complied with all administrative steps required, including proper notice and summons. Id. at ¶ 16.

Because the Government has carried its initial burden and established a prima facie case, the burden shifts to Lui to rebut the Government's assertions. Crystal, 172 F.3d at 1144.

A. Lack of Possession as a Defense to Document Summons

The IRS seeks documents related to Lui's interest in foreign entities and bank accounts. ECF No. 84 at 5. The IRS summons is broad in scope. It seeks various agreements, certificates, articles for establishing the entity, by-laws, letters, documents identifying various positions and organizational structures, invoices, bank documents, contracts and other important documents. ECF No. 1-3. Lui argues that he does not possess, control, or have custody of any of these documents. ECF No. 82, 88. The Government contends that Lui had an obligation to retain such documents and has not provided credible evidence as to why they are not — or no longer — in his possession. ECF No. 84.

***3** Pursuant to 26 U.S.C. § 982(c)(1), the IRS may issue a foreign document request ("FDR") to any taxpayer to request foreign-based documentation. "Foreign-based documentation" is "any documentation which is outside the United States and which may be relevant or material to the tax treatment of the examined item." 26 U.S.C. § 982(d). "Congress enacted Section 982 as a pretrial discovery tool 'to discourage taxpayers from delaying or refusing disclosure of certain foreign-based information to the IRS.' " Matter of Int'l Mktg., Ltd. v. United States, No. C-901839-SAW, 1990 WL 138528, at *1 (N.D. Cal. Aug. 20, 1990) (citations omitted). Enforcement of a FDR is subject to the same standards as an administrative summons under Powell. See Larue v. United States, No. 3:15-cv-00705-HZ, 2015 WL 9809798, at *2 (D. Or. Dec. 22, 2015).

"An IRS summons imposes a duty to retain possession of summoned documents pending a judicial determination of the enforceability of the summons." United States v. Asay, 614 F.2d 655, 660 (9th Cir. 1980). A party's obligations become fixed when the summons is served. See Couch v. United States, 409 U.S. 322, 329 n. 9, 93 S. Ct. 611, 616 (1973) (citing United States v. Zakutansky, 401 F.2d 68, 72 (7th Cir. 1968), cert. denied, 393 U.S. 1021, 89 S.Ct. 628; United States v. Lyons, 442 F.2d 1144 (1st Cir. 1971)); see also United States v. Darwin Const. Co., Inc., 873 F.2d 750, 755 (4th Cir. 1989) ("When an IRS summons is served, the rights and obligations of the party on whom the summons is served become fixed."). The party resisting enforcement bears the burden of producing credible evidence that he does not possess or control the documents sought.[2] See United States v. Huckaby, 776 F.2d 564, 567-8 (5th Cir. 1985); United States v. Billie, 611 Fed. Appx. 608, 610 (11th Cir. 2015).

It is Lui's burden to establish any affirmative defense. See United States v. Seetapun, 750 F.2d 601, 604 (7th Cir. 1984) (citing United States v. Kis, 658 F.2d 526, 542 (7th Cir. 1981)). Lack of custody or control is one such defense to enforcement of the document summons. United States v. Bright, 596 F.3d 683, 695 (9th Cir. 2010); see also United States v. Rylander, 460 U.S. 752, 757 (1983) (holding that one "appropriate ground" to challenge an IRS summon is the "lack of possession or control of records"). It is unclear exactly

> what a taxpayer must show to meet his or her burden of demonstrating a lack of possession, custody, or control of the requested documents. However, the taxpayer's "responsibilities surely go further than a *pro forma* demand and cursory search for records," or a "conclusory, self-serving affidavit, lacking detailed facts and any supporting evidence."

Larue, 2015 WL 9809798, at *3(quoting Seetapun, 750 F.2d at 605; FTC v. Publ'g Clearing House, Inc., 104 F.3d 1168, 1171 (9th Cir. 1997)). A taxpayer may face contempt sanctions if he cannot produce credible evidence that the documents requested were outside his or her possession or control at the time of the summons. Asay, 614 F.2d at 660.

***4** Some Circuit Courts of Appeals "have held that it is within the district court's discretion to simply determine whether the facts show that the taxpayer does, or does not, possess the relevant documents." See United States v. Malhas, No. 15-CV-3932, 2015 WL 6955496, at *4 (N.D. Ill. Nov. 10, 2015) (citing cases). Others have required the party resisting enforcement bear the burden of producing credible evidence of non-possession, operating on a "sliding scale." Id. The Government has suggested that the Court consider the evidence based on this "sliding scale: the more the Government's evidence suggests the defendant possesses the documents at issue, the heavier the defendant's burden to successfully demonstrate that he does not." Malhas, 2015 WL 6955496, at *4. In Malhas, the taxpayer "failed to satisfy his burden regardless of what standard the Court applie[d]." Id. Malhas provided no credible evidence and relied only on his own affidavits and testimony. Id. at *1-2. Meanwhile, the IRS presented a "plethora of documents and records illustrating Malhas' connections with the international banks and the accounts at issue [which] overshadowed Malhas' cursory references to the signatory and asset-transfer documents." Id. at *4. The court held that Malhas failed to overcome his heavy burden because he lacked evidence in comparison to the evidence provided by the government.

The Court adopts the sliding scale test from Malhas, but reaches a different result, because the facts here are markedly different than in Malhas. For one thing, Lui presents far more than his own affidavit to support his argument of non-possession. ECF No. 82 at 21-24. Lui argues he does not have possession of the requested documents because the non-produced records were either beyond his control or no longer existed as of July 29, 2015, the date of the IRS document summons. ECF No. 82 at 14-17, 21-24. On July 26, 2014, Lui resigned as a director of Netfinity and any related records were transferred out of his possession, custody, care and control to the custody of his siblings. ECF No. 82 at 15, citing ECF No. 24-2 at 154; ECF No. 24-6 at 63-71. Lui argues that "[c]oncurrently," the 2002 Trust assets were distributed among Lui's siblings, and "all shares in Netfinity and WG were transferred to Lui's" siblings." Id. Lui contends that "[u]pon distribution of the assets, the 2002 Trust dissolved because it no longer held any assets." ECF No. 82 at 15 (citing ECF No. 23 at 7). Lui presents numerous exhibits that show Lui had limited power over the trust that held Netfinity shares, ECF No. 24-2 at 17-18, 12, 73, 77, 75, 79; ECF No. 22-2 at 3-7; that the interests in Netfinity and WG were transferred to Lui's siblings at their request, ECF No. 24-2 at 38-41, 19, 35, 105,107-112; that the documents sought are now in the possession of Lui's siblings, ECF No. 24-2 at 63-71, 154; ECF No. 22-2 at 3-7; and that Lui was never a beneficial owner, ECF No. 24-2 at 14-16. Moreover, Lui has attached advisory letters from law firms within the foreign jurisdictions, explaining that non-beneficial owners have no legal right to compel production of the documents. ECF No. 21-5 at 3-7. Therefore, Lui argues, he has no enforceable legal right to obtain the records. ECF No. 82 at 15. Lastly, Lui presents evidence that he did not receive a dividend from Galaxy during the audit period, ECF No. 24-2 at 81-82, and asserts he is not the beneficial owner of the Netfinity shares, ECF No. 88 at 4.

The Government offers little direct evidence to the contrary.[3] It primarily relies on a 2005 SEC filing that lists Lui as the owner of Netfinity. ECF No. 33-1. In addition, the Government also asks the Court to consider the suspicious timing of events by which the shares of Netfinity were distributed out of Lui's control and to his siblings, ECF No. 84 at 10, as well as Lui's lack of documentation surrounding the transfer of the Netfinity stock to his siblings. Id. at 8.

***5** These circumstances, though suspicious, are insufficient to demonstrate that Lui possesses or has the capacity to obtain the challenged documents. Although Lui may have been on notice of the IRS' investigation into his foreign assets because of the FDR or the testimonial summons in 2014, Lui's duty to retain these documents was not fixed until July 29, 2015, the date of the document summons.[4] The Court finds that the suspicious timing alone is not enough to overcome the plethora of evidence that Lui has offered to show that he did not possess, control, or have custody of the documents at issue which the IRS sought in its July 29, 2015 document summons as of that date. The Court cannot compel Lui to produce documents that he does not have in his possession or control.

Nonetheless, although Lui has succeeded in demonstrating that he does not possess documents directly related to the Netfinity or WG assets, he has not met his burden of showing that he has no documents related to the transfer of those assets. As the Government argues, "[i]t is difficult to believe that such a significant purchase and transfer of stock would be unaccompanied by correspondence or at least emails maintained by the transferor." ECF No. 84 at 8. In the IRS' initial summons, it included "letters of wishes, letters of intent, orders of instructions and other similar documents expressing the founder's or beneficiary's wishes or instructions regarding the entity." ECF No. 1-3 at 7. Lui has not included any emails or other correspondence with regard to the transfer of the Netfinity stock. He has, however, been able to provide declarations from his siblings corroborating the fact that he no longer has access to Netfinity documents. ECF No. 83-1, 83-2, 83-3, 83-4, 83-5, 83-6, 83-7, 83-8, 83-9, 83-10, 83-11. Therefore, Lui is ordered to turn over any additional correspondence or other records in his possession regarding the transfers, or to submit a declaration under penalty of perjury that no such documents exist and that none existed as of July 29, 2015. Such declaration must be filed by August 11, 2017.

B. Defenses to Testimonial Summons

1. 5th Amendment

The Government also challenges Lui's assertion of the Fifth Amendment at his summons interview. A taxpayer may invoke his Fifth Amendment rights in response to an IRS summons when there are "substantial hazards of self-incrimination that are real and appreciable." United States v. Drollinger, 80 F.3d 389, 392 (9th Cir. 1996) (internal quotation omitted). "The defendant must have 'reasonable cause to apprehend [such] danger from a direct answer' to questions posed to him." Id. (quoting United States v. Neff, 615 F.2d 1235, 1239 (9th Cir. 1980)). A taxpayer may invoke the Fifth Amendment when his testimony carries a risk of incrimination and "the penalty he suffered amounted to compulsion." United States v. Antelope, 395 F.3d 1128, 1134 (9th Cir. 2005). The taxpayer may not, however, "convert the privilege from the shield against compulsory self-incrimination which it was intended to be into a sword whereby a claimant asserting the privilege would be freed from adducing proof in support of a burden which would otherwise have been his." US v. Rylander, 460 U.S. 752, 755 (1983). Mere "blanket assertion[s]" of Fifth Amendment rights are insufficient. United States v. Brown, 918 F.2d 82, 84 (9th Cir. 1990).

"In determining whether a real and appreciable danger of incrimination exists, the trial court must examine 'the questions, their setting, and the peculiarities of the case.' " Drollinger, 80 F.3d at 392 (quoting Neff, 615 F.2d at 1240). The process requires a question-by-question or document-by-document review. United States v. Bodwell, 66 F.3d 1000, 1001 (9th Cir. 1995).

***6** Here, Lui asserted his Fifth Amendment privilege to almost every question asked of him during his testimony, including "[Did] you take any accounting classes in college?," "Did you take any accounting or tax classes in graduate school?," and "Do you have any education in accounting or tax matters?" ECF No. 11-1 at 41. Answers such as these make it difficult for the Court to conclude that Lui asserted the Fifth Amendment on a question-by-question basis, as the law requires.

Accordingly, because it appeared likely that Lui's assertion of Fifth Amendment privilege was overbroad and that he should be required to answer at least some additional questions, the Court asked the parties to submit further briefing regarding follow-up questions the Government was entitled to ask. See ECF No. 94. The Court now rules as follows on the parties' disputes.

a. General Background Questions

By stipulation of the parties, Lui is ordered to answer the general background questions identified in the parties' joint brief. Id. at 3.

b. Questions Related to Lui's FBAR Obligations and Compliance

The parties dispute whether Lui should answer questions pertaining to his foreign financial accounts, foreign financial account reporting obligations, and his personal knowledge of FBAR and other requirements. Lui properly invoked his rights under the Fifth Amendment to these questions, as he faces a real and substantial risk of criminal incrimination and did not open himself to these questions by the scope of his declaration. See In re Master Key Litig., 507 F.2d 292, 293 (9th Cir. 1974). The Court likewise will not compel any follow-up questions about Lui's interests held in foreign accounts. See ECF No. 94 at 21, 24-25.

c. Questions Related to Lui's Ownership and Reporting of Foreign Entities, Including Galaxy Entertainment Group Limited and Netfinity Assets Corporation

Similarly, the Court finds Lui did not waive his right to invoke the privilege regarding questions 1-19 and 21-44 related to his ownership and reporting of foreign entities. ECF No. 94 at 26-28. The Court finds, however, that Lui waived his Fifth Amendment the privilege with respect to question 20, "Who keeps the books and records of Netfinity Asset Corporation?" as this topic was included in his declaration. See ECF No. 21-3 ¶ 9. The Government may ask Question 20.

d. Lui's June 2016 Declaration

In addition to the testimony identified above, Lui also submitted a declaration to the Court on June 21, 2016. ECF No. 21-3. The declaration sets forth facts related to his siblings' acquisition of the books and records of Netfinity and WG, his attempts to obtain copies of those records, and his retention of the law firms of Baker & McKenzie and Maples & Calder to provide legal opinions concerning his rights and obligations concerning the Netfinity/WG records. The Government seeks to ask Lui questions regarding this declaration; Lui opposes this request.

Paragraph 6 of Lui's declaration provides that "[a]fter diligent search and efforts, I have produced all of the records requested in the record summons that were in my possession, custody, care or control." ECF No. 21-3 ¶ 6. Paragraph 9 states that "[s]ince July 26, 2014 all the records of Netfinity and WG have been in possession, custody, care and control of [Lui's] siblings." Id. ¶ 9. Because the statements made in these two paragraphs are not incriminating, Lui may be questioned or "cross-examined" about his lack of possession or control of the summonsed documents as of the date of the Document Summons. The Government may therefore ask Lui the following questions:

***7** (1) Did you possess any summonsed documents as of July 29, 2015 (the service date for the Document Summons)?

(2) Who possessed the Netfinity documents on July 29, 2015?

(3) Where do the individuals that possessed the documents on July 29, 2015 reside?

(4) How did you know that your siblings possessed or controlled the documents on July 29, 2015?

(5) What documents do you possess that evidence your siblings' possession or control of the Netfinity documents?

In Paragraph 10 of his Declaration in support of his opposition to the summons, Lui sets out "an additional demonstration of good faith to try to comply with the record summons." ECF No. 21-3 ¶ 10. He elaborates on his 2015 and 2016 efforts to obtain requested documents after receipt of the July 29, 2015 Document Summons. Lui "did not make any statements about the establishment of a trust in 2002, the establishment of Netfinity, the receipt of funds by Netfinity used to acquire Galaxy shares, Lui's role as a trustee prior to 2015, other foreign entities or accounts, [or] the establishment or incorporation of a trust or foreign entity." ECF No. 94 at 7-8. He did, however, "retain[ ] and obtain[ ] opinions of counsel in Hong Kong and in the British Virgin Islands" to "show that" he had "no legally enforceable right to obtain the summoned records that have not been produced from the companies," and "no valid legal ground to sue to get them." ECF No. 21-3 ¶ 10. The Court agrees with Lui that "merely referencing documents does not create waiver," ECF No. 94 at 9 (citing Rutherford v. PaloVerde Health Care Dist., 2014 WL 12637901 (C.D. Cal. Sep. 23, 2014)), and the government does not provide any persuasive authority supporting the contention that the documents Lui provided to these law firms must be produced.

2. Other Privileges

At his interview, in addition to his Fifth Amendment privilege, Lui asserted the attorney-client privilege in response to 14 questions, the work product doctrine in response to six questions, and the tax practitioner privilege in response to 15 questions.[5] ECF No. 82 at 33. It is not necessary for the Court to rule on these objections, however, because the Court has upheld his assertion of the Fifth Amendment privilege as to the same questions.

C. Challenges to Government's Prima Facie Case

The Court also rules on separate challenges Lui has made to the Government's summons.

1. Verification

Lui argues that the government's initial summons was inadequate because Agent Lee's verification was insufficient. ECF No. 82 at 34. Affidavits must be based on personal knowledge. Fed.R.Civ.P. 56(e). Here, Agent Lee's declaration was based on personal knowledge and belief. ECF No. 1 at 5. After Lui challenged the sufficiency of the verification, the Government provided the Court with Agent Lee's affidavit explaining how she attained her personal knowledge. ECF No. 84-1 at 1-3. Lui contends that the declaration is an inadequate solution because it cannot cleanse the deficiency of the initial summons. ECF No. 88 at 6. Agent Lee, however, has testified that she reviewed Lui's file personally and conducted part of the investigation personally. ECF No. 1 at 5. This is not a circumstance in which the complaining officer "clearly showed that [s]he had no personal knowledge of the matters on which his charge was based." United States v. Greenberg, 320 F.2d 467, 471 (9th Cir. 1963). Therefore, the Government's summons does not fail for lack of verification.

2. Relevance

***8** Lui argues that the summoned records of Netfinity, WG, and Jatur are not relevant or material to his tax liabilities. ECF No. 82 at 35. "The relevance standard for an IRS summons is different from, and more relaxed than, admissibility standards under the Federal Rules of Evidence. Summoned material is relevant if it might 'throw light' upon the correctness of the return." Schoop v. Commissioner of Internal Revenue, No. C 13092230 SI, 2013 WL 5487040, at *3 (N.D. Cal. Oct. 2, 2013) (quoting United States v. Arthur Young & Co., 465 U.S. 805, 814 (1984)). "Congress expressly intended for the IRS to obtain materials 'of even *potential* relevance to an ongoing investigation.' " Id. (emphasis in original).

The Government concedes that Lui has complied with the summons as it pertains to Jatur, and therefore Jatur is not at issue here. ECF No. 82 at 19. With regard to

Netfinity and WG, however, the Government contends that Lui's alleged beneficial ownership of Galaxy stock (through Netfinity's ownership) is relevant. ECF No. 84 at 5 ("the audit was expanded to determine if taxpayer was required to report dividend income from the $161 Million Galaxy Entertainment Group's stock held under Netfinity Assets Corporation, BVI.") Lui does not dispute that Netfinity owned 161,066,521 shares of Galaxy stock. Id. Lui, as the 100% owner of Netfinity, was the owner of the Galaxy stock at some point. Id. In order for the IRS to definitively decide whether Luis has any tax obligations as they relate to Netfinity, it requires documents that explain the ownership and management of Netfinity. Id. Lui's transfer of his interest in Netfinity on July 26, 2014, two weeks after the testimony summons and one week before his summons interview, and conflicting information between SEC submissions [6] and Lui's explanation of his role as merely "a trustee," do not adequately establish that he has met his burden of challenging the summoned information as irrelevant. ECF No. 33 at 7-8; ECF No. 21-1 at 21-22. The Court is not persuaded that the IRS will not discover potentially relevant information.

3. Abuse of Process and Bad Faith

Lui also includes a three-sentence argument that the IRS' requests are duplicative and made in bad faith or with the intent to prosecute in the future. ECF No. 82 at 35.

"[T]he dispositive question in each case is whether the Service is pursuing the authorized purposes in good faith." United States v. Anderson, Case No. 14-cv-01932-JST, 2014 WL 6682534, at *2 (N.D. Cal., Nov. 25, 2014) (quoting Crystal, 172 F.3d at 1144-45). "Abuse of process, such as bad faith use of the procedure to harass or pressure the taxpayer regarding other disputes, is also recognized as grounds to invalidate the summons." Id. (citing Powell, 379 U.S. at 58). To raise an inference of bad faith on the government's part, "[t]he taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive." United States v. Clarke, 134 S. Ct. 2361, 2367–68 (2014). In light of the Government's broad discretion to request documents related to its legitimate purpose, Lui has failed to carry his burden of demonstrating the summons is not valid. See Crystal, 172 F.3d at 1141.

***9** Moreover, Lui contends that the Government repeatedly asked him questions related to filing requirements so it could criminally prosecute or intimidate him. ECF No. 82 at 35. But "[n]aked allegations of improper purpose are not enough: The taxpayer must offer some credible evidence supporting his charge." United States v. Clarke, 134 S.Ct. at 2367. Lui offers no credible evidence that supports this contention, and the Government stated in its petition that it has not referred any matter to the Department of Justice for prosecution. ECF No. 1 ¶ 17. Lui has not presented evidence that the IRS's statement that it did not have a copy of a previously filed FBAR was intended to mislead Lui or was made in bad faith.

IV. GOVERNMENT'S MOTION TO QUASH

The Government moves to quash the request for admissions filed by Lui pursuant to Rule 36 of the Federal Rules of Civil Procedure and the request for production of documents filed by Lui pursuant to Rule 34 of the Federal Rules of Civil Procedure. ECF Nos. 15, 32, 45. The Court will grant the Government's motions.

"As a general rule, discovery is available in summons enforcement proceedings only in extraordinary situations." United States v. Southern Tanks, Inc., 619 F.2d 54, 56 (10th Cir. 1980) (citing United States v. Fensterwald, 553 F.2d 231 (D.C. Cir. 1977); United States v. Wright Motor Co., 536 F.2d 1090 (5th Cir. 1976)). Occasionally, limited discovery is allowed "in order to examine an agency's institutional posture with respect to possible criminal proceedings." Id. Discovery is "the exception rather than the rule," and whether to permit such discovery is within the Court's "great discretion." Chen Chi Wang v. United States, 757 F.2d 1000, 1004-05 (9th Cir. 1985).

To merit discovery, Lui must make "a substantial preliminary showing that enforcement of the summons would result in an abuse of the court's process" and that "discovery would likely lead to useful, relevant evidence." Roberts v. United States, 364 F.3d 988, 999-1000 (8th Cir. 2004). "The party resisting enforcement" must "do more than allege an improper purpose before discovery is granted." United States v. Church of Scientology of California, 520 F.2d 818, 824 (9th Cir. 1975). "Conclusory allegations carefully tailored to the language of Powell ... that the Service has issued a summons for an improper purpose such as to harass the taxpayer or to put pressure on him to settle a collateral dispute, are easily made." Id. A taxpayer has a right to conduct an examination of IRS officials, but only "when he points to specific facts or circumstances plausibly raising an inference of bad faith." United States v. Clarke, 134 S. Ct. 2361, 2365 (2014).

Because the Court has determined that Lui failed to successfully rebut the Government's *prima facie* case under Powell, and has raised no credible inference of bad faith, he is not entitled to discovery and the Government's motions to quash are granted.

V. MOTION TO DISMISS

Lui also filed a motion to dismiss the July 8, 2015 document summons because the IRS failed to provide evidence that the documents sought actually existed. ECF No. 59-1 at 6-7. The Court has already found that the Government satisfied its *prima facie* burden under Powell, and the initial summons need not "prove by positive evidence the existence of the records and their possession by the sumonee." Lawn Builders of New England, 856 F.2d at 392 (1st Cir. 1988). Lui's motion to dismiss is denied.

CONCLUSION

For the foregoing reasons, the Government's petition to enforce the IRS' document summons against Lui is granted for any document or records he has in his possession regarding the transfer of any relevant stock. For all other documents, the petition is denied due to Lui's non-possession. The Government's petition to enforce the IRS' testimonial summons is granted in part. Lui is ordered to appear before Revenue Agent Esther Lee, or any other proper officer or employee of the IRS, at such time and place as may be set by Revenue Agent Lee or her designee, and produce the documents and give the testimony as discussed herein.

***10** IT IS SO ORDERED.

All Citations

Slip Copy, 2017 WL 3232578, 120 A.F.T.R.2d 2017-5332, 2017-2 USTC P 50,294

Footnotes

[1] Lui originally moved to strike the Government's reply to his sur-reply on the grounds that it was untimely filed, and the Government responded. ECF Nos. 52, 55, 57. Lui then withdrew his motion to strike. ECF Nos. 89, 90.

[2] Lui has submitted a motion to dismiss in which he argues that the Government must establish that the requested documents exist in order to defend its summons. ECF No. 59 at 1. The Court agrees with those courts that have held it is the summonee's burden to establish non-possession through the presentation of credible evidence. See United States v. Lawn Builders of New England, Inc., 856 F.2d 388, 392 (1st Cir. 1988) ("We have previously rejected the contention that the IRS must *prove by positive evidence* the existence of the records and their possession by the summonee.") (emphasis in original) (citing cases).

[3] Compare Larue, 2015 WL 9809798, at *3 (relying on IRS' declaration, based on information obtained, that taxpayers "facilitate[d] a scheme whereby [they] set up offshore trusts to improperly avoid U.S. income tax" and petitioners "fail[ed] to present any evidence" that they did "not possess or control the documents at issue" or that they "made any efforts to retrieve the summoned documents from any party.").

[4] The Government argues the relevant summons date was July 8, 2014 because it placed Lui "on notice that the IRS was examining his foreign interests." ECF No. 84 at 8. The obligation to retain documents does not begin until the actual document summons is issued. See Asay, 614 F.2d 660.

[5] Lui asserted the marital communications and adverse spousal testimonial privileges to two questions, but no longer asserts them given that his wife answered the questions at issue in an IRS recorded interview. ECF No. 82 at 33, n. 14.

[6] Lui argues in his sur-reply that the SEC submission was first introduced by the Government's original reply, rather than its original Petition. ECF No. 88 at 3, n 3. Lui cites Smith v. Marsh, 194 F.3d 1045, 1052 (9th Cir. 1999) to support the assertion that this argument is waived. Id. However, Lui was already aware of the SEC submission as he submitted part of it as an exhibit in his own Opposition, ECF No. 27, Ex. 24-2, at 83-85. He also submitted a sur-reply giving him the opportunity to respond to the Government's argument on the merits.

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187 F.Supp.3d 350
United States District Court, D. Connecticut.

UNITED STATES of America, Plaintiff,
v.
Diane M. GARRITY, Paul G. Garrity, Jr., and Paul M. Sterczala, as fiduciaries of the Estate of Paul G. Garrity, Sr., deceased, Defendants.

No. 3:15-cv-243 (MPS)
|
Signed May 20, 2016

Synopsis
Background: United States brought action against fiduciaries of taxpayer's estate, seeking to collect civil penalty assessed by IRS based on taxpayer's failure to timely report his financial interest in or authority over foreign bank account. Fiduciaries moved to amend scheduling and add proposed counterclaim regarding IRS's alleged disclosure of certain materials to agents not involved in investigation of taxpayer.

[Holding:] The District Court, Michael P. Shea, J., held that estate could not assert claim under statute permitting "such taxpayer" to sue for government agents inspecting or disclosing any of taxpayer's tax return or return information.

Motion denied.

Attorneys and Law Firms

***351** Austin L. Furman, U.S. Department of Justice, Christine L. Sciarrino, U.S. Attorney's Office, New Haven, CT, Steven Marcus Dean, Carl Lewis Moore, Washington, DC, for Plaintiff.

Daniel F. Brown, Randall P. Andreozzi, Andreozzi, Bluestein, Weber, Brown, LLP, Clarence, NY, Michael Menapace, Wiggin & Dana, Hartford, CT, for Defendants.

MEMORANDUM AND ORDER

Michael P. Shea, United States District Judge.

Plaintiff, the U.S. Government (the "Government"), brought this action to collect an outstanding civil penalty from the Estate of Paul G. Garrity, Sr. (the "Estate"). (ECF No. 1.) Defendants Diane M. Garrity, Paul G. Garrity, Jr., and Paul M. Sterczala, fiduciaries of the Estate, move to amend the scheduling order in this case to extend the deadline to amend pleadings and allow them to assert a counterclaim. (ECF No. 40.) Because the Court finds that the Estate cannot, under the circumstances of this case, invoke the damages remedy created by Congress for the type of counterclaim it seeks to bring, the Court DENIES Defendants' motion to amend the scheduling order and add their proposed counterclaim.

I. BACKGROUND

On February 20, 2015, the Government filed a complaint seeking to collect an outstanding civil penalty from the Estate. (ECF No. 1 at 1.) Specifically, the Internal Revenue Service (the "IRS") had assessed a penalty against Paul G. Garrity, Sr., "for his failure to timely report his financial interest in, and/or his signatory or other authority over, a foreign bank account for the 2005 calendar year, as required by 31 U.S.C. § 5314 and its implementing regulations." (*Id.*) Section 5314 requires certain individuals to keep records or file reports on foreign financial agency transactions, and Section 5321 authorizes the Secretary of the Treasury to impose a civil penalty, known as an FBAR penalty, "on any person who violates, or causes a violation of any provision of section 5314." 31 U.S.C. § 5321(a)(5). Defendants filed their answer and affirmative defenses on April 24, 2015 (ECF No. 9), and the Court entered a scheduling order on June 17, 2015, setting the deadline for filing motions to amend the pleadings for July 24, 2015, and a discovery deadline of June 10, 2016. (ECF No. 20.)

After the July 24 deadline for amending the pleadings passed, Defendants' counsel discovered that certain publicly-available IRS training materials contained information about the IRS's investigation of Paul G. Garrity, Sr. (ECF No. 40 at 1–2.) Specifically, Defendants allege that Dennis Brager of the Brager Tax Law Group submitted a Freedom of Information Act ***352** ("FOIA") request to the IRS by letter dated April 3, 2014. (ECF No. 40–2 at 16.) On September 30, 2014, the IRS produced 6,601 pages of documents in response to the FOIA request, including "unredacted PowerPoint slides from an IRS training program" that "included a case study discussing the IRS investigation of Paul G. Garrity, Sr. that was the genesis of the Title 31 and 26 penalties and proposed income tax deficiencies against" Paul G. Garrity, Sr. (the "Case Study Materials"). (*Id.* at 16–17.) The Brager Tax Law Group posted the Case Study Materials on its website, where Defendants later found it and immediately recognized that it contained Paul G. Garrity, Sr.'s return information. (*Id.*) On June 29, 2015, Defendants served their First Request for Production of Documents on the Government in this action. (*Id.*) Defendants argue that the Case Study Materials are responsive to this request, but the Government disagrees, and did not produce the Case Study Materials. (ECF No. 44 at 3 n. 1; ECF No. 40 at 3.)

Defendants have now filed a motion to amend the scheduling order to extend the deadline to amend pleadings and allow them to file an amended answer and assert a counterclaim. (ECF No. 40 at 4.) In their proposed counterclaim, Defendants allege that the Government violated 26 U.S.C. § 6103(a) by disclosing the Case Study Materials to IRS agents not directly concerned with the investigation and the law firm, which disclosed the information to the public through its website. [1] (ECF No. 40–2 at 15–16.) Section 6103(a)(1) provides, in relevant part, that "no officer or employee of the United States ... shall disclose any return or return information obtained by him in any manner in connection with his service as such an officer or an employee or otherwise or under the provisions of this section." Section 7431(a) provides a private right of action for damages against the Government for such unauthorized disclosures.

II. STANDARD

[1] **[2]** Rule 15(a)(2) of the Federal Rules of Civil Procedure provides that "a party may amend its pleading only with the opposing party's written consent or the court's leave. The court should freely give leave when justice so requires." Fed. R. Civ. P. 15(a)(2). Despite this liberal standard, "[a] district court has discretion to deny leave for good reason, including futility, bad faith, undue delay, or undue prejudice to the opposing party." *McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 200 (2d Cir.2007) (citing *Foman v. Davis*, 371 U.S. 178, 182, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962)). "In this Circuit, it is well settled that an amendment is considered futile if the amended pleading fails to state a claim or would be subject to a motion to dismiss on some other basis." *Gilbert, Segall & Young v. Bank of Montreal*, 785 F.Supp. 453, 457 (S.D.N.Y.1992) (internal citations omitted).

III. DISCUSSION

[3] **[4]** The Government argues that Defendants should not be allowed to bring their proposed counterclaim because they lack standing, making the amendment futile. (ECF No. 44 at 4–5.) Although the parties have treated this issue as one involving "standing," recent case law suggests that it is more properly considered as a question of whether the proposed counterclaim would state a claim under the relevant statute, 26 U.S.C. § 7431. "[A] ***353** plaintiff must have a cause of action under the applicable statute. This was formerly called 'statutory standing.' " *Am. Psychiatric Ass'n v. Anthem Health Plans, Inc.*, No. 14–3993–CV, 821 F.3d 352, 359, 2016 WL 2772853, at *4 (2d Cir. May 13, 2016). "The Supreme Court has recently clarified, however, that what has been called 'statutory standing' in fact is not a standing issue, but simply a question of whether the particular plaintiff 'has a cause of action under the statute.' " *Id.* (quoting *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, ––– U.S. ––––, 134 S.Ct. 1377, 1387, 188 L.Ed.2d 392 (2014)). In order to determine whether 26 U.S.C. § 7431(a) provides Defendants with a private right of action under the circumstances of this case, the court must examine the statute and "apply traditional principles of statutory interpretation." *Lexmark Int'l, Inc.*, 134 S.Ct. at 1388.

Section 7431(a) provides:

> If any officer or employee of the United States knowingly, or by reason of negligence, inspects or discloses any return or return information with respect to a taxpayer in violation of any provision of section 6103, *such taxpayer* may bring a civil action for damages against the United States in a district court of the United States.

26 U.S.C. § 7431(a) (emphasis added).

The plain language of the statute calls for reading "such taxpayer" to refer to the taxpayer whose "return information" has been disclosed, not to anyone else. And if there were any doubt about the meaning of those words, the principle that waivers of sovereign immunity are narrowly construed would call for the same conclusion. "Under settled principles of sovereign immunity, the United States, as sovereign, is immune from suit, save as it consents to be sued. ..." *United States v. Dalm,* 494 U.S. 596, 608, 110 S.Ct. 1361, 108 L.Ed.2d 548 (1990) (citations and internal quotation marks omitted). "A waiver of the Federal Government's sovereign immunity must be unequivocally expressed in statutory text, and will not be implied. Moreover, a waiver of the Government's sovereign immunity will be strictly construed, in terms of its scope, in favor of the sovereign." *Lane v. Pena*, 518 U.S. 187, 192, 116 S.Ct. 2092, 135 L.Ed.2d 486 (1996) (internal quotation marks and citations omitted). Other courts have likewise interpreted the phrase "such taxpayer" in Section 7431 as "the taxpayer whose 'return' or 'return information' has been allegedly disclosed." *Ruiz Rivera v. I.R.S.*, 226 F.Supp.2d 345, 349 (D.P.R.2002) *aff'd*, 93 Fed.Appx. 244 (1st Cir.2004); *Clark v. I.R.S.*, No. CIV. 06–00544SPK–LEK, 2007 WL 1374742, at *1 (D.Haw. Mar. 1, 2007) (taxpayer was estate, and therefore beneficiary of estate could not enforce terms of Section 7431; proper party is estate).

Two neighboring statutes in the Internal Revenue Code, Sections 7432[2] and 7433,[3] similarly permit "such taxpayer" to bring a civil action for damages against the United ***354** States. Courts have also interpreted the phrase "such taxpayer" in those statutes as referring only to the "direct taxpayer," *i.e.*, the individual from whom the IRS seeks to collect taxes. *See, e.g., Parker v. United States*, No. 09CV1394JAH, 2010 WL 3894977, at *3 (S.D.Cal. Sept. 29, 2010) (agreeing with other courts "that only direct taxpayers have standing to sue under § 7432"); *Ibraham v. United States*, 123 F.Supp.2d 408, 409 (S.D.Ohio 2000) (citing cases holding "that § 7432 provides a cause of action only to the individual against whom the IRS is trying to collect."); *Ludtke v. United States*, 84 F.Supp.2d 294, 300 (D.Conn.1999) (citing cases holding "that Section 7433 confers jurisdiction only to the taxpayer at whom collection efforts were directed," not third parties).

[5] Given the clear text of the statute and the strict construction of waivers of sovereign immunity, this Court agrees that the private cause of action in Section 7431 is limited to claims brought by taxpayers whose return information has been disclosed. Here, the allegations in the counterclaim make clear that the "taxpayer" whose "return information" was disclosed was Paul G. Garrity, Sr., and not the Estate. Therefore, the plain reading and the one consistent with construing waivers of sovereign immunity narrowly is that the Estate is not "such taxpayer" and may not bring suit.

[6] **[7]** Defendants contend that the Estate may sue under Section 7431 because the Estate "is a legal continuation of the deceased taxpayer" (ECF No. 45 at 5), but the plain language of the statute does not embrace such a broad class of plaintiffs, which would also sweep in assignees and all other manner of successors-in-interest. Nor does it matter if the right of action under Section 7431 is considered to be a property interest of the type that would ordinarily pass upon death, as the court found in *Schachter v. United States*, 847 F.Supp. 140 (N.D.Cal.1993). Declining to follow *Shapiro v. Smith*, 652 F.Supp. 218, 218–19 (S.D.Ohio 1986)—which had held that an older version of Section 7431 was akin to a tort action protecting personal privacy rights and did not survive the taxpayer's death—the *Schachter* court held that Section 7431 creates "a property interest which should survive death," and allowed the substitution of the estate of a plaintiff who had died after bringing suit. *Schachter*, 847 F.Supp. at 141. *Schachter* reasoned that: (1) "all taxpayers, not just individuals, can sue under § 7431, while under tort law a corporation or association has no right to privacy," (2) Section 7431 "provides for 'actual' damages, an indication that property rights were to be taken into account," and (3) allowing a right of survival is consistent with the legislative aim of discouraging "governmental intimidation through disclosure." *Id.* Even if the Court accepts the reasoning in *Schachter* that Section 7431 creates a property right, the disclosure of Paul G. Garrity, Sr.'s return information occurred years after Paul G. Garrity, Sr.'s death, according to the allegations in the proposed counterclaim.[4] Thus, Paul G. Garrity, Sr., never had a property right in such a cause of action during his lifetime, and there was, at the time of his death, no such property right to pass to the Estate.[5]

***355** Defendants argue that this interpretation of Section 7431 would render superfluous a provision of Section 6103 dealing with the disclosure of tax return information of the deceased. In the case of a deceased individual, Section 6103 provides:

> The return of the decedent shall, upon written request, be open to inspection by or disclosure to—(A) the administrator, executor, or trustee of his estate, and (B) any heir at law, next of kin, or beneficiary under the will, of such decedent, or a donee of property, but only if the Secretary finds that such heir at law, next of kin, beneficiary, or donee has a material interest which will be affected by information contained therein.

26 U.S.C. § 6103(e)(3). Defendants argue that such an exception would be superfluous if Congress did not intend to "impose liability upon the IRS for disclosure of the taxpayer information of decedents or estates." (ECF No. 45 at 4.)

[8] The Court disagrees. Section 6103 is not rendered meaningless simply because Section 7431, an independent statute creating a damages remedy for violations of Section 6103, limits that remedy (and the waiver of sovereign immunity) to the taxpayer whose return information is improperly disclosed. More specifically, construing Section 7431 to foreclose the Estate from suing the Government for disclosure of Paul G. Garrity, Sr.'s tax return information does not make the prohibition on disclosure of a decedent's return information in Section 6103—to which Section 6103(e)(3) creates certain exceptions—a dead letter. That prohibition is independently enforceable by the criminal law and through internal discipline at the IRS. For example, it is a felony punishable by a fine not to exceed $5,000, or imprisonment of not more than five years (or both), "for any officer or employee of the United States or any person described in section 6103(n) (or an officer or employee of any such person), or any former officer or employee, willfully to disclose to any person, except as authorized ... any return or return information (as defined in section 6103(b))." 26 U.S.C. § 7213(a)(1). It is a misdemeanor punishable by a fine not to exceed $1,000, or imprisonment of not more than one year (or both), for any officer or employee of the U.S. or any person described in sections 6103(l)(18) or 6103(n) (or an officer or employee of any such person) "willfully to inspect, except as authorized in this title, any return or return information [as defined in section 6103(b)]." 26 U.S.C. § 7213A(a), (c). In addition to these criminal penalties, "Congress created the Treasury Inspector General for Tax Administration, an entity distinct from the IRS, which investigates claims of IRS employee misconduct, in an effort to deter such misconduct." *Hudson Valley Black Press v. I.R.S.*, 409 F.3d 106, 111–12 (2d Cir.2005) (citing 5 U.S.C. App. 3 § 2(B)(ii)). The statute, 5 U.S.C. App. 3 § 7(a), authorizes the Inspector General to "receive and investigate complaints or information from an employee ... concerning the possible existence of an activity constituting a violation of law, rules, or regulations. ..." 5 U.S.C. App. 3 § 7(a). Finally, Section 6103(e), the provision the Estate contends would be rendered superfluous by a plain language reading of Section 7431, is itself independently enforceable by executors or beneficiaries, who may bring lawsuits in federal court to obtain a decedent's tax information pursuant to the FOIA. *See e.g., Goldstein v. Internal Revenue Serv.*, No. 14-CV-02186, 174 F.Supp.3d 38, 47–48, 2016 WL 1180157, at *6 (D.D.C. Mar. 25, 2016) ("to the extent that the IRS denied Plaintiff access to tax returns requested in Items 2, 3, 4, 7, and 10, those denials are actionable under FOIA and therefore are appropriately before this court"). These additional avenues of enforcing the prohibitions and exceptions of Section 6103 ***356** show that the decedent exception in Section 6103(e) is not superfluous simply because, under the circumstances of this case, the Estate does not have a private cause of action for damages.

[9] Especially given the principle that courts construe waivers of sovereign immunity narrowly, there is no reason to believe that Congress meant the damages remedy in Section 7431 to be coextensive in all cases with the prohibitions in Section 6103. Although Section 7431 refers to "any officer or employee" disclosing "return information" in violation of "any provision of section 6103," it also adds the restriction that the damages action must be brought by the same taxpayer whose information was improperly disclosed. If Congress had wanted Sections 6103 and 7431 to be perfectly coextensive, it could have used broader language in identifying the persons who may sue under Section 7431, such as "any aggrieved person" or "any affected taxpayer." *See Allied/Royal Parking L.P. v. United States*, 166 F.3d 1000, 1003 (9th Cir.1999) (holding that Section 7433 limits cause of action to "such taxpayers" from whom the IRS is attempting to collect: "Where Congress intends to provide a cause of action for a broad class of plaintiffs, it has used unambiguous language to do so. For example, if a person's property has been wrongfully levied upon to satisfy the tax obligation of another person, the wrongful levy statute provides a cause of action to '*any person* (other than the person against whom is assessed the tax out of which such levy arose)' to recover his or her property. 26 U.S.C. § 7426(a)(1)." (emphasis in original)). Because "such taxpayer" does not include the Estate in this case, the Estate has no cause of action for damages for the violation of Section 6103.

Having found that Defendants do not have a cause of action under Section 7431 to bring their proposed counterclaim, the Court does not address the parties' other arguments.

IV. CONCLUSION

For the foregoing reasons, the Court DENIES Defendants' motion to amend the scheduling order and add their proposed counterclaim. (ECF No. 40.) The Court GRANTS Defendants' motion to extend the period for fact discovery for 90 days. (ECF No. 46.) Discovery shall close on September 8, 2016.

By June 3, 2016, Defendants shall file a document —no more than eight pages—detailing exactly what information they seek related to the Case Study Materials, what they expect the documents would show, and how such information is relevant to defending the Government's claim for an FBAR penalty. The Government shall file a response of no more than eight pages by June 17, 2016. There shall be no replies. After receiving the parties' filings, the Court will review them and issue a ruling on whether the Government must produce the Case Study Materials.

IT IS SO ORDERED.

All Citations

187 F.Supp.3d 350, 117 A.F.T.R.2d 2016-1809

Footnotes

[1] Defendants represent that they "do not seek damages for each of the untold number of third-parties who read, copied, or downloaded the disclosed information from the third-party law firm website or from websites or platforms to which the information may have been transferred or re-posted." (ECF No. 45 at 8–9.)

[2] 26 U.S.C. § 7432(a) provides: "If any officer or employee of the Internal Revenue Service knowingly, or by reason of negligence, fails to release a lien under section 6325 on property of the taxpayer, *such taxpayer* may bring a civil action for damages against the United States in a district court of the United States." (emphasis added).

[3] 26 U.S.C. § 7433(a) provides: "If, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title, *such taxpayer* may bring a civil action for damages against the United States in a district court of the United States. Except as provided in section 7432, such civil action shall be the exclusive remedy for recovering damages resulting from such actions." (emphasis added).

[4] Paul G. Garrity, Sr. died on February 10, 2008. (ECF No. 40 at 1.)

[5] It is worth noting that, at common law, no right of action for invasion of personal privacy, and thus no property right in such an action, could have accrued to Paul G. Garrity, Sr., after his death. A dead person has no cognizable right of action when his privacy is invaded. *See* Restatement (Second) of Torts § 652I, cmt. b. ("In the absence of statute, the action for the invasion of privacy cannot be maintained after the death of the individual whose privacy is invaded.").

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2016 WL 416516
United States District Court, C.D. California.

UNITED STATES
v.
BUSSELL.

CV 15–02034 SJO (VBKx)
|
Signed January 11, 2016

Attorneys and Law Firms

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PROCEEDINGS (in chambers): ORDER DENYING MOTION FOR RECONSIDERATION

[Docket No. 180]

THE HONORABLE S. JAMES OTERO, UNITED STATES DISTRICT JUDGE

***1** This matter is before the Court on Defendant Letantia Bussell's ("Defendant") Motion for Reconsideration of the Order on Motion for Summary Judgment and Judgment on the Pleadings ("Motion"), filed December 15, 2015. On December 21, 2015, Plaintiff United States of America ("Plaintiff") filed an Opposition to Defendant's Motion. Defendant did not file a Reply. Having carefully considered the issues raised, the Court deems the matter appropriate for decision without oral argument and vacates the hearing set for January 25, 2015. *See* Fed.R.Civ.P. 78. For the reasons set forth below, the Court **DENIES** the Motion.

I. *FACTUAL AND PROCEDURAL BACKGROUND*

A. *Factual Background*

Defendant was married to John Bussell ("Mr.Bussell") from 1972 until his death in 2002. (Index of Exs. and Decls. in Supp. of Pl.'s Mot. ("Index"), ECF No. 24–1, Ex. 11 ¶ 3.) Defendant is a licensed physician who specializes in dermatology. *Bussell v. Comm'r,* 130 T.C. 222, 224 (2008). Defendant has maintained a dermatology practice in Beverly Hills, California since 1979. *Id.* From 1981 through approximately 1995, when Defendant filed for bankruptcy, Defendant conducted her medical practice through various corporations, including Letantia Bussell M.D. Inc. *Id.*

Before Mr. Bussell and Defendant (collectively, the "Bussells") filed for bankruptcy in 1995, the Bussells restructured Defendant's medical practice to conceal her interest in the practice. (Index, Ex. 21 at IOE_000104–105.) [1] The Bussells funneled Defendant's profits between 1993 and 1995, which totaled $1,149,048, into a non-interest bearing account with Sanwa Bank ("Sanwa Account"). The Bussells maintained control over the Sanwa Account, but the Sanwa Account was under the name of BBL Medical Management, Inc. ("BBL"). (Index, Ex. 21, at IOE_000105.) In January 1996, Defendant transferred the balance of the Sanwa Account to a personal bank account at Swiss Bank Corp. *Bussell v. Comm'r,* T.C. Memo.2005–77, 2005 WL 775755 at *4 (April 7, 2005). Swiss Bank Corp. later became known as UBS AG. (Index, Ex. 11 ¶ 2.) The Defendant failed to disclose the funds from the Sanwa Account and her interest in the Swiss account in her 1996 tax return. *Id.*

B. *The Subject Account and Defendant's Tax Filings*

On January 29, 1997, the Bussells opened a second bank account with Swiss Bank Corp., account no. xxxx3235 (the "Subject Account"). (*See* Index, Ex. 4; Ex. 11 ¶ 2.) As part of the process of opening the Subject Account, the Bussells signed a Swiss Bank Corp. document naming themselves as the beneficial owners of the account. (*See* Index, Ex. 4. at IOE_000011.) The Bussells also signed a Swiss Bank Corp. document entitled "General power of attorney" granting Todd John Bussell, their son, signature authority over the Subject Account. (Index, Ex. 4 at IOE_000015.) Defendant also had signature authority over the Subject Account. (Index, Ex. 4 at IOE_000014.)

***2** On October 15, 2007, Defendant filed her individual income tax return for the 2006 tax year. (*See* Index, Ex. 4.) In her 2006 tax return, Defendant did not report the interest income earned from the Subject Account. (Index, Ex. 11 ¶ 6.) Furthermore, Defendant did not file a Treasury Department Form 90–22.1, Report of Foreign Bank and Financial Accounts ("FBAR Form"), disclosing her financial interest in the Subject Account for the 2006 tax year. (Index, Ex. 11 ¶ 6.) During 2006, the Subject Account had a balance that exceeded $10,000. (Index, Ex. 11 ¶ 4.) On December 31, 2006, the Subject Account had a balance of $2,241,027. (Index, Ex. 11 ¶ 5.)

On October 23, 2007, Todd Bussell wrote to UBS AG and asked the bank to liquidate the Subject Account, as well as a second account, and requested that the balances be transferred to two accounts at Finter Bank Zurich. Todd Bussell requested that 50% of the balances be transferred to an account with Wakaduku Foundation as the beneficiary ("Wakaduku Account"), and the other 50% transferred to an account with Valmadera Foundation as the beneficiary ("Valmadera Account"). (Plaintiff's Proposed Statement of Uncontroverted Facts ("PSUF"), ECF No. 23–1, ¶ 16; *See also* Index, Ex. 5 at IOE 000018.)

Several transfers then occurred between the Subject Account and the other accounts. On November 1, 2007, the Subject Account had zero balance. (Index, Ex. 5 at IOE 000021.) On November 9, 2007, the Subject Account had a closing balance of $2,918,299.28. (Index Ex. 5 at IOE 000021.) Pursuant to Todd Bussell's request, on November 13, 2007, UBS AG made three separate payments to the Wakaduku Account and the Valmadera Account. (Index Ex. 5 at IOE 000022.) By November, 14, 2007, the Subject Account had zero balance again. (Index Ex. 5 at IOE 000022.)

C. *History of Legal Proceedings Against the Bussells*

On May 3, 2000, an Indictment was filed against the Bussells in the Central District of California. (Index, Ex. 18 at IOE_000074.) On January 31, 2002, a Redacted First Superseding Indictment (the "Indictment") was filed against the Bussells in which the Government brought various counts related to bankruptcy fraud and attempted tax evasion. (PSUF ¶ 3.)

On February 6, 2002, a jury convicted Defendant of the following: (1) one count of violating 18 U.S.C. § 371 (conspiracy to commit an offense against or defraud the United States); (2) two counts of violating 18 U.S.C. § 152(1) (concealment of assets in bankruptcy); (3) two counts of violating 18 U.S.C. § 152(3) (false declaration and statement as to avoid material matters); and (4) one count of violating 26 U.S.C. § 7201 and 18 U.S.C. § 2 (evading payment of income tax). (PSUF ¶ 3.)

After the conviction, on or about April 29, 2002, the Internal Revenue Service ("IRS") issued a jeopardy levy with regard to the Bussells' income tax liabilities for 1983, 1984, 1986, and 1987. (Index, Ex. 21, at IOE_000107.) The IRS also approved a jeopardy assessment against the Bussells for the 1996 tax year ("1996 Assessment"). The total amount of the jeopardy levy/assessment was $3.4 million, with $1,283,522 attributable to the 1996 tax year and the remaining $2,116,478 to the 1980s. (Index, Ex. 21, at IOE_000107.) The government explained that it levied a jeopardy assessment in part because:

> [I]n 1996 [Defendant] received $1,149,048 from financial accounts which were previously undisclosed and not reported on [Defendant's] Individual Income Tax Return Form 1040 for this period. These funds were concealed as part of the conspiracy to commit bankruptcy fraud.

(Index, Ex. 21, at IOE_000115.)

On August 23, 2002, Defendant filed a complaint in federal district court seeking review of the 1996 Assessment pursuant to 26 U.S.C. § 7429(b). (PSUF ¶ 4.) On December 11, 2002, the Court issued an order granting the Government's motion for summary judgment and denying Defendant's motion for summary judgment. (PSUF ¶ 5.) The Court held that the IRS's jeopardy determination was reasonable because Defendant's criminal history demonstrated that she had failed to report income and engaged in a scheme to hide assets from the IRS in an attempt to defeat the collection of unpaid taxes. (PSUF ¶ 5.)

***3** While the jeopardy case was pending, Defendant filed a petition with the United States Tax Court (the "Tax Court") seeking a redetermination of deficiency in the Bussells' 1996 taxes, as well as a redetermination of the civil tax fraud penalty imposed by the IRS pursuant to 26 U.S.C. § 6663(a). (PSUF ¶ 7.) The Tax Court concluded that the Bussells maintained, and failed to report, two foreign bank accounts in their 1996 tax return, a Swiss account and a "Syntex" bank account. *Bussell v. Commissioner of Internal Revenue,* T.C. Memo.2005–77, 2005 WL 775755 at *4 (April 7, 2005). The Tax Court held that Defendant was liable for the civil fraud penalty imposed pursuant to 26 U.S.C. § 6663(a), a decision that was affirmed by the Ninth Circuit Court of Appeals. (PSUF ¶ 8.)

D. *Procedural History of the Instant Case*

On June 5, 2013, the IRS assessed against the Defendant an FBAR penalty in the amount of $1,221,806 ("Assessment") for her alleged willful failure to disclose and report her interest in the Subject Account for the 2006 tax year. (Index, Ex. 1.) On March 19, 2015, the Government initiated the instant action to recover from the Defendant the Assessment and to reduce the Assessment to a judgment against Defendant. (*See generally* Compl., ECF No. 1; Mot., ECF No. 23.) The Government seeks a judgment ordering Defendant to pay $1,361,694.41, which includes the Assessment, the penalty for failure-to-pay the Assessment, and interest as of January 23, 2015, plus any accruing interest thereafter. (*See generally* Compl.; Index, Ex. 2.)

On December 8, 2015, this Court granted in part and denied in part the Government's Motion for Summary Judgment, and granted in part and denied in part Defendant's Motion for Judgment on the Pleadings. The Court ordered the Defendant to pay a penalty amount of $1,120,513. (*See generally* Order on Mtn. for Summ. J. and J. on the Pleadings ("Summary Judgment Order"), ECF No. 35.) Defendant now brings the instant Motion for Reconsideration.

II. *LEGAL STANDARDS*

A. *Motion for Reconsideration*

Federal Rule of Civil Procedure 60(b) provides that a Court, upon a motion and just terms, "may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons:

> (1) mistake, inadvertence, surprise, or excusable neglect;
>
> (2) newly discovered evidence that, with reasonable diligence, could not have been discovered in time to move for a new trial under Rule 59(b);
>
> (3) fraud (whether previously called intrinsic or extrinsic), misrepresentation, or misconduct by an opposing party;
>
> (4) the judgment is void;
>
> (5) the judgment has been satisfied, released, or discharged; it is based on an earlier judgment that has been reversed or vacated; or applying it prospectively is no longer equitable; or
>
> (6) any other reason that justifies relief."

Fed.R.Civ.P. 60(b). The Court of Appeals for the Ninth Circuit has instructed that a "motion for reconsideration should not be granted, absent highly unusual circumstances, unless the district court is presented with ***newly discovered evidence***, committed ***clear error***, or if there is an ***intervening change in the controlling law***." *399 Orange St. Partners v. Arnold,* 179 F.3d 656, 665 (9th Cir.1999) (emphasis added) (citation omitted). Further, a motion for reconsideration "may not be used to raise arguments or present evidence for the first time when they could reasonably have been raised earlier in the litigation." *Carroll v. Nakatani,* 342 F.3d 934, 945 (9th Cir.2003).

Moreover, the Court strictly adheres to Local Rule 7–18, which limits the viable bases for a motion for reconsideration. Local Rule 7–18 provides that a motion for reconsideration "may be made only on the grounds of (a) a ***material difference in fact or law*** from that presented to the Court before such decision that in the exercise of reasonable diligence could not have been known to the party moving for reconsideration at the time of such decision, or (b) the emergence of ***new material facts*** or a ***change of law*** occurring after the time of such decision, or (c) a manifest showing of a ***failure to consider material facts*** presented to the Court before such decision." Local Rule 7–18 (emphasis added).

III. *DISCUSSION*

***4** Defendant's Motion does little more than rehash arguments already made in the Motion for Summary Judgment and the Motion for Judgment on the Pleadings. Defendant, thus, does not meet the requirements set out in Federal Rule of Civil Procedure 60(b) or the Court's Local Rules. Notably, Defendant restates its affirmative defenses based on the Fifth Amendment's Double Jeopardy Clause and the Eighth Amendment's Excessive Fines Clause. (Mtn. at 5.) The Court addressed these arguments in its Summary Judgment Order. (*See* Summ. J. Order 8–10.) The Court, in fact, reduced the Government's penalty assessment to comport with the Excessive Fines Clause of the Eighth Amendment. (Summ. J. Order 10–11.) The Court will not revisit this decision and reduce the penalty assessment further.

Defendant goes on to argue that the Court's Summary Judgment Order does not account for the source of the funds in the Subject Account. According to Defendant, the Government's penalty assessment violates the protection against double jeopardy because the funds that Defendant deposited in the Subject Account had been the subject of prior proceedings by the Government. (Mtn. at 5.) The Court addressed this argument in its prior Order. As the Court held, the Bussells had at least two accounts in Switzerland. The Bussells transferred the full balance of the Sanwa Account to “a Swiss account” at Swiss Bank Corp, and the last transfer to this Swiss account was on or about June 11, 1996. *Bussell v. Commissioner,* T.C. Memo.2005–77, 2005 WL 775755 at *4–5 (April 7, 2005). The Bussells then opened the Subject Account, a second Swiss account, on January 29, 1997. (*See* Index, Ex. 4.) The funds from the Sanwa Account, which were the subject of prior penalties, could not have been transferred to the Subject Account because the Sanwa Account funds were transferred to the first account in 1996, six months before the Subject Account even existed. Defendant's arguments concerning the penalties assessed on funds from the Sanwa Account are not applicable to the penalties assessed in the instant case.

Defendant responds that “the source of the subject account are not fully accounted for in the Court's conclusion.” (Mtn. at 5.) Defendant, however, has provided no evidence as to the source of the funds in the Subject Account. In order to establish an affirmative defense based on Double Jeopardy, Defendant bears the burden to show that the funds in the Subject Account came from funds that were the subject of prior proceedings. *See C.A.R. Transp. Brokerage Co. v. Darden Rests., Inc.,* 213 F.3d 474, 480 (9th Cir.2000) (“When the party moving for summary judgment would bear the burden of proof at trial, it must come forward with evidence which would entitle it to a directed verdict if the evidence went uncontroverted at trial. In such a case, the moving party has the initial burden of establishing the absence of a genuine issue of fact on each issue material to its case.” (citations omitted)). Defendant has not carried this burden.

IV. *RULING*

Based on the foregoing, it is hereby ordered that Defendant's Motion for Reconsideration is **DENIED**.

IT IS SO ORDERED.

All Citations

Not Reported in Fed. Supp., 2016 WL 416516, 117 A.F.T.R.2d 2016-446

Footnotes

[1] Pursuant to Federal Rule of Evidence 201, the Court takes judicial notice of Exhibits 18 through 23 of the Index of Exhibits filed concurrently with the Government's Request for Judicial Notice. (*See generally* Index.) Each of these Exhibits represents a publicly available record or filing, and is therefore not reasonably subject to dispute. *See* Fed.R.Evid. 201(b)(2).

End of Document

2013 WL 1499341
Only the Westlaw citation is currently available.
United States District Court,
E.D. California.

Nadia ROBERTS, et al., Plaintiffs,
v.
UBS AG, et al., Defendants.

No. CV F 12–0724 LJO SKO.
|
April 11, 2013.

Attorneys and Law Firms

William J. King, The WJK Law Firm, Tustin, CA, for Plaintiffs.

Dean J. Kitchens, Lauren Allyn Eber, Gibson, Dunn & Crutcher LLP, Los Angeles, CA, for Defendants.

ORDER ON DEFENDANT UBS AG'S F.R.Civ.P. 12 MOTION TO DISMISS (Doc. 38.)

LAWRENCE J. O'NEILL, District Judge.

PRELIMINARY STATEMENT TO PARTIES AND COUNSEL

***1** Judges in the Eastern District of California carry the heaviest caseload in the nation, and this Court is unable to devote inordinate time and resources to individual cases and matters. This Court cannot address all arguments, evidence and matters raised by parties and addresses only the arguments, evidence and matters necessary to reach the decision in this order given the shortage of district judges and staff. The parties and counsel are encouraged to contact United States Senators Diane Feinstein and Barbara Boxer to address this Court's inability to accommodate the parties and this action. The parties are required to consider, or reconsider, consent to a U.S. Magistrate Judge to conduct all further proceedings in that the Magistrate Judges' availability is far more realistic and accommodating to parties than that of U.S. District Judge Lawrence J. O'Neill who must prioritize criminal and older civil cases.

Civil trials set before Judge O'Neill trail until he becomes available and are subject to suspension mid-trial to accommodate criminal matters. Civil trials are no longer reset to a later date if Judge O'Neill is unavailable on the original date set for trial. If a trial trails, it may proceed with little advance notice, and the parties and counsel may be expected to proceed to trial with less than 24 hours notice. Moreover, this Court's Fresno Division randomly and without advance notice reassigns civil actions to U.S. District Judges throughout the nation to serve as visiting judges. This action is under consideration for such reassignment. In the absence of Magistrate Judge consent, this action is subject to reassignment to a U.S. District Judge from outside the Eastern District of California.

INTRODUCTION

Defendant UBS AG seeks to dismiss as improperly pled and legally barred plaintiffs'[1] fraud, malpractice and related claims arising from tax penalties plaintiffs incurred in connection with foreign investments and tax shelters with defendant UBS AG. Plaintiffs contend that their operative Second Amended Complaint ("SAC") allege facts "to show that Plaintiffs are entitled to relief from UBS AG." This Court considered UBS AG's F.R.Civ.P. 12(b)(6) motion to dismiss on the record and VACATES the April 17, 2013 hearing, pursuant to Local Rule 230(g). For the reasons discussed below, this Court DISMISSES the SAC's claims, except limited negligence and conversion claims.

BACKGROUND[2]

Summary

UBS AG is a Swiss corporation, provides banking and investment services, and operates worldwide branches. The SAC also names as defendants four individuals associated with UBS AG, three Swiss business entities, two private Swiss banks, and a Bermuda corporation.[3] The individual plaintiffs are residents of California, Texas, Washington and New York and are former UB S AG clients. The SAC alleges that UBS AG induced plaintiffs to transfer accounts to or to keep accounts with UBS AG and concealed U.S. tax reporting requirements to result in plaintiffs' failure to pay U.S. taxes on their UBS AG foreign investments and consequent penalties. The SAC alleges that each plaintiff "faced criminal investigation relating to the shell company structure set up and carried out by Defendants" and "agreed to pay millions of dollars in tax penalties, plus interest, on top of related costs and professional fees." UBS AG challenges the SAC's multiple tort and related claims as lacking sufficient facts and as barred by plaintiffs' own conduct.

IRS Foreign Account And Trust Reporting

***2** Internal Revenue Service ("IRS") Form 1040, Schedule B, Line 7a ("Line 7a") asks: "did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?" Schedule B indicates that if a taxpayer has a foreign account, the taxpayer generally must identify the account's location and complete IRS Form TD F 90–22.1 known as the Report of Foreign Bank and Financial Accounts ("FBAR"). FBAR instructions require a taxpayer to file a FBAR if the taxpayer has more than $10,000 in foreign accounts and to disclose maximum account values and financial institutions holding accounts.

UBS AG's Scheme

In 2001, the U.S. Treasury required UBS AG to enter into a Qualified Intermediary ("QI") Agreement to require UBS AG clients to complete Internal Revenue Service ("IRS") Forms W–8BEN or W–9 to identify beneficial account owners believed or known to be U.S. citizens or residents.[4] According to the SAC, "UB S AG informed the IRS that it would agree to the QI Agreement terms while devising a scheme to avoid doing just that and would conceal from its clients the QI terms pertaining to said clients while failing to provide necessary documentation to keep its clients, including Plaintiffs, in compliance with U.S. Tax Laws."

Execution Of The Scheme As To Plaintiffs

The Roberts

The Roberts are married. In 2004, Sean Roberts ("Mr.Roberts") owned a UBS AG account in the Isle of Mann and UB S AG banker Claude Ullman ("Mr.Ullman") convinced Mr. Roberts to transfer his account to UBS AG's Swiss location. In 2004, Mr. Ullman told Mr. Roberts that Mr. Roberts could set up a third party trust "to keep his money in a confidential account without having to report it on his taxes because the new entity would be the beneficiary." UBS AG hired defendant Beda Singenberger ("Mr.Singenberger") to create a third-party trust for the Roberts but UBS AG, Mr. Ullman and Mr. Singenberger failed to advise the Roberts "of the illegal nature of said third party trust" and of UBS AG's and the Roberts' tax reporting obligations regarding the trust.

In June 2011, the Roberts entered into plea agreements to plead guilty to filing a false tax return.

The Gubsers

The Gubsers were married during 1978–2008 and held a Swiss UBS AG account which they allowed to sit and which grew to $5.5 million. UBS AG banker Gerard Hofmann ("Mr.Hofmann") advised the Gubsers that the account was set up so that the Gubsers would not need to pay taxes or disclose the account until they brought funds into the United States. UBS AG never advised the Gubsers that they were required to file an IRS Form W–8BEN and "intentionally withheld information pertaining to the QI Agreement." In December 2010, the Gubsers "realized that they may be subject to prosecution by the IRS for failing to declare a 40–year old account originating in Switzerland." The Gubsers participated in the Voluntary Disclosure program and "were forced to pay penalties they should not have paid ."

Mr. Ginzburg

***3** In 2000, UBS AG banker Gian Gisler ("Mr.Gisler") advised Mr. Ginzburg, a medical professional, to change the structure of Mr. Ginzburg's UBS AG funds. Mr. Gisler, defendant Matthias Rickenbach ("Mr.Rickenbach"), a Swiss citizen, and UBS AG director Daniel Perron ("Mr.Perron") advised Mr. Ginzburg to close a Liechtenstein-based trust structure and to open a Hong Kong-based trust, that Mr. Ginzburg "would not have to pay any taxes on any capital gains or dividends until the funds were repatriated" to Mr. Ginzburg's future domicile, the United States or Israel, and that he would pay only taxes on possible capital gains and dividends when he repatriated the funds. Mr. Ginzburg allowed Mr. Rickenbach to set up the Hong Kong trust, and "his account was invested in U.S. stocks" despite UBS AG's agreement to report income and to withhold taxes. Mr. Ginzburg was never informed of the QI Agreement, and in November 2008, UBS AG froze his accounts to prevent him to mitigate market losses. UBS AG representatives refused to disclose information about Mr. Ginzburg's accounts and without Mr. Ginzburg's authorization, "forcefully liquidated the stock portfolio at 2009 levels" to result in a $1.5 million loss. A $565,000 "sales tax" was "wrongfully withheld without any benefit" to Mr. Ginzburg.

In July 2011, Mr. Ginzburg pled guilty to criminal tax fraud.

Mr. Eisenberg

Mr. Eisenberg held a UBS AG account in the Grand Caymans and during a vacation there, entered a UBS AG branch to inquire about the account. He was informed that his account was on the "abandoned accounts" list and transferred to Switzerland. In 2001, Mr. Eisenberg traveled to Switzerland, and defendant UBS AG regional market manager Hansredi Schumacher ("Mr.Schumacher") advised Mr. Eisenberg to set up a trust account. Mr. Eisenberg permitted Mr. Schumacher to set up a Liechtenstein trust and was advised "that he would legally not be required to disclose his account to the IRS because of the trust formation." In 2010, Mr. Eisenberg discovered that UBS AG double charged fees during the account's life.

UBS AG failed to advise Mr. Eisenberg of release by UBS AG of his name to the United States to preclude Mr. Eisenberg to correct defects or seek voluntary disclosure. Mr. Eisenberg's name was one of the first released to the IRS.

The IRS prosecuted Mr. Eisenberg who entered into a December 2010 agreement to plead guilty to filing a false tax return and paid $2.5 million penalties on a $65,000 tax bill.

Mr. Chernick, Shumba And Simba

Mr. Chernick succeeded in manufacturing toys with his Shumba corporation. In 2000, UBS AG executive director Phillip Bigger ("Mr.Bigger") recommended to move Mr. Chernick's Cayman Islands account to UBS AG's Hong Kong office, and Mr. Chernick opened up UBS AG Hong Kong accounts under Shumba. Mr. Bigger advised Mr. Chernick that Mr. Chernick would legally not be required to report the account on his taxes.

***4** In 2001, UBS AG account advisor Juergen Hirsch ("Mr.Hirsch") managed Mr. Chernick's Hong Kong account and advised Mr. Chernick to hold U.S. securities in the Hong Kong accounts "without disclosing that Chernick would have to report such holdings to the U.S. or otherwise advising him of the QI Agreement terms." In 2002, defendant Mr. Rickenbach with UBS AG's authorization "caused the setup of a sham entity to hold Shumba and Simba." In 2006, Mr. Bigger caused Mr. Chernick to close his Shumba account at UBS AG's Hong Kong office and transferred the account's assets, including U.S. securities, to a UBS AG Zurich account. Mr. Bigger failed to inform Mr. Chernick of QI Agreement requirements to file IRS forms or UBS AG withholding of taxes.

Mr. Chernick entered into a July 2009 agreement to plead guilty to filing a false tax return.

Common Allegations

As to all plaintiffs, the SAC alleges that USB AG agents, financial and account advisors, executive directors, and bankers, "under the direction of USB AG":

1. Concealed the QI Agreement and need for UBS AG to withhold taxes or send IRS reporting forms;

2. Failed to include on plaintiffs' statement "tax withholding";

3. Failed to send plaintiffs IRS Forms 1099, W–9 or W–8BEN;

4. Failed to advise plaintiffs "that their accounts were set up in violation of the QI Agreement and U.S. tax

codes, and that said plaintiffs needed to take steps to advise the IRS of said third-party trusts";

5. Failed to send an amnesty letter to advise plaintiffs of the option to disclose to the United States their UBS AG accounts through a "Voluntary Disclosure" program;

6. Violated UBS AG protocols and Swiss laws on disclosure of client identities;

7. Were not properly licensed to provide banking services and tax and investment advice and solicited and serviced plaintiffs "in violation of U.S. securities laws"; and

8. Failed to register themselves and offered securities to violate federal law.

Criminal Prosecution Of UBS AG And Plaintiffs

In November 2008, the United States government filed indictments against UBS AG executives, managers and bankers. On February 18, 2009, UBS AG and the United States government entered into a Deferred Prosecution Agreement ("DPA") by which UBS AG admitted that during 2000–2007, UBS AG "participated in a scheme to defraud the United States and its agency, the IRS by actively assisting or otherwise facilitating a number of United States individual taxpayers in establishing accounts at UBS in a manner designed to conceal the United States taxpayers' ownership or beneficial interest in these accounts." On August 12, 2009, the United States government and UBS AG reached an agreement in principle to disclose 4,450 UBS AG clients.

By 2010, the IRS and U.S. Department of Justice had approached each plaintiff and advised that investments since 2001 were subject to taxation. Each plaintiff faced criminal investigation and paid millions of dollars in tax penalties in addition to interest and professional fees.

DISCUSSION

F.R.Civ.P. 12(b)(6) Motion To Dismiss Standards

***5** The FAC alleges 15 tort and related claims which UBS AG contends are precluded by plaintiffs' "own tax fraud" in that all plaintiffs but the Gubsers have pled guilty to tax fraud by knowingly filing false tax returns and concealing income. UBS AG holds plaintiffs to "the burden of their own tax fraud" and faults the SAC's failure to plead sufficient facts to support its claims.

"When a federal court reviews the sufficiency of a complaint, before the reception of any evidence either by affidavit or admissions, its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheurer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974); *Gilligan v. Jamco Development Corp.,* 108 F.3d 246, 249 (9th Cir.1997). A F.R .Civ.P. 12(b)(6) dismissal is proper where there is either a "lack of a cognizable legal theory" or "the absence of sufficient facts alleged under a cognizable legal theory." *Balisteri v. Pacifica Police Dept.,* 901 F.2d 696, 699 (9th Cir.1990); *Graehling v. Village of Lombard, Ill.,* 58 F.3d 295, 297 (7th Cir.1995). A F.R .Civ.P. 12(b)(6) motion "tests the legal sufficiency of a claim." *Navarro v. Block,* 250 F.3d 729, 732 (9th Cir.2001).

In addressing dismissal, a court must: (1) construe the complaint in the light most favorable to the plaintiff; (2) accept all well-pleaded factual allegations as true; and (3) determine whether plaintiff can prove any set of facts to support a claim that would merit relief. *Cahill v. Liberty Mut. Ins. Co.,* 80 F.3d 336, 337–338 (9th Cir.1996). Nonetheless, a court is not required "to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *In re Gilead Sciences Securities Litig.,* 536 F.3d 1049, 1055 (9th Cir.2008) (citation omitted). A court "need not assume the truth of legal conclusions cast in the form of factual allegations," *U.S. ex rel. Chunie v. Ringrose,* 788 F.2d 638, 643, n. 2 (9th Cir.1986), and must not "assume that the [plaintiff] can prove facts that it has not alleged or that the defendants have violated ... laws in ways that have not been alleged." *Associated General Contractors of California, Inc. v. California State Council of Carpenters,* 459 U.S. 519, 526, 103 S.Ct. 897, 74 L.Ed.2d 723 (1983). A court need not permit an attempt to amend if "it is clear that the complaint could not be saved by an amendment." *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.,* 416 F.3d 940, 946 (9th Cir.2005).

A plaintiff is obliged "to provide the 'grounds' of his 'entitlement to relief' [which] requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Bell Atl. Corp. v. Twombly,* 550 U.S. 554,550 U.S. 544, 127 S.Ct. 1955, 1964–65, 167 L.Ed.2d 929 (2007) (internal citations omitted). Moreover, a court "will dismiss any claim that, even when construed in the light most favorable to plaintiff, fails to plead sufficiently all required elements of a cause of action." *Student Loan Marketing Ass'n v. Hanes,* 181 F.R.D. 629, 634 (S.D.Cal.1998). In practice, a complaint "must contain either direct or inferential allegations respecting all the material elements necessary to sustain recovery under some viable legal theory." *Twombly,* 550 U.S. at 562, 127 S.Ct. at 1969 (quoting *Car Carriers, Inc. v. Ford Motor Co.,* 745 F.2d 1101, 1106 (7th Cir.1984)).

***6** In *Ashcroft v. Iqbal,* 556 U.S. 662, 129 S.Ct. 1937,1949, 173 L.Ed.2d 868 (2009), the U.S. Supreme Court explained:

> ... a complaint must contain sufficient factual matter, accepted as true, to "state a claim to relief that is plausible on its face." ... A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.... The plausibility standard is not akin to a "probability requirement," but it asks for more than a sheer possibility that a defendant has acted unlawfully. (Citations omitted.)

After discussing *Iqbal,* the Ninth Circuit summarized: "In sum, for a complaint to survive [dismissal], the non-conclusory 'factual content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief ." *Moss v. U.S. Secret Service,* 572 F.3d 962, 989 (9th Cir.2009) (quoting *Iqbal,* 556 U.S. 662, 129 S.Ct. at 1949, 173 L.Ed.2d 868).

The U.S. Supreme Court applies a "two-prong approach" to address dismissal:

> First, the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.... Second, only a complaint that states a plausible claim for relief survives a motion to dismiss.... Determining whether a complaint states a plausible claim for relief will ... be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.... But where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged—but it has not "show[n]"—"that the pleader is entitled to relief." Fed. Rule Civ. Proc. 8(a)(2).
>
> In keeping with these principles a court considering a motion to dismiss can choose to begin by identifying pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth. While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations. When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief.

Iqbal, 556 U.S. 662, 129 S.Ct. at 1949–1950, 173 L.Ed.2d 868.

A plaintiff suing multiple defendants "must allege the basis of his claim against each defendant to satisfy Federal Rule of Civil Procedure 8(a)(2), which requires a short and plain statement of the claim to put defendants on sufficient notice of the allegations against them." *Gauvin v. Trombatore,* 682 F.Supp. 1067, 1071 (N.D.Cal.1988). "Specific identification of the parties to the activities alleged by the plaintiffs is required in this action to enable the defendant to plead intelligently." *Van Dyke Ford, Inc. v. Ford Motor Co.,* 399 F.Supp. 277, 284 (D.Wis.1975).

***7** With these standards in mind, this Court turns to UBS AG's challenges to the SAC claims.

Fraud

UBS AG seeks dismissal of the SAC's (first) fraudulent misrepresentation and concealment, (second) constructive fraud, and (third) negligent misrepresentation claims as barred by plaintiffs' own fraud and lacking facts to support elements of the fraud claims.

To support the fraud claims, the SAC alleges that the "UBS AG Defendants": [5]

1. Prepared documentation to form shell corporations which was not permissible under the QI Agreement or U.S. tax laws;

2. Represented that plaintiffs need not be named as signatories on accounts to maintain privacy and failed to report each plaintiff's information to the IRS;

3. Created and implemented a scheme that was illegal and not permitted by the QI Agreement;

4. Provided erroneous tax and legal advice and intentionally prepared wrongful and misleading documents and sent them to plaintiffs;

5. Concealed that plaintiffs owed taxes on their investments and faced criminal investigation for the management structure of plaintiffs' account set up by the UBS AG Defendants;

6. Were not licensed and permitted to provide banking services, investment advice, manage funds, and solicit securities transactions to plaintiffs;

7. Formed shell corporations and invested in corporations using plaintiffs' assets without advising plaintiffs; and

8. Manipulated plaintiffs to open or maintain accounts, charged unnecessary fees and converted assets.

Bar Of Plaintiffs' Own Fraud

UBS AG initially challenges the complaint's fraud claims as barred by plaintiffs' own fraud. UBS AG points to *Olenicoff v. UBS AG,* 2012 WL 1192911, at *1 (C.D.Cal.2012), where the plaintiff pursued claims against UBS AG after the plaintiff pled guilty to knowingly and willfully failing to disclose off-shore accounts on his tax returns. The fellow district judge in *Olenicoff,* 2012 WL 1192911, at *1, observed:

> To defend itself, UBS is forced to strenuously insist that its prior guilty plea only admitted to assisting willing clients with tax fraud, not forcing unsuspecting clients into tax evasion. While its argument is ironic, UBS is right. Even assuming that UBS gave [plaintiff] fraudulent tax advice, that makes UBS a co-conspirator, not a defendant in this litigation.

In *Thomas v. UBS AG,* 706 F.3d 846, 850 (7h Cir.2013), the Seventh Circuit Court of Appeals addressed fraud claims against UBS AG similar to those here and observed that the "plaintiffs are tax cheats, and it is very odd, to say the least, for tax cheats to seek to recover their penalties ... from the source, in this case, UBS, of the income concealed from the IRS." As to fraud, the *Thomas* court further explained:

> The plaintiffs also charge fraud: that the bank inveigled them into continuing to invest with it (they had opened their accounts before the bank joined the Qualified Intermediary Program) by concealing its agreement with the IRS and the obligation entailed by the agreement to report tax information about the plaintiffs to the IRS. This is a private-entrapment argument: by letting the plaintiffs think that keeping their money in foreign accounts would enable them to evade federal tax law successfully, UBS caused the plaintiffs to commit tax fraud. That is another frivolous theory of liability. For if it were adopted, not only would everyone have a legally enforceable duty to prevent crimes and other wrongs when he could; a failure to perform the duty would give the criminal or other wrongdoer a right of action against the failed protector.

***8** *Thomas,* 706 F.3d at 853.

UBS AG argues that plaintiffs "must bear the responsibility for their own actions" and "cannot shift blame to UBS" in that plaintiffs failed to disclose and pay taxes on their foreign accounts. *See Olenicoff,* 2012 WL 1192911, at *1 (plaintiff "may not avoid the consequences of his own plea by getting UBS to indemnify him for his criminal acts”). UBS AG points to the absence of allegations that plaintiffs misinterpreted or did not know of Line 7a.

Unclean Hands

Plaintiffs characterize UBS AG to assert an unclean hands defense which is inapplicable and a matter of factual determination. Plaintiffs argue that the unclean hands doctrine does not apply because it addresses plaintiffs' misconduct “which is unconnected with the matter in litigation” in that UBS AG was not involved in DOJ actions against plaintiffs.

“It is one of the fundamental principles upon which equity jurisprudence is founded, that before a complainant can have a standing in court he must first show that not only has he a good and meritorious cause of action, but he must come into court with clean hands.” *Keystone Driller Co. v. General Excavator Co.,* 290 U.S. 240, 244, 54 S.Ct. 146, 78 L.Ed. 293 (1933).

Plaintiffs fail to establish that the unclean hands doctrine is at issue. UBS AG contends that plaintiffs' own fraud bars their fraud claims. The gist of the fraud claims is that UBS AG caused plaintiffs to commit tax fraud by cajoling plaintiffs into questionable investments and failing to disclose plaintiffs' tax reporting obligations. Plaintiffs' failure to report their foreign accounts is tax fraud to defeat their fraud claims, not unclean hands.

Judicial Estoppel

Plaintiffs further characterize UBS AG to apply judicial estoppel to bar the fraud claims. Plaintiffs contend that their guilty pleas and voluntary disclosures should not be considered to analyze the SAC's claims.

Judicial estoppel “precludes a party from gaining an advantage by taking one position, and then seeking a second advantage by taking an incompatible position.” *Rissetto v. Plumbers and Steamfitters Local 343,* 94 F.3d 597, 600 (9th Cir.1996). The Ninth Circuit has explained the rationale of judicial estoppel:

> The policies underlying preclusion of inconsistent positions are general considerations of the orderly administration of justice and regard for the dignity of judicial proceedings.... Judicial estoppel is intended to protect against a litigant playing fast and loose with the courts.... Because it is intended to protect the dignity of the judicial process, it is an equitable doctrine invoked by a court at its discretion.

Russell v. Rolfs, 893 F.2d 1033, 1037 (9th Cir.1990), *cert. denied,* 501 U.S. 1260, 111 S.Ct. 2915, 115 L.Ed.2d 1078 (1991).

The U.S. Supreme Court has further explained: “[W]here a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.” *Davis v. Wakelee,* 156 U.S. 680, 689, 15 S.Ct. 555, 39 L.Ed. 578 (1895).

***9** Similar to the unclean hands doctrine, plaintiffs fail to demonstrate UBS AG's invocation of judicial estoppel. In its reply papers, UBS AG notes it “did not expressly rely on this doctrine.” Plaintiffs' failure to report their foreign accounts is tax fraud to defeat their fraud claims. UBS AG does not rely on plaintiffs' inconsistent positions, especially given that SAC allegations that UBS AG duped plaintiffs to commit tax fraud. Plaintiffs' claims of reliance on UBS AG's advice contradicts their plea agreements that they willfully filed false tax returns.

Plaintiffs' unclean hands and judicial estoppel points equate to unavailing straw men.

Fraud Elements—Justifiable Reliance

UBS AG faults the SAC's failure to support fraud elements, in particular, justifiable reliance. The elements of a California fraud claim are: (1) misrepresentation (false representation, concealment or nondisclosure); (2) knowledge of the falsity (or “scienter”); (3) intent to defraud, i.e., to induce reliance; (4) justifiable reliance; and (5) resulting damage. *Lazar v. Superior Court,* 12 Cal.4th 631, 638, 49 Cal.Rptr.2d 377, 909 P.2d 981 (1996). The same elements comprise a cause of action for negligent misrepresentation, except there is no requirement of intent to induce reliance. *Caldo v. Owens–Illinois, Inc.,* 125 Cal.App.4th 513, 519, 23 Cal . Rtpr.3d 1 (2004).

"[T]o establish a cause of action for fraud a plaintiff must plead and prove in full, factually and specifically, all of the elements of the cause of action." *Conrad v. Bank of America,* 45 Cal.App.4th 133, 156, 53 Cal.Rptr.2d 336 (1996). There must be a showing "that the defendant thereby intended to induce the plaintiff to act to his detriment in reliance upon the false representation" and "that the plaintiff actually and justifiably relied upon the defendant's misrepresentation in acting to his detriment." *Conrad,* 45 Cal.App.4th at 157, 53 Cal.Rptr.2d 336; *see Grant Thornton LLP v. Prospect High Income Fund,* 314 S.W.3d 913, 923 (Tex.2010) ("Both fraud and negligent misrepresentation require that the plaintiff show actual and justifiable reliance"); *J.A. O. Acquisition Corp. v. Stavitsky,* 8 N.Y.3d 144, 148, 831 N.Y.S.2d 364, 863 N.E.2d 585 (N.Y.2007); *Lawyers Title Ins. Corp. v. Baik,* 147 Wash.2d 536, 624, 55 P.3d 619 (Wash.2002). "The absence of any one of these required elements will preclude recovery." *Wilhelm v. Pray, Price, Williams & Russell,* 186 Cal.App.3d 1324, 1332, 231 Cal.Rptr. 355 (1986).

UBS AG faults the SAC's absence of facts to support plaintiffs' actual and justifiable reliance on UBS AG's misrepresentations or omissions given plaintiffs' obligation to report truthfully their income. UBS AG notes that "Plaintiffs cannot allege reasonable reliance on advice from UBS which caused them to lie on their tax returns." UBS AG argues that fraud claims based on an "omission" theory fail in that Line 7a seeks an unequivocal disclosure ("did you have a financial interest in or signature authority over a financial account ... located in a foreign country?"). *See Browning v. C.I.R.,* 2011 WL 5289636, at *14 (U.S.Tax Ct.2011) ("It is inconceivable that ... petitioner, a college graduate with a successful business background, ... could misinterpret" Line 7a).

***10** UBS AG attacks an affirmatively misrepresented tax-reporting theory in that there is no justifiable reliance if a plaintiff unreasonably fails to conduct an independent inquiry that would have uncovered the truth or disregards known and obvious risks. *See Cameron v. Cameron,* 88 Cal.App.2d 585, 594, 199 P.2d 443 (1948) ("If [one] becomes aware of facts that tend to arouse his suspicion, or if he has reason to believe that any representations made to him are false or only half true, it is his legal duty to complete his investigation and he has no right to rely on statements of the other contracting party."); *Mark Patterson, Inc. v. Bowie,* 237 A.D.2d 184, 654 N.Y.S.2d 769 (N.Y.App.Div.1997) ("reliance is negated by the fact that plaintiff had independent access to this information"). UBS AG contends that given clarity of disclosure required by IRS tax forms, plaintiffs could not have justifiably relied on UBS AG's alleged statements suggesting otherwise. UBS AG concludes that the simplicity of Line 7a renders inconceivable plaintiffs' misinterpretation, "regardless of what UBS representative told or failed to tell Plaintiffs."

Plaintiffs respond that the fraud claims "extend well beyond" tax advice and point to claims of improperly established shell corporations. Plaintiffs claim they were induced "to invest and rely on UBS's expertise" and give "unfettered control over Plaintiffs' assets." Plaintiffs claim that nothing "suggests that Plaintiffs had any degree of sophistication or expertise over UBS."

Despite plaintiffs' characterizations of alleged fraud, the distilled allegations are that UBS AG made representations to induce plaintiffs to invest in foreign accounts which plaintiffs failed to report. The SAC lacks facts to support actual or justifiable reliance given Line 7a clear disclosure requirements. UBS AG's "purported expertise and knowledge" are insufficient in that the SAC alleges facts to no less than arouse suspicion that plaintiffs needed to address reporting their foreign accounts. The SAC's clear import is that UBS AG provided investing services, not legal or tax advice, to support reliance.

Constructive Fraud

The SAC's (second) constructive fraud claim is premised on "a confidential and fiduciary relationship" among UBS AG and plaintiffs. In *Salahutdin v. Valley of California, Inc.,* 24 Cal.App.4th 555, 562, 29 Cal.Rptr.2d 463 (1994), the California Court of Appeal explained constructive fraud:

> Constructive fraud is a unique species of fraud applicable only to a fiduciary or confidential relationship.... [A]s a

> general principle constructive fraud comprises any act, omission or concealment involving a breach of legal or equitable duty, trust or confidence which results in damage to another even though the conduct is not otherwise fraudulent. Most acts by an agent in breach of his fiduciary duties constitute constructive fraud. The failure of the fiduciary to disclose a material fact to his principal which might affect the fiduciary's motives or the principal's decision, which is known (or should be known) to the fiduciary, may constitute constructive fraud. Also, a careless misstatement may constitute constructive fraud even though there is no fraudulent intent. (Citation and internal punctuation omitted).

***11** "California courts have not extended the 'special relationship' doctrine to include ordinary commercial contractual relationships." *Martin v. U–Haul Co. Of Fresno,* 204 Cal.App.3d 396, 412, 251 Cal.Rptr. 17 (1988) (citations omitted). The "relationship between a bank and its depositor is not fiduciary in character." *Das v. Bank of America, N.A.,* 186 Cal.App.4th 727, 741, 112 Cal.Rptr.3d 439 (2010). "[U]nder ordinary circumstances the relationship between a bank and its depositor is that of debtor-creditor, and is not a fiduciary one." *Lawrence v. Bank of America,* 163 Cal.App.3d 431, 437, 209 Cal.Rptr. 541 (1985); *see Thomas,* 706 F.3d at 853 (a "bank is not a fiduciary of its depositors. It is merely a debtor"); *Bennice v. Lakeshore Sav. & Loan Ass'n,* 254 A.D.2d 731, 732, 677 N.Y.S.2d 842 (1998) ("Absent the existence of a special relationship of trust and confidence, a bank has no duty to inform a customer or depositor of the tax consequences of a transaction"); *Tokarz v. Frontier Federal Sav. and Loan Ass'n,* 33 Wash.App. 456, 459, 656 P.2d 1089 (1982); *Jockusch v. Towsey,* 51 Tex. 129, 131 (1879).

This Court's prior order noted the absence of "facts to support fiduciary-based claims and dismissed with prejudice "claims arising from an alleged fiduciary relationship among UBS AG and plaintiffs." Based on the parties' stipulation, this Court dismissed the SAC's (fourth) breach of fiduciary duty claim. The complaint lacks facts to support a confidential or fiduciary duty, regardless of dismissal of the breach of fiduciary duty claim. Plaintiffs offer no meaningful opposition to dismissal of the constructive fraud claim. The SAC depicts a banking investment relationship among UBS AG and plaintiffs, not a fiduciary or confidential relationship.

In sum, the SAC fails to support the fraud claims which are subject to dismissal.

Malpractice

The SAC's (seventh) malpractice claim is premised on allegations that defendants:

1. Charged "unreasonable, excessive, and unethical fees";

2. Failed "to disclose and comply with the QI Agreement and other disclosure and tax law requirements";

3. Implemented a scheme to manipulate plaintiffs "into keeping their assets with UBS AG and held by specific trusts";

4. Advised plaintiffs "that the transactions were legitimate, proper, and in accordance with all applicable tax laws, rules, and regulations";

5. Failed to advise plaintiffs that defendants "were not properly licensed to provide banking services, offer investment advice, manage funds and solicit and execute the purchase and sale of securities to and for U.S. citizens";

6. Recommended and assisted plaintiffs "in the formation of unnecessary business entities and incurring unnecessary fees, penalties and criminal investigations";

7. Transferred assets to "shell" entities to create unnecessary fees;

8. Promoted and sold "unregistered and ineffective tax shelters";

***12** 9. Failed "to ensure that the advised transaction complied with applicable federal rules and regulations";

10. Violated "professional rules of conduct"; and

11. Provided personal and erroneous financial information to third parties.

The SAC's (fourteenth) breach of confidentiality claim alleges that defendants violated Swiss law by "revealing a customer's private information to any third party" to prevent plaintiffs "to apply for voluntary disclosure being afforded by the IRS."

UBS AG faults the absence of facts to support elements of the malpractice and breach of confidentiality claims.

Malpractice Elements

The elements of a malpractice claim are (1) the professional's duty to use such skill, prudence, and diligence as members of his/her profession commonly possess and exercise; (2) breach of that duty; (3) a proximate causal connection between the breach and the resulting injury; and (4) actual loss or damage resulting from the negligence. *Coscia v. McKenna & Cuneo,* 25 Cal.4th 1194, 1199, 108 Cal.Rptr.2d 471, 25 P.3d 670 (2001). "A key element of any action for professional malpractice is the establishment of a duty by the professional to the claimant. Absent duty there can be no breach and no negligence." *Moore v. Anderson Zeigler Disharoon Gallagher & Gray,* 109 Cal.App.4th 1287, 1294, 135 Cal.Rptr.2d 888 (2003).

Failure To Disclose UBS AG's QI Agreement Requirements

Plaintiffs place on UBS AG "a duty to disclose to its customers the requirement that it either disclose potential confidential information of its customers to the IRS or otherwise withhold a percentage of profits each year."

UBS AG argues that the malpractice claim turns on whether plaintiffs' relationship with UBS AG triggered UBS AG's duty to disclose QI Agreement requirements. UBS AG notes that the QI Agreement requirements ran between UBS AG and the IRS, not plaintiffs, and fail to invoke UBS AG duties to plaintiffs to provide tax advice or IRS disclosure requirements under the QI Agreement. *See Thomas v. UBS AG,* 2012 WL 2396866, at * 5 (N.D.Ill.2012) ("Plaintiffs' allegation that UBS had a duty to Plaintiffs is not plausible").

UBS AG further faults the absence of facts to support proximate cause of damages arising from UBS AG's failure to disclose UBS AG's QI Agreement requirements. UBS AG points to the following from *Thomas,* 2012 WL 2396866, at *6:

> With respect to causation, Plaintiffs allege that "UBS's failure to meet the applicable standard of care" caused them to fail to "disclose their UBS Swiss Accounts on their U.S. tax returns." (*Id.* ¶ 78.) But Plaintiffs fail to allege how UBS's alleged negligence caused Plaintiffs to fail to disclose their foreign accounts on their U.S. tax returns.

The SAC lacks facts that UBS AG's breach of an actionable duty caused plaintiffs damage regarding plaintiffs' tax reporting obligations. The SAC fails to allege facts to invoke UBS AG's duty running from its QI Agreement obligations owed to the IRS. The SAC lacks facts to connect plaintiffs' alleged damages to UBS AG's negligence to induce plaintiffs' failure to report foreign accounts. Plaintiffs' tax penalties arose from their failure to disclose their foreign accounts. Plaintiffs' claims of lost "investment and tax savings opportunities" are unavailing in absence of sufficient supporting facts.

Confidentiality

***13** Turning to UBS AG's release of plaintiffs' names to the IRS, UBS AG argues that such alleged breach of confidentiality caused no damages to plaintiffs given plaintiffs' failure to complete truthful tax returns. UBS AG notes that plaintiffs cannot fault UBS AG "for revealing confidential information where the information in question revealed that Plaintiffs were perpetrating knowing frauds on the U.S. government."

Plaintiffs respond that "UBS's breach of its own regulations and Swiss laws, coupled with its failure to timely advise Plaintiffs of the Voluntary Disclosure problem, resulted in greater penalties than the respective Plaintiffs should have suffered."

Plaintiffs fail to support breach of confidentiality claims. The gist of the confidentiality claim is that UBS AG was obligated to decrease plaintiffs' penalties arising from plaintiffs' own tax fraud. Plaintiffs provide neither supporting facts nor law for such notion.

Account Management

Turning from disclosure of tax reporting and plaintiffs' identities, the remainder of the malpractice claim focuses on management of plaintiffs' accounts, for instance, placing plaintiffs in improper accounts or trusts. UBS AG contends that this Court's prior order effectively dismissed such claims. UBS AG is correct that the order dismissed account management claims based on fiduciary breaches. However, the order did not dismiss account management claims under a malpractice or negligence theory and granted leave to amend such claims. UBS AG fails to challenge meaningfully the SAC's amended account management claims based on a malpractice or negligence theory. As such, negligence claims based on account management and related services survive to the extent not based on tax reporting, tax compliance or confidentiality allegations.

RICO[6]

The SAC's (fifth) RICO claim alleges defendants' violation of 18 U.S.C. § 1962(c) ("section 1962(c)") based on predicate acts of:

1. Embezzlement and bribery "for setting up illegal and improper trusts";

2. Embezzlement "for false annual billings for 'legal services' not provided and for arbitrarily freezing and then liquidating" Mr. Ginzburg's account, and charging "an unauthorized $565,000 'sales tax' "; and

3. "Fraudulent misrepresentation and concealment ... relating to fund management, tax withholding and/or tax from provision, tax legalities, liabilities, and filing requirements, misappropriation of funds, and true use of assets."

The SAC's (sixth) RICO conspiracy claim alleges that "Defendants unlawfully ... conspired ... to conduct and participate ... in the affairs fo UBS AG and its affiliated professional service providers ... through a pattern of racketeering, all in violation of 18 U.S.C. § 1962(d) [("section 1962(d)")]." The section 1962(d) conspiracy claim relies on the same predicate acts as the section 1963(c) claim.

Section 1962(c) and (d) provide:

> ***14** (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.
>
> (d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

A violation of § 1962(c) "requires (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. The plaintiff must, of course, allege each of these elements to state a claim." *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 496, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985).

Subsection (5) of 18 U.S.C. § 1961 ("section 1961") defines "pattern of racketeering activity" to require "at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity." Section 1961 "does not so much define a pattern of racketeering activity as state a minimum necessary condition for the existence of such a pattern." *H.J., Inc. v. Northwest Bell Telephone Co.,* 492 U.S. 229, 237, 109 S.Ct. 2893, 106 L.Ed.2d 195 (1989). Section 1961(5) "says of the phrase 'pattern of racketeering activity' only that it 'requires at least two acts of racketeering activity, one of which occurred after [October 15, 1970,] and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity.' It thus places an outer limit on the concept of a pattern of racketeering activity that is broad indeed." *H.J., Inc.,* 492 U.S. at 237, 109 S.Ct. 2893, 106 L.Ed.2d 195. "Section 1961(5) concerns only the minimum *number* of predicates necessary to establish a pattern; and it assumes that there is something to a RICO pattern *beyond* simply the number of predicate acts involved .” *H.J., Inc.,* 492 U.S. at 238, 109 S.Ct. at 2900 (italics in original).

The Ninth Circuit applies F.R.Civ.P. 9(b) particularity requirements to RICO claims under 18 U.S.C. § 1962. *Moore v. Kayport Package Exp., Inc.,* 885 F.2d 531, 541 (9th Cir.1989); *Alan Neuman Prods., Inc. v. Albright,* 862 F.2d 1388, 1392–93 (9th Cir.1988) (“The allegations of predicate acts in the complaint concerning those elements of RICO are entirely general; no specifics of time, place, or nature of the alleged communications are pleaded. This is a fatal defect under Fed.R.Civ.P. 9(b), which requires that circumstances constituting fraud be stated with particularity.”); *Schreiber Distrib. Co. v. ServWell Furniture Co.,* 806 F.2d 1393, 1401 (9th Cir.1986) (“We have interpreted Rule 9(b) to mean that the pleader must state the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation.”)

***15** “The mere assertion of a RICO claim consequently has an almost inevitable stigmatizing effect on those named as defendants. In fairness to innocent parties, courts should strive to flush out frivolous RICO allegations at an early stage of the litigation.” *Figueroa Ruiz v. Alegria,* 896 F.2d 645, 650 (1st Cir.1990).

“The particularity requirements of Rule 9(b) apply to allegations of mail fraud, 18 U.S.C. § 1341, and wire fraud, 18 U.S.C. § 1343, when used as predicate acts for a RICO claim.” *Murr Plumbing, Inc. v. Scherer Bros. Financial Services Co.,* 48 F.3d 1066, 1069 (8th Cir.1995).

UBS AG faults the SAC's failure to allege “predicate acts as required for their RICO claims.” UBS AG argues that a RICO claim based on fraud or concealment as predicate acts fails in the absence of “the particular contents of the purported fraudulent representations sufficient to constitute a pattern of racketeering activity.” UBS AG contends that embezzlement and bribery allegations fail in the absence of “specific instances of illegal activity” and reliance on vague allegations of illegal and improper trusts.

UBS AG faults the RICO conspiracy claim's absence of “allegations of coordination or organization among UBS AG and other Defendants who are alleged to have ‘continued’ some sort of scheme during the years after Plaintiffs closed their UBS accounts in June 2005.”

Plaintiffs respond that the RICO claims survive based on SAC allegations that UBS AG participated in continued activity to defraud the IRS and customers, to permit bribes and kickbacks, and to charge excessive fees.

The FAC's RICO claims fail in absence of particularity to satisfy F.R.Civ.P. 9(b). The SAC as a whole lacks facts to support embezzlement, bribery and fraud to support RICO claims. The SAC alleges no more than general predicate acts without necessary specifics. The gravity of RICO claims requires the SAC to plead sufficient specificity, and the SAC fails to do so.

Unfair Business Practices

The SAC's (eighth through eleventh) claims allege unfair business practices under California, Texas, New York and Washington statutes based on defendants' embezzlement, securities fraud and fraudulent misrepresentation and concealment “relating to fund management, tax legalities, liabilities, and filing requirements, privacy, quality of securities, true price of securities, and true use assets.”

UBS AG challenges the unfair business practices claims as conclusory and failing to demonstrate harm caused by UBS AG.

California

The SAC's eighth claim proceeds under California's Unfair Competition Law (“UCL”), Cal. Bus. & Prof.Code, § § 17200, et al. “Unfair competition is defined to include ‘unlawful, unfair or fraudulent business practice and unfair, deceptive, untrue or misleading advertising.’ ” *Blank v. Kirwan,* 39 Cal.3d 311, 329, 216 Cal.Rptr. 718, 703 P.2d 58 (1985) (quoting Cal. Bus. & Prof.Code, § 17200). The UCL establishes three varieties of unfair competition—“acts or practices which are unlawful, or unfair, or fraudulent.” *Shvarts v. Budget Group, Inc.,* 81 Cal.App.4th 1153, 1157, 97 Cal.Rptr.2d 722 (2000). An “unlawful business activity” includes anything that can properly be called a business practice and that at the same time is forbidden by law. *Blank,* 39 Cal.3d at 329, 216 Cal.Rptr. 718, 703 P.2d 58 (citing *People v. McKale,* 25 Cal.3d 626, 631–632, 159 Cal.Rptr. 811, 602 P.2d 731 (1979)). “A business practice is ‘unlawful’ if it is 'forbidden by law.' " *Walker v. Countrywide Home Loans, Inc.,* 98 Cal.App.4th 1158, 1169, 121 Cal.Rptr.2d 79 (2002) (quoting *Farmers Ins. Exchange v. Superior Court,* 2 Cal.4th 377, 383, 6 Cal.Rptr.2d 487, 826 P.2d 730 (1992)).

***16** The UCL prohibits "unlawful" practices "forbidden by law, be it civil or criminal, federal, state, or municipal, statutory, regulatory, or court-made." *Saunders v. Superior Court,* 27 Cal.App.4th 832, 838, 33 Cal.Rptr.2d 548 (1999). The UCL "thus creates an independent action when a business practice violates some other law." *Walker,* 98 Cal.App.4th at 1169, 121 Cal.Rptr.2d 79. According to the California Supreme Court, the UCL "borrows" violations of other laws and treats them as unlawful practices independently actionable under the UCL. *Farmers Ins.,* 2 Cal.4th at 383, 6 Cal.Rptr.2d 487, 826 P.2d 730.

A fellow district court has explained the borrowing of a violation of law other than the UCL:

> To state a claim for an "unlawful" business practice under the UCL, a plaintiff must assert the violation of any other law. *Cel–Tech Commc'ns, Inc. v. Los Angeles Cellular Telephone Co.,* 20 Cal.4th 163, 180, 83 Cal.Rptr.2d 548, 973 P.2d 527 (1999) (stating, "By proscribing 'any unlawful' business practice, section 17200 'borrows' violations of other law and treats them as unlawful practices that the unfair competition law makes independently actionable.") (citation omitted). Where a plaintiff cannot state a claim under the "borrowed" law, she cannot state a UCL claim either. *See, e.g., Smith v. State Farm Mutual Automobile Ins. Co.,* 93 Cal.App.4th 700, 718, 113 Cal.Rptr.2d 399 (2001). Here, Plaintiff has predicated her "unlawful" business practices claim on her TILA claim. However, as discussed above, Plaintiff's attempt to state a claim under TILA has failed. Accordingly, Plaintiff has stated no "unlawful" UCL claim.

Rubio v. Capital One Bank, 572 F.Supp.2d 1157, 1168 (C.D.Cal.2008).

"Unfair" under the UCL "means conduct that threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition." *Cal–Tech Communications, Inc. v. Los Angeles Cellular Telephone,* 20 Cal.4th 163,187, 83 Cal.Rptr.2d 548 (1999). A business practice is unfair when it "offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers." *Podolsky v. First Healthcare Corp.,* 50 Cal.App.4th 632, 647, 58 Cal.Rptr.2d 89 (1996) (internal quotations and citations omitted). The "unfairness" prong of the UCL "does not give the courts a general license to review the fairness of contracts." *Samura v. Kaiser Found. Health Plan,* 17 Cal.App.4th 1284, 1299 & n. 6, 22 Cal.Rptr.2d 20 (1993).

The "fraudulent" prong under the UCL requires a plaintiff to "show deception to some members of the public, or harm to the public interest," *Watson Laboratories, Inc. v. Rhone–Poulenc Rorer, Inc.,* 178 F.Supp.2d 1099, 1121 (C.D.Ca.2001), or to allege that "members of the public are likely to be deceived," *Schnall v. Hertz Corp.,* 78 Cal.App.4th 1144, 1167, 93 Cal.Rptr.2d 439 (2000); *Medical Instrument Development Laboratories v. Alcon Laboratories,* 2005 WL 1926673, at *5 (N.D.Cal.2005). A UCL "plaintiff need not show that he or others were actually deceived or confused by the conduct or business practice in question." *Schnall,* 78 Cal.App.4th at 1167, 93 Cal.Rptr.2d 439.

***17** "A plaintiff alleging unfair business practices under these statutes [UCL] must state with reasonable particularity the facts supporting the statutory elements of the violation." *Khoury v. Maly's of California, Inc.,* 14 Cal.App.4th 612, 619, 17 Cal.Rptr.2d 708 (1993).

Texas

The SAC's ninth claim proceeds under the Texas Deceptive Trade Practices and Consumer Protection Act ("Texas Act"), Tex. Bus. & Com.Code, §§ 17.41, et al.

The Texas Act renders unlawful "[f]alse, misleading, or deceptive acts or practices in the conduct of any trade or commerce." Tex. Bus. & Com.Code, § 17.46. Under the Texas Act, a consumer may pursue an action when "a false, misleading, or deceptive act or practice" is "relied on by a consumer to the consumer's detriment" and is an "unconscionable action or course of action." Tex. Bus. & Com.Code, § 17.50(a). The Texas Act defines an "unconscionable action or course of action" as "an act or practice which, to a consumer's detriment, takes advantage of the lack of knowledge, ability, experience, or capacity of the consumer to a grossly unfair degree." Tex. Bus. & Com.Code, § 17.45(5).

New York

The SAC's tenth claim proceeds under New York General Business Law section 349 ("section 349"), which renders unlawful "[d]eceptive acts or practices in the conduct or any business, trade or commerce or in the furnishing or any service in this state." "A plaintiff under section 349 must prove three elements: first, that the challenged act or practice was consumer-oriented; second, that it was misleading in a material way; and third, that the plaintiff suffered injury as a result of the deceptive act." *Stutman v. Chemical Bank,* 95 N.Y.2d 24, 29, 709 N.Y.S.2d 892, 731 N.E.2d 608 (2000).

Washington

The SAC's eleventh claim proceeds under the Washington Consumer Protection Act ("Washington CPA"), Rev.Code.Wash., § 19.86.020, et al. "[T]o state a claim for relief under the CPA, plaintiffs must allege that acts by defendant were unfair or deceptive, occurred in the course of trade or commerce, affected the public interest, and caused injury to plaintiffs' business or property." *Segal Co. (Eastern States), Inc. v. Amazon.Com,* 280 F.Supp.2d 1229, 1232 (W.D.Wash.2003).

UBS AG argues that the SAC's conclusory allegations as to unfair business practices (premised on embezzlement, fraudulent concealment and securities fraud) are insufficient and fail to satisfy pleading requirements. UBS AG argues that the SAC lacks details of UBS AG's accomplishment of embezzlement, fraudulent concealment and securities fraud and points to this Court's prior dismissal with prejudice of securities fraud claims.

Plaintiffs respond that the SAC "read as a whole" states claims for unfair business practices given allegations that UBS AG committed fraud, negligence and breach of fiduciary duties, evaded U .S. Treasury rules and regulations, "took advantage of Plaintiffs' lack of knowledge," and "deceived Plaintiffs into believing that their accounts were being handled and that they would receive a benefit."

***18** The only surviving claim to support unfair business practices is negligent account management. The gist of the negligent account management claims is that UBS AG created for and placed plaintiffs in investment vehicles which were unsuitable for plaintiffs. Negligent account management sounds in tort, not unlawful business practice, and as discussed below was particular to plaintiffs, not the general public.

Public Harm

UBS AG further challenges the SAC's absence of allegations to support harm to members of the public. *See New York Univ. v. Continental Ins. Co.,* 87 N.Y.2d 308, 320, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995) (defendant's acts or practices must have a broad impact on consumers at large; private contract disputes unique to the parties do not fall "within the ambit of the statute"); *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.,* 105 Wash.2d 778, 784, 719 P.2d 531 (1986) (Washington CPA requires "a showing that the public interest would be served by each private plaintiff's lawsuit"). UBS AG notes that unfair business practices statutes are not used to redress plaintiffs' tort and contract claims in that to allow such use would be "an all-purpose substitute for a tort or contract action, something the Legislature never intended." *Korea Supply Co. v. Lockheed Martin Corp.,* 29 Cal.4th 1134, 1151, 131 Cal.Rptr.2d 29, 63 P.3d 937 (2003).

Plaintiffs respond that under the UCL, a plaintiff "need only show that members of the public are likely to be deceived." *Bank of the West v. Superior Court,* 2 Cal.4th 1254, 1267, 10 Cal.Rptr.2d 538, 833 P.2d 545 (1992) (internal quotation omitted). Plaintiffs claim that Texas and New York laws require no pleading of public harm. Plaintiffs note that the multiple plaintiffs indicates "this deception was not an isolated incident." Plaintiffs continue that UBS AG's "business practice is injurious to the public interest because it violates Federal RICO laws, injured multiple parties as evidence by the nine Plaintiffs ..., and had the capacity to injury many others."

Plaintiffs attempt to use the unfair business practices laws as a substitute for a tort action. Plaintiffs fails to substantiate such use, given the limited survival of a negligent account management claim. Moreover, the SAC's pleads no facts that the public at large was subject to

UBS AG's alleged wrongdoing in that the SAC alleges that UBS AG targeted limited, exclusive wealthy clients with need to avoid large taxes. The unfair business practices claims fail.

Breach Of Contract

The SAC's (twelfth) breach of contract claim alleges that plaintiffs entered into "oral and/or written contracts" to "maintain accounts or open new accounts with UBS AG," which agreed to provide "professionally competent investment and securities advisory and execution services, tax and legal advice and service, and accounting services." The breach of contract claim alleges material breach in that defendants:

***19** 1. Provided plaintiffs with advice and services "in furtherance of the conduct described above";

2. Charged "fees, costs, and expenses that were not chargeable or agreed to by each Plaintiff";

3. Liquidated Mr. Ginzburg's funds without "properly evaluating the securities held and the negative impacts such an unauthorized liquidation would have";

4. Allowed a $565,000 "sales tax";

5. Caused Mr. Roberts, Mr. Ginzburg and Mr. Chernick "to waste money on ill-conceived and illegal trusts" and on "annual services";

6. Caused creation of a third-party trust without authorization of Mr. Chernick, Simba and Shumba;

7. Failed "to prevent the losses incurred as penalties instead of advising Plaintiffs that the recommended program was in fact illegal ... and that Plaintiffs should report their accounts, and take advantage of the Voluntary Disclosure program"; and

8. Disclosed "each Plaintiff's name to the DOJ prematurely."

UBS AG faults the SAC's absence of facts to support breach of contract elements.

"The standard elements of a claim for breach of contract are: (1) the contract, (2) plaintiff's performance or excuse for nonperformance, (3) defendant's breach, and (4) damage to plaintiff therefrom." *Wall Street Network, Ltd. v. New York Times Co.,* 164 Cal.App.4th 1171, 1178, 80 Cal.Rptr.3d 6 (2008). "To form a contract, an 'offer must be sufficiently definite ... that the performance promised is reasonably certain.' " *Alexander v.Codemasters Group Limited,* 104 Cal.App.4th 129, 141, 127 Cal.Rptr.2d 145. 127 Cal.Rptr.2d 145 (2002).

Essential elements to contract existence are: (1) "[p]arties capable of contracting;" (2) "[t]heir consent;" (3) a "lawful object;" and (4) a "sufficient cause or consideration." Cal. Civ.Code, § 1550.

"A written contract may be pleaded either by its terms —set out verbatim in the complaint or a copy of the contract attached to the complaint and incorporated therein by reference—or by its legal effect. In order to plead a contract by its legal effect, plaintiff must allege the substance of its relevant terms." *McKell v. Washington Mutual, Inc.,* 142 Cal.App.4th 1457, 1489, 49 Cal.Rptr.3d 227 (2006) (internal citations omitted).

UBS AG characterizes the SAC "as too vague and indefinite, and therefore unenforceable, for plaintiff's failure to allege, in nonconclusory language, as required, the essential terms of the parties' purported contract, including the specific provisions of the contract upon which liability is predicated." *Sud v. Sud,* 211 A.D.2d 423, 621 N.Y.S.2d 37, 38 (App.Div.1995); *Bissessur v. Indiana University Bd. of Trustees,* 581 F.3d 599, 603 (7th Cir.2009) ("A plaintiff may not escape dismissal on a contract claim, for example, by stating that he had a contract with the defendant, gave the defendant consideration, and the defendant breached the contract. What was the contract? The promises made? The consideration? The nature of the breach?"). UBS AG faults the purported breaches' lack of connection to "specific contractual provisions between any of the plaintiffs and UBS." UBS AG characterizes the breach of contract claim "to assert the same common law breach of duty claims against UBS again."

***20** Plaintiffs respond that "a contract existed separately between each of the Plaintiffs and UBS" and breaches included charging fees not agreed to, unauthorized liquidation, and failure to release funds and "to provide professionally competent advice."

UBS AG is correct that the SAC's purported breach of contract claims are vague and conclusory. The FAC fails to identify sufficiently precise contract terms, their breach, who breached them, and how they were breached. The SAC fails to identify sufficiently plaintiffs' consideration to support breach of contract claims. At its essence, the breach of contract claim alleges account management negligence, and plaintiffs are able to pursue such claims and remedies through their limited surviving negligence claim.

Conversion

The SAC's (thirteenth) conversion claim alleges that UBS AG:

1. Charged Mr. Eisenberg "twice the rate he was supposed to be charged as evidenced by some statement charges"; and

2. Converted from Mr. Ginzburg "$565,000 under the guise of 'sales tax' at the time they arbitrarily liquidated his account in 2009."

"Conversion is the wrongful exercise of dominion over the property of another." *Oakdale Village Group v. Fong,* 43 Cal.App.4th 539, 543, 50 Cal.Rptr.2d 810 (1996). "To establish conversion, a plaintiff must show: (1) the plaintiff's ownership or right to possession to the property at the time of conversion; (2) the defendant's conversion by a wrongful act; and (3) damages." *Oakdale Village Group,* 43 Cal.App.4th at 543–544, 50 Cal.Rptr.2d 810. "Money cannot be the subject of a cause of action for conversion unless there is a specific, identifiable sum involved, such as where an agent accepts a sum of money to be paid to another and fails to make the payment." *McKell v. Washington Mut., Inc.,* 142 Cal.App.4th 1457, 1491, 49 Cal.Rptr.3d 227 (2006). "A specific and identified amount of money can form the basis of a conversion claim, but when the money is not identified and not specific, the action is to be considered as one upon contract or for debt and not for conversion." *Ross v. U.S. Bank Nat. Ass'n,* 542 F.Supp.2d 1014, 1024 (N.D.Cal.2008) (internal quotation omitted).

UBS AG notes that the SAC alleges a specific $565,000 sum as to Mr. Ginzburg but fails to allege that UBS AG applied the money for its use or even retained the money. UBS AG faults the absence of SAC allegations to identify as to other plaintiffs a specific sum allegedly converted.

The SAC lacks sufficient specificity to support a conversion claim, except as to Mr. Ginzburg's $565,000. Other alleged funds converted are not a specific, identifiable sum to warrant dismissal of the conversion claim, except as to Mr. Ginzburg's $565,000. Moreover, the conversion claim seeks relief available from the limited account management negligence claim.

Declaratory Relief

The SAC's (fifteen) declaratory relief claim appears to seek this Court's declaration that defendants "are legally responsible" for:

***21** 1. Interest and/or tax penalties assessed by the IRS;

2. Plaintiffs' professional fees and costs in connection with investigations and audits by tax authorities; and

3. Professional fees and expenses incurred "on account of Defendants' violations of law and other actionable conduct."

UBS AG challenges availability of declaratory relief in the absence of a "substantive claim" alleged in the SAC.

The Declaratory Judgment Act ("DJA"), 28 U.S.C. §§ 2201, 2202, provides in pertinent part:

> In a case of actual controversy within its jurisdiction ... any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

28 U.S.C. § 2201(a).

The DJA's operation "is procedural only." *Aetna Life Ins. Co. of Hartford, Conn. v. Haworth,* 300 U.S. 227, 240, 57 S.Ct. 461, 463, 81 L.Ed. 617 (1937). "A declaratory judgment is not a theory of recovery." *Commercial Union Ins. Co. v. Walbrook Ins. Co., Ltd.,* 41 F.3d 764, 775 (1st Cir.1994). The DJA "merely offers an *additional remedy* to litigants." *Nat'l Union Fire Ins. Co. v. Karp,* 108 F.3d 17, 21 (2nd Cir.1997) (italics in original). A DJA action requires a district court to "inquire whether there is a case of actual controversy within its jurisdiction." *American States Ins. Co. v. Kearns,* 15 F.3d 142, 143 (9th Cir.1994).

Declaratory relief is appropriate "(1) when the judgment will serve a useful purpose in clarifying and settling the legal relations in issue, and (2) when it will terminate and afford relief from the uncertainty, insecurity, and controversy giving rise to the proceeding." *Bilbrey by Bilbrey v. Brown,* 738 F.2d 1462, 1470 (9th Cir.1984).

As to a controversy to invoke declaratory relief, the question is whether there is a "substantial controversy, between parties having adverse legal rights, or sufficient immediacy and reality to warrant the issuance of a declaratory judgment." *Maryland Cas. Co. v. Pacific Coal & Oil Co.,* 312 U.S. 270, 273, 61 S.Ct. 510, 512, 85 L.Ed. 826 (1941). The U.S. Supreme Court has further explained:

> A justiciable controversy is thus distinguished from a difference or dispute of a hypothetical or abstract character; from one that is academic or moot.... The controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests.... It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts.

Haworth, 300 U.S. at 240–241, 57 S.Ct. at 464 (citations omitted).

A declaratory relief action "brings to the present a litigable controversy, which otherwise might only be tried in the future." *Societe de Conditionnement v. Hunter Eng. Co., Inc.,* 655 F.2d 938, 943 (9th Cir.1981). As an equitable remedy, declaratory relief is "dependent upon a substantive basis for liability" and has "no separate viability" if all other causes of action are barred. *Glue–Fold, Inc. v. Slautterback Corp.,* 82 Cal.App.4th 1018, 1023, n. 3, 98 Cal.Rptr.2d 661 (2000).

***22** The SAC fails to support a declaratory relief claim given dismissal of other claims subject to UBS AG's motion to dismiss. The SAC fails to substantiate an independent claim for declaratory relief, and such claim is subject to dismissal, despite survival of the limited negligent account management and conversion claims.

CONCLUSION AND ORDER

For the reasons discussed above, this Court:

1. DISMISSES with prejudice the SAC's (first) fraudulent misrepresentation and concealment, (second) constructive fraud, and (third) negligent misrepresentation claims;

2. DISMISSES with prejudice the SAC's (fifth and sixth) RICO claims;

3. DISMISSES with prejudice the SAC's (seventh) professional malpractice claim to extent based on disclosure of tax reporting requirements and plaintiffs' identities but DENIES dismissal of the professional malpractice claim to the extent based on management of plaintiffs' accounts;

4. DISMISSES with prejudice the SAC's (eighth through eleventh) unfair business law claims;

5. DISMISSES with prejudice the SAC's (twelfth) breach of contract claim;

6. DENIES dismissal of the SAC's (thirteenth) conversion claim as to only Mr. Ginzburg's $565,000 but otherwise DISMISSES the conversion claim with prejudice;

7. DISMISSES with prejudice the SAC's (fourteenth) breach of confidentiality claims;

8. DISMISSES with prejudice the SAC's (fifteenth) declaratory relief claim;

9. ORDERS UBS AG, no later than May 2, 2013, to file an F.R.Civ.P. 7(a)(2) answer to the SAC.

To reiterate, the claims remaining against UBS AG are limited to negligent management of plaintiffs' accounts and conversion of Mr. Ginzburg's $565,000.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2013 WL 1499341

Footnotes

[1] Plaintiffs are Nadia and Sean Roberts (the “Roberts”), Bernhard and Heidi Gubser (the “Gubsers”), Anton Ginzburg (“Mr.Ginzburg”), Arthur Joel Eisenberg (“Mr.Eisenberg”), Jeffrey Chernick (“Mr.Chernick”) and Mr. Chernick's Liberian corporation Shumba and Hong Kong corporation Simba, and all plaintiffs will be referred to collectively as “plaintiffs.”

[2] The factual recitation summarizes the SAC and is derived from other matters which this Court may consider.

[3] These defendants and UBS AG will be referred to collectively as “defendants.”

[4] UBS AG notes that the IRS established the QI Program to require financial institutions to identify and withhold tax on U.S. source income paid to foreign bank accounts, including income generated by U.S. securities, real estate and other investments. UBS AG further notes that the QI Agreement “does not create any obligations in favor of accountholders.”

[5] The “UBS AG Defendants” include UBS AG and most of the10 other defendants named in the SAC.

[6] RICO refers to the Racketeer and Corrupt Practices Act (“RICO”), 18 U.S.C. §§ 1961, et seq.

End of Document

730 F.Supp.2d 73
United States District Court,
District of Columbia.

Richard LUBOW, et al., Plaintiffs,
v.
UNITED STATES DEPARTMENT OF STATE, et al., Defendants.

Civil Action No. 10–0510 (JDB).
|
Aug. 10, 2010.

Synopsis

Background: Current or retired member of the State Department's Bureau of Diplomatic Security deployed to Iraq brought action against State Department challenging determination that the owed valid debt on alleged salary overpayments. The parties cross-moved for summary judgment.

[Holding:] The District Court, John D. Bates, J., held that remand was warranted for consideration of effect of pay cap waiver passed by Congress.

Plaintiffs' motion granted in part and remanded.

Attorneys and Law Firms

***74** Brigid F. Cech Samole, Elliot H. Scherker, Greenberg Traurig LLP, Miami, FL, Danielle M. Diaz, Joe Robert Reeder, Greenberg Traurig, LLP, Washington, DC, Jonathan C. Chane, Greenberg Traurig, P.A., West Palm Beach, FL, for Plaintiffs.

Marian L. Borum, U.S. Attorney's Office for the District of Columbia, Washington, DC, for Defendants.

MEMORANDUM OPINION & ORDER

JOHN D. BATES, District Judge.

Richard Lubow, Joseph Bopp, David Bennett, Frank Benevento and James Landis, each a current or retired member of the State Department's Bureau of Diplomatic Security, "deploy[ed] to Iraq [as Foreign Service Specialists] in support of State's attempt to establish a diplomatic presence in Iraq, after the fall of Saddam Hussein's regime." Pls.' Mem. in Supp. of Mot. for Summ. J. ("Pls.' Mem.") [Docket Entry 19], at 1. While deployed, plaintiffs were eligible for both basic pay—compensation for a forty-hour work week—and premium pay—overtime, compensatory time off, and holiday premium pay. *See, e.g.,* Administrative Record of Frank Benevento ("FBAR"), 67–68 (Explanation of Benefits).[1] At issue in this action are alleged salary overpayments made to plaintiffs for their work in Iraq in 2004.

Federal law establishes the aggregate amount of basic pay and premium pay an employee may receive. Under 5 U.S.C. § 5547(a), an employee's aggregate of basic pay plus premium pay for any biweekly pay period cannot exceed the greater of "the maximum rate of basic pay payable for GS–15 (including any applicable locality-based comparability payment)" or "the rate payable for level V of the Executive Schedule." Because a particular employee's basic pay is consistent for each pay period, section 5547(a) establishes a cap on the amount of premium pay that an employee can earn. Nevertheless, where an agency determines that there is an emergency that "involves a direct threat to life or property," the agency may waive the biweekly pay cap and instead apply an annual cap on compensation. 5 U.S.C. § 5547(b)(1).[2] The State Department concluded that the war in Iraq and its aftermath qualified as such an emergency. *See, e.g.,* Administrative Record ("AR"), 29 (Landis Letter Regarding Overpayment) ("The ongoing response to the September 11 terrorist attacks and the war in Iraq have each been deemed to constitute such an emergency."). In such circumstances, an employee's aggregate pay for a calendar year cannot exceed the greater of "the maximum rate of basic pay payable for GS–15 in effect at the end of such calendar year (including any applicable locality- ***75** based comparability payment)" or "the rate payable for level V of the Executive Schedule in effect at the end of such calendar year." 5 U.S.C. § 5547(b)(2).[3]

Plaintiffs initially deployed to Iraq in December 2003. At that time, plaintiffs' pay cap was $130,305—the sum of the maximum rate of pay for a GS–15, $113,674, and the applicable locality based comparability payment for the District of Columbia. *See, e.g.,* AR at 84 (June 22, 2005 Landis Board of Contract Appeals Decision). Plaintiffs had a District of Columbia pay cap because, although they were deployed in Iraq, they were on temporary duty status, which requires the State Department to apply the District of Columbia pay cap. *See, e.g.,* AR at 340 (July 28, 2008 Landis Foreign Service Grievance Board Decision). In July 2004, the State Department established the new United States Embassy in Baghdad, and plaintiffs were transferred to a permanent duty assignment in Iraq. *See id.* This transfer reduced plaintiffs' pay cap to $128,200. *See id.* at 341. This is so because there are no locality based comparability payments available for overseas locations. *See* June 22, 2005 Landis Board of Contract Appeals Decision at 84. Accordingly, plaintiffs' pay cap was the $128,200 maximum available under level V of the Executive Schedule, which was greater than the $113,674 maximum available for GS–15. *See, e.g., id.*

Because of this immediately-effective reduction in plaintiffs' annual pay cap, the State Department advised plaintiffs in November 2004 that their "earnings applicable toward the 2004 premium pay cap have already or could shortly put you above the cap for the current pay year." AR at 316 (Nov. 24, 2004 Email to Richard Lubow). The Department also indicated that "[i]f such payments are made erroneously, the Department is obligated to seek collection of such overpayments." *Id.* In April 2005, the State Department notified plaintiffs that each of them had been overpaid because each had exceeded his pay cap for 2004. *See, e.g.,* AR at 29 (Apr. 27, 2005 Letter to Landis Regarding Overpayment). The Department therefore requested that plaintiffs repay their debt, but indicated that they had "the right to request either an internal administrative review or a hearing conducted by a non-Department of State official with respect to the existence of the debt, the amount of the debt, or the repayment schedule." *Id.*

Each plaintiff availed himself of this opportunity. Frank Benevento sought internal review, and Deputy Assistant Secretary of State James Millete concluded that Benevento had been overpaid and therefore owed a valid debt. *See* FBAR at 25–27 (Aug. 30, 2005 Millete Decision). The remaining plaintiffs, Richard Lubow, Joseph Bopp, David Bennett, and James Landis, sought external review by the General Services Administration's Board of Contract Appeals. In substantively identical decisions, the Board upheld the State Department's determination that plaintiffs had been overpaid. *See, e.g.,* June 22, 2005 Landis Board of Contract Appeals Decision at 89.

***76** Each plaintiff then requested that the State Department waive his indebtedness pursuant to 5 U.S.C. § 5584. *See, e.g.,* AR at 34 (Landis Request for Waiver). That statute permits an agency to waive collection of erroneous payments made to a party, where collection "would be against equity and good conscience and not in the best interest of the United States." 5 U.S.C. § 5584(a). The Department declined to do so. *See* AR at 404 (Jan. 7, 2010 Opinion of the Foreign Service Grievance Board). The Foreign Service Grievance Board initially overturned a decision by the State Department denying waiver, and remanded the request to the State Department. *See id.* On remand, the Department once again found waiver inappropriate, and the Board upheld that decision. *See id.*

Plaintiffs then brought this action. They challenge, as contrary to 5 U.S.C. § 5547 and the Office of Personnel Management's regulations, Deputy Assistant Secretary of State Millete's and the Board of Contract Appeals's decisions that they owed a valid debt. And they contend that the Foreign Service Grievance Board acted arbitrarily and abused its discretion in denying their requests for a waiver of indebtedness. Before the Court are the parties' cross-motions for summary judgment on these issues.

[1] The Court will not reach plaintiffs' substantive challenges. Where "an intervening event may affect the validity of the agency action at issue, a remand is generally required." *Sierra Club v. Van Antwerp,* 560 F.Supp.2d 21, 23 (D.D.C.2008); *accord Ethyl Corp. v. Browner,* 989 F.2d 522, 524 (D.C.Cir.1993); *see also Citizens Against the Pellissippi Parkway Extension, Inc. v. Mineta,* 375 F.3d 412, 416 (6th Cir.2004) (it may be "an abuse of discretion to prevent an agency from acting to cure the very legal defects asserted by plaintiffs challenging federal action"); *cf. Fl. Power & Light Co. v. Lorion,* 470 U.S. 729, 744, 105 S.Ct. 1598, 84 L.Ed.2d 643 (1985) ("If the record before the agency does not support the agency action, if the agency has not considered all relevant factors, or if the reviewing court simply cannot evaluate the challenged agency action on the basis of the record before it, the proper course, except in rare circumstances, is to remand to the agency for additional investigation or explanation."). Here, there is just such an intervening event.

[2] In 2005, Congress passed the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief of 2005 ("Appropriations Act of 2005"), Pub.L. No. 109–13, 119 Stat. 231 (2005). In section 1008 of the Act, Congress permitted federal agencies to waive section 5547's federal pay cap for certain federal employees during calendar year 2005, up to a maximum of $200,000. *See* Appropriations Act of 2005, 119 Stat. 231, 243 ("During calendar year 2005 ... the head of an Executive agency may waive the limitation, up to $200,000, established in [5 U.S.C. § 5547] for total compensation, including limitations on the aggregate of basic pay and premium pay payable in a calendar year...."). Pursuant to the Act, the State Department waived the "limitation, up to $200,000, on the aggregate of basic pay and premium pay payable in calendar year 2005 for employees working in Iraq and Afghanistan." AR at 184 (Aug. 19, 2005 State Department Cable). And the Department applied this pay cap waiver "to all premium pay earnings payable in calendar year 2005, e.g. for work performed in pay period 25 of 2004 (pay date January 8, 2005)." *Id.* at 184–85.

By its plain terms, then, the State Department's pay cap waiver applied not just ***77** to work done during 2005, but also to work done during pay period 25 of 2004. Yet neither the State Department nor the Board of Contract Appeals considered the effect of this waiver of plaintiffs' purported debts. The Board of Contract Appeals issued its decision confirming the debts of Richard Lubow, Joseph Bopp, David Bennett, and James Landis prior to the State Department's waiver in August 2005. *See, e.g.,* June 22, 2005 Landis Board of Contract Appeals Decision at 84. And although Deputy Assistant Secretary of State Millete issued his decision after the State Department's pay cap waiver took effect, the decision does not discuss the pay cap waiver at all. Perhaps the State Department could conclude that the waiver either affects the fact or the amount of plaintiffs' debts. Perhaps not. But it is not for the Court to conduct "a *de novo* inquiry into the matter being reviewed and ... reach its own conclusions based on such an inquiry." *Fl. Power & Light Co.,* 470 U.S. at 744, 105 S.Ct. 1598. Rather, because there is no evidence in the record that the State Department considered how the 2005 pay cap waiver affects plaintiffs' debts based on 2004 overpayments, "the proper course ... is to remand to the agency for additional investigation or explanation." *Id.* [4]

The State Department raises two challenges to plaintiffs' argument that the pay cap waiver requires the Department to recalculate their overpayments. First, it contends that it cannot recompute each plaintiff's entire salary for 2004 pursuant to the waiver because this would be "in direct contravention of the language of the 2005 Premium Pay Cap Waiver as well as Congressional intent in enacting Public Law 109–13." Defs.' Mem. at 25. This may be so, but it is of no moment. Even if the waiver does not apply to all of plaintiffs' 2004 salary, it does apply, by its plain terms, to work performed during pay period 25 of 2004. Hence, the State Department, at the least, must evaluate whether and how the waiver affects any overpayments made to plaintiffs during pay period 25.

Second, the State Department argues that Landis, Bennett, Bopp, and Lubow cannot raise the pay cap waiver issue with this Court. Plaintiffs sought external review of the validity of their debt with the Board of Contract Appeals, but did not seek further administrative review of that decision before the Foreign Service Grievance Board. Nor, according to the State Department, could they. *See* Defs.' Mem. at 25 (citing 22 U.S.C. § 4139 ("A grievant may not file a grievance with the [Foreign Service Grievance] Board if the grievant has formally requested, prior to filing a grievance, that the matter ... be considered or resolved and relief be provided under another provision of law, regulation or Executive Order.")). And in the State Department's view, because those plaintiffs could not raise the validity of their debt with the Foreign Service Grievance Board, they "cannot challenge the determination of the proper pay cap here" as part of their challenge to the Foreign Service Grievance Board's decision. Defs.' Reply in Supp. of Cross–Mot. for Summ. J. ("Def.'s Reply") [Docket Entry 25], at 7.

But Landis, Bennett, Bopp, and Lubow also separately challenge the validity of ***78** the Board of Contract Appeals decision in this action. And it is undisputed that the Board did not consider the Department's pay cap waiver when adjudicating the validity of plaintiffs' debt. The pay cap waiver was an intervening event that may affect the validity of the Board's decision. This is sufficient to require a remand. *See Sierra Club,* 560 F.Supp.2d at 23. [5] As the Court indicated, this does not mean that plaintiffs will prevail on their argument. But that is a decision that this Court cannot make in the first instance. *See Fl. Power & Light Co.,* 470 U.S. at 744, 105 S.Ct. 1598.

Therefore, upon consideration of the parties' cross-motions for summary judgment, the parties' several memoranda, and the entire record herein, and for the foregoing reasons, it is hereby

ORDERED that plaintiffs' motion is **GRANTED in part;** and it is further

ORDERED that the decisions of Deputy Assistant Secretary of State Millete and the Board of Contract Appeals that plaintiffs owe a valid debt are **REMANDED** to the State Department and the Board of Contract Appeals, respectively, for additional consideration in light of the Department's August 2005 waiver of the premium pay cap, which the Department has applied to earnings for work performed in pay period 25 of 2004.

SO ORDERED.

All Citations

730 F.Supp.2d 73

Footnotes

[1] The State Department has produced the administrative record in several volumes, including separate volumes for materials relating to each plaintiff, and a single, general volume for remaining materials. Many of the records in the various volumes are substantively identical and therefore, where appropriate, the Court has cited to only one of the volumes.

[2] Waiving the biweekly cap permits employees to "work more overtime hours." *See* Defs.' Mem. in Supp. of Mot. for Summ. J. ("Defs.' Mem.") [Docket Entry 21], at 2 n. 3.

[3] According to the Office of Personnel Management, which promulgated regulations interpreting section 5547(b), an agency must use the GS–15 or Executive Schedule level V rate "in effect on the last day of the calendar year" to determine an employee's pay cap. 5 C.F.R. § 550.106(c); *see also* 69 Fed. Reg. 55,941, at 55,941 (Sept. 17, 2004) ("A geographic move to an area with different pay rates can raise or lower an employee's aggregate basic pay and the end-of-year annual cap on premium pay. In turn, a change in aggregate basic pay or the end-of-year cap can change retroactively the date on which an employee reached the annual premium pay cap.").

[4] The record does not indicate, for example, whether, notwithstanding the fact that it was covered by the 2005 pay cap waiver, the State Department included plaintiffs' pay period 25 earnings when calculating plaintiffs' 2004 overpayments. Nor does it show how much money plaintiffs' received in pay period 25 that was in excess of the statutory cap. Such information would be necessary for the Court to evaluate the effect of the pay cap waiver on plaintiffs' debts.

[5] Although quite opaque, the State Department arguably contends in its reply that Landis, Bennett, Bopp, and Lubow simply cannot bring a separate challenge to the Board of Contract Appeals decision in this action. *See* Def.'s Reply at 7. But to the extent it makes this argument, it offers no support for it. And, in any event, courts may review "final agency action for which there is no other adequate remedy." 5 U.S.C. § 704. Here, the State Department argues that the Board of Contract Appeals decision was a final agency action. *See* Def.'s Reply at 7–8.

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2015 WL 8968785
Only the Westlaw citation is currently available.
United States District Court,
W.D. Missouri, Western Division.

United States of America, Plaintiff,
v.
Verna Cheryl Womack, Defendant.

Case No. 13–00441–01–CR–W–GAF
|
Filed November 25, 2015

Attorneys and Law Firms

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REPORT AND RECOMMENDATION

SARAH W. HAYS, UNITED STATES MAGISTRATE JUDGE

***1** This matter is currently before the Court on Defendant Verna Cheryl Womack's Motion to Dismiss the Indictment Pursuant to Fed.R.Crim.P. 12(b)(3)(B) (docs # 72 and # 73).[1] For the reasons set forth below, it is recommended that this motion be denied.

I. *INTRODUCTION*

On December 12, 2013, the Grand Jury returned a ten count indictment against Verna Cheryl Womack. The indictment provides in part:

> ***INTRODUCTION***
>
> 1. Beginning in or about 1996, and continuing to the date of this indictment, Defendant VERNA CHERYL WOMACK ... corruptly endeavored, in the Western District of Missouri, and elsewhere, to obstruct and impede the due administration of the internal revenue laws of the United States. As part of her endeavors, WOMACK opened a series of bank accounts and organized a series of nominee companies and trusts in the Cayman Islands to conceal a portion of her income from the IRS. At all times, WOMACK exercised control over the nominee companies and trusts, and they were maintained for her financial benefit. When necessary to maintain her control, WOMACK appointed family members and employees as directors of the nominee companies and trusts, sometimes without their knowledge. As part of her corrupt endeavors, WOMACK repeatedly failed, year after year, to report her financial interests in her nominee companies and trusts to the IRS despite the multiple legal requirements that, as a United States citizen, she do so.
>
> 2. As part of her corrupt endeavors, WOMACK established at least 19 accounts at the Bank of Butterfield and Caledonian Bank in the Cayman Islands in her own name, and in the name of her various nominee companies and trusts. For at least the calendar years 2005 through 2008, WOMACK failed to report her financial interest and signatory authority over all of the financial accounts in the Cayman Islands that she had an interest in or signatory authority over to the IRS despite the multiple legal requirements that, as a United States citizen, she do so.
>
> 3. For the calendar years 2005 through 2008, WOMACK maintained balances of between $40,964.00 and $173,541.08 in one of the Bank of Butterfield accounts, an interest-bearing account that she maintained in her own name. WOMACK had signature authority on that account, and she corresponded in person and via e-mail with the bank concerning disbursements to and from that account. Despite her custody and control of that account, WOMACK repeatedly failed, year after year, to report her financial interests in her Bank of Butterfield interest-bearing account to the IRS despite the multiple legal requirements that, as a United States citizen, she do so.
>
> ***2** 4. WOMACK's corrupt endeavors to conceal income from the IRS included the use of a nominee company in the Cayman Islands called Lucy Limited, for which she established at least two separate

accounts at the Bank of Butterfield. One example of how WOMACK attempted to use Lucy Limited to conceal her income was the March 15, 2008, sale of a portion of her personal wine collection at an auction house in New York, New York. Following the sale, WOMACK personally directed the auction house to wire transfer a total of $1,613,899.89 to a Lucy Limited account at the Bank of Butterfield that WOMACK controlled. WOMACK then employed a number of false and fraudulent business agreements, that appeared to be arm's length transactions but were in fact WOMACK's self-dealing, resulting in wires of those proceeds back to the United States for WOMACK's personal use. She did not disclose her control of Lucy Limited or the existence of its bank account to the IRS, and she did not properly report the income she derived from that sale—at least $851,188.00—on her individual tax return as required by the internal revenue laws of the United States.

5. Further obstructing and impeding the administration of the internal revenue laws of the United States, WOMACK repeatedly lied to employees of the United States about her interests in Cayman Island businesses, trusts and financial accounts. On one occasion, WOMACK lied to two FBI agents, falsely claiming that she did not own any foreign businesses and that those businesses were owned by other investors, when she knew that no other investors existed. On a second occasion, WOMACK repeatedly lied during a sworn deposition to a trial attorney from the United States Department of Justice about her financial interests in the Cayman Islands.

6. The United States alleges that during the period charged in this indictment, WOMACK's schemes to interfere with the administration of the internal revenue laws, including but not limited to her corrupt endeavors using Cayman Island nominees and financial accounts alleged in this indictment, caused a total tax loss in excess of $7,000,000.00.

* * *

COUNT ONE

(Attempts to Interfere with Administration of Internal Revenue Laws)

29. The factual allegations in paragraphs 1 through 28 are incorporated herein by reference.

> 30. Beginning in or about 1996, and continuing to the date of this indictment, in the Western District of Missouri and elsewhere, the defendant did corruptly endeavor to obstruct and impede the due administration of the internal revenue laws of the United States by the following conduct:
>
> [failing to acknowledge any interest in or signature authority over any foreign financial accounts on defendant's U.S. Individual Tax Return, Form 1040, for the calendar years 2005, 2006, 2007 and 2008; failure to file with the IRS a Report of Foreign Bank and Financial Accounts, Form TD F 90–22.1 (FBAR) for the calendar years 2005, 2006, 2007 and 2008; and filing an inadequate FBAR for the calendar year 2009]
>
> * * *
>
> 35. In or about March 2008, WOMACK provided a list of her financial accounts to an FBI Special Agent in relation to a separate federal criminal investigation. WOMACK's list of her accounts did not include any of her foreign bank accounts.
>
> 36. On or about March 15, 2008, WOMACK sold and caused to be sold at auction at an auction house in New York, New York, approximately half of the wine stored in the basement of her residence in Mission Hills, Kansas. WOMACK attempted to use her nominee company Lucy Limited and its financial accounts at the Bank of Butterfield to conceal the revenues and profits she derived from the sale of the wine....
>
> * * *
>
>> g. As a result of her efforts to disguise the self-dealing nature of these transactions, WOMACK did not report the income she derived from the sale of the wine on her U.S. Individual Tax Return, Form 1040, for the calendar year 2008.
>
> * * *

39. On or about December 15, 2008, WOMACK was interviewed by two FBI Special Agents. During that interview, WOMACK knowingly made numerous false and fraudulent statements ...

40. At the end of the interview with the two FBI Special Agents that took place on or about December 15, 2008, WOMACK was provided a form that stated both that "[t]he Agents listed below introduced themselves to me and told me that they are conducting a federal criminal investigation regarding bank fraud, wire fraud and/or tax evasion" and that "I have been advised that it is a separate Federal felony to knowingly and willfully make any materially false, fictitious, or fraudulent statement or representation during this interview." WOMACK initialed beside both of those statements, signed the form, and dated it 956 am 12/15/08." Later that day, and to conceal her prior false and fraudulent statements to the agents, WOMACK made a handwritten annotation to the form stating "regarding Brandy Wheeler VCW 12/15/08" and caused the annotated form to be transmitted to the agents at their office in Kansas City, Missouri.

***3** 41. On or about May 19, 2009, in Kansas City, Missouri, WOMACK testified under oath in a deposition by a trial attorney for the United States Department of Justice, Tax Division, regarding a lawsuit under the internal revenue laws of the United States then pending in the Western District of Missouri that sought to enjoin a third party from providing tax advice. During that deposition, WOMACK knowingly made numerous false and fraudulent statements....

* * *

All in violation of 26 U.S.C. § 7212(a).

COUNTS TWO through TEN

45. The factual allegations in paragraph 1 through 28 and 31 through 44 are incorporated herein by reference.

46. On or about May 9[sic], 2009, in Kansas City, in the Western District of Missouri, the defendant VERNA CHERYL WOMACK, in a matter within the jurisdiction of the executive branch of the Government of the United States, that is, the United States Department of the Treasury and the United States Department of Justice, did voluntarily and intentionally make the false and fraudulent statements of material fact corresponding to each count below, while knowing those statements to be false and fraudulent at the time she made them....

2 WOMACK falsely and fraudulently stated that she did not know when JoJoDi was started, when she knew that she organized and caused to be organized JoJoDi in or about 1997.

3 WOMACK falsely and fraudulently stated that she did not know why JoJoDi was located in the Cayman Islands, when she knew that she organized and caused to be organized JoJoDi to perform the business function previously performed by MFC without MFC's duties to file United States tax returns.

4 WOMACK falsely and fraudulently stated that she did not know who owned JoJoDi and that it was owned by a group of investors, when she knew that there were no such investors, that JoJoDi was owned by the Emerald Star Trust, that she created and caused to be created that trust, and that she was a secondary enforcer of that trust.

5 WOMACK falsely and fraudulently stated that she did not have an ownership interest in DAR Holding and that she did not know who owned DAR Holding, when she knew that she organized and caused to be organized DAR Holding and that she exercised ownership, custody and control over DAR Holding and its assets.

6 WOMACK falsely and fraudulently stated that she did not know how long DAR Holding had been in existence, when she knew that she organized and caused to be organized DAR Holding in or about 1996.

7 WOMACK falsely and fraudulently stated that she did not own a condominium in the Cayman Islands and only rented one, when she knew that, through the nominee company DAR Holding, she owned and maintained full custody and control over her condominium at The Sovereign, George Town, Grand Cayman, Cayman Islands.

8 WOMACK falsely and fraudulently stated that Lucy Limited was owned by another group of

> investors, that she did not have an ownership interest in Lucy Limited, and that she had never invested in Lucy Limited, when she knew that there were no such investors, that she organized and caused to be organized Lucy Limited, and that she exercised ownership, custody and control over Lucy Limited and its assets.
>
> 9 WOMACK falsely and fraudulently stated that Lucy Limited's investors paid her to purchase the wine, manage the wine, and properly contain the wine, when she knew that there were no such investors, that she organized and caused to be organized Lucy Limited, and that she exercised ownership, custody and control over Lucy Limited and its assets.
>
> ***4** 10 WOMACK falsely and fraudulently stated that Lucy Limited's investors paid her a percentage for managing the auction of the wine, when she knew that there were no such investors, that she organized and caused to be organized Lucy Limited, and that she exercised ownership, custody and control over Lucy Limited and its assets.
>
> All in violation of 18 U.S.C. § 1001(a)(2).

(Indictment (doc # 1))

The statutes under which defendant Womack has been charged, 26 U.S.C. § 7212(a) and 18 U.S.C. § 1001(a)(2), provide in part:

> **§ 7212. Attempts to interfere with administration of internal revenue laws**
>
> **(a) Corrupt or forcible interference.** —Whoever corruptly ... endeavors to ... impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly ... obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than 3 years, or both....

26 U.S.C. § 7212(a).

> **§ 1001. Statement or entries generally**
>
> (a) Except as otherwise provided in this section, whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, knowingly and willfully—
>
> * * *
>
> (2) makes any materially false, fictitious, or fraudulent statement or representation ...
>
> * * *
>
> shall be fined under this title, imprisoned not more than 5 years ... or both.

18 U.S.C. § 1001(a)(2).

II. *DISCUSSION*

The Sixth Amendment to the Constitution provides that "[i]n all criminal prosecutions, the accused shall enjoy the right ... to be informed of the nature and cause of the accusation...." This Constitutional requirement is implemented by Rule 7(c)(1) of the Federal Rules of Criminal Procedure which specifies that "[t]he indictment ... must be a plain, concise, and definite written statement of the essential facts constituting the offense charged...." An indictment is sufficient if it: (1) contains the essential elements of the offenses charged; (2) fairly informs the defendant of the charges against which he must defend; and (3) enables the defendant to plead an acquittal or conviction in bar of future prosecution for the same offenses. *See Hamling v. United States,* 418 U.S. 87, 117 (1974); *United States v. O'Hagan*, 139 F.3d 641, 651 (8th Cir. 1998); *United States v. Wessels,* 12 F.3d 746, 750 (8th Cir. 1993), *cert. denied,* 513 U.S. 831 (1994). The sufficiency of a criminal indictment is determined from its face. There is no summary judgment procedure in criminal cases nor do the rules provide for a pre-trial determination of the sufficiency of the evidence. *See United States v. Nabors,* 45 F.3d 238, 240 (8th Cir. 1995); *United States v. Critzer,* 951 F.2d 306, 307 (11th Cir. 1992). Indictments are normally sufficient unless no reasonable construction can be said to charge the offense. *See O'Hagan*, 139 F.3d at 651; *United States v. Fleming,* 8 F.3d 1264, 1265 (8th Cir. 1993).

Defendant Womack contends that the indictment must be dismissed because:

> [Count One] fails to state an offense because 26 U.S.C. § 7212(a) can be used only to prosecute corruptly

> interfering with administration of Title 26 of the United States Code—that is, the Internal Revenue Code ("IRC")—but the conduct alleged, if true, would only impede administration of the Bank Secrecy Act, not the IRC. Other allegations of "corrupt" conduct are not "corrupt" within the meaning of the statute.
>
> ***5** The remaining nine counts of the Indictment (Counts 2 through 10) charge Ms. Womack with making false statements during a deposition conducted by a trial attorney for the U.S. Department of Justice, Tax Division, in violation of 18 U.S.C. § 1001(a)(2)....
>
> Each of these Counts fails to state an offense for one or more reasons. First, the undisputed facts establish the literal truth of the statements attributed to Ms. Womack in Counts 3, 4, 5, 7, 8, 9, and 10. In these Counts, the Indictment generally alleges that Ms. Womack falsely told government officials that she had no ownership interest in certain companies in the Cayman Islands, which is true because, as the Indictment itself states, 100% of the issued and outstanding shares of each company is owned by a trust validly organized under Cayman Island law.
>
> Second, the allegedly false statements described in Counts 2 and 6, where the government charges that Ms. Womack falsely stated she could not remember when certain Cayman Island companies were organized, are immaterial as a matter of law because Ms. Womack told the government rough, accurate approximations of the timeframe during which they were organized. These counts thus likewise fail to state an offense.
>
> Third, Counts 9 and 10 are multiplicitous and threaten to violate the Double Jeopardy Clause if not dismissed because they allege the same false statement, and demand the same proof of falsity, as that alleged in Count 8. These counts are thus defective and must be dismissed.

(Motion to Dismiss (docs # 72 and # 73) at 2–3)

A. *Count One*

26 U.S.C. § 7212(a), the statute under which defendant Womack is charged in Count One provides: "Whoever ... in any ... way corruptly ... obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, shall, upon conviction thereof, be fined ... or imprisoned ... or both." As set forth above, the Introduction section of the Indictment, which is incorporated into Count One, charges in part:

> 1. Beginning in or about 1996, and continuing to the date of this indictment, Defendant VERNA CHERYL WOMACK ... corruptly endeavored, in the Western District of Missouri, and elsewhere, to obstruct and impede the due administration of the internal revenue laws of the United States. As part of her endeavors, WOMACK opened a series of bank accounts and organized a series of nominee companies and trusts in the Cayman Islands to conceal a portion of her income from the IRS.... As part of her corrupt endeavors, WOMACK repeatedly failed, year after year, to report her financial interests in her nominee companies and trusts to the IRS despite the multiple legal requirements that, as a United States citizen, she do so.
>
> 2. As part of her corrupt endeavors, WOMACK established at least 19 accounts at the Bank of Butterfield and Caledonian Bank in the Cayman Islands in her own name, and in the name of her various nominee companies and trusts. For at least the calendar years 2005 through 2008, WOMACK failed to report her financial interest and signatory authority over all of the financial accounts in the Cayman Islands that she had an interest in or signatory authority over to the IRS despite the multiple legal requirements that, as a United States citizen, she do so.
>
> ***6** 3. For the calendar years 2005 through 2008, WOMACK maintained balances of between $40,964.00 and $173,541.08 in one of the Bank of Butterfield accounts, an interest-bearing account that she maintained in her own name.... Despite her custody and control of that account, WOMACK repeatedly failed, year after year, to report her financial interests in her Bank of Butterfield interest-bearing account to the IRS despite the multiple legal requirements that, as a United States citizen, she do so.
>
> 4. WOMACK's corrupt endeavors to conceal income from the IRS included the use of a nominee company in the Cayman Islands called Lucy Limited, for which she established at least two separate accounts at the Bank of Butterfield.... She did not disclose her control of Lucy Limited or the existence of its bank account to the IRS, and she did not properly report the income she derived from that sale—at least $851,188.00—on her individual

> tax return as required by the internal revenue laws of the United States.
>
> 5. Further obstructing and impeding the administration of the internal revenue laws of the United States, WOMACK repeatedly lied to employees of the United States about her interests in Cayman Island businesses, trusts and financial accounts....
>
> 6. The United States alleges that during the period charged in this indictment, WOMACK's schemes to interfere with the administration of the internal revenue laws, including but not limited to her corrupt endeavors using Cayman Island nominees and financial accounts alleged in this indictment, caused a total tax loss in excess of $7,000,000.00.

(Indictment (doc # 1) at 1–3) Count One then provides: "Beginning in or about 1996, and continuing to the date of this indictment, ... the defendant did corruptly endeavor to obstruct and impede the due administration of the internal revenue laws of the United States by the following conduct: [listing of specific conduct which was more generally described in the above Introduction section]." (*Id.* at 10–18)

The Court finds that Count One of the instant indictment tracks the statutory language of 26 U.S.C. § 7212(a) and contains all the essential elements of a section 7212(a) violation. The Court finds no merit to defendant's argument that she can allegedly lie on her individual tax returns and to government agents by failing to report and/or acknowledge interests in foreign financial accounts and not be said to be impeding administration of the Internal Revenue Code, but rather to be only impeding administration of the Bank Secrecy Act. Nor does the Court find merit in defendant's argument that the indictment does not allege conduct that is " 'corrupt'–that is conduct undertaken in 'an effort to secure an unlawful advantage or benefit.' " (Motion to Dismiss (docs # 72 and 73) at 12) The indictment alleges that defendant's schemes to interfere with the administration of the internal revenue laws caused a tax loss in excess of $7,000.000.00, taxes that allegedly would have been owed by defendant and collected under the Internal Revenue Code, but for defendant's schemes to obstruct and impede.

Defendant's arguments that the alleged conduct was not "corrupt" would require the Court to look outside the indictment and/or make a pre-trial determination of the evidence. Whether the government will introduce sufficient evidence to prove its allegations cannot be resolved prior to the government's presentation of its case to the jury. Count One of the indictment is sufficient.

B. *Counts Two Through Ten*

***7** 18 U.S.C. § 1001(a)(2), the statute under which defendant Womack is charged in Counts Two through Ten provides: "whoever, in any matter within the jurisdiction of the ... Government of the United States, knowingly and willfully ... makes any materially false, fictitious, or fraudulent statement or representation ... shall be fined under this title, imprisoned not more than 5 years ... or both." As set forth above, Counts Two through Ten charge:

> 46. On or about May 9[sic], 2009, in Kansas City, in the Western District of Missouri, the defendant VERNA CHERYL WOMACK, in a matter within the jurisdiction of the executive branch of the Government of the United States, that is, the United States Department of the Treasury and the United States Department of Justice, did voluntarily and intentionally make the false and fraudulent statements of material fact corresponding to each count below, while knowing those statements to be false and fraudulent at the time she made them.

(Indictment (doc # 1) at 19) The context in which the alleged false and fraudulent statements were made was further described in Count One (which paragraph was incorporated into Counts Two through Ten):

> 41. On or about May 19, 2009, in Kansas City, Missouri, WOMACK testified under oath in a deposition by a trial attorney for the United States Department of Justice, Tax Division, regarding a lawsuit under the internal revenue laws of the United States then pending in the Western District of Missouri that sought to enjoin a third party from

> providing tax advice. During that deposition, WOMACK knowingly made numerous false and fraudulent statements....

(Indictment (doc # 1) at 15)

To find a violation of 18 U.S.C. § 1001(a)(2), the Eighth Circuit's model jury instructions require that the defendant (1) knowingly and intentionally made the statement; (2) the statement was false or fraudulent; (3) the statement concerned a material fact; (4) the statement was made about a matter within the jurisdiction of a federal agency; and (5) the defendant knew it was untrue when she made the statement. *See* Eighth Circuit Model Criminal Jury Instruction 6.18.1001B. The Court finds that Counts Two through Ten of the instant indictment track the statutory language of 18 U.S.C. § 1001(a)(2) and contain all the essential elements of a section 1001(a)(2) violation.

The Court finds no merit in defendant's argument that some of defendant's statements are literally true because this argument requires the Court to look outside the indictment and/or make a pre-trial determination of the evidence. Likewise, the Court finds no merit in defendant's argument that some of defendant's statements are immaterial. As set forth by the Eighth Circuit Court of Appeals in *United States v. Ferro,* 252 F.3d 964, 968 (8th Cir. 2001), "so long as the indictment contains a facially sufficient allegation of materiality, federal criminal procedure does not 'provide for a pre-trial determination of sufficiency of the evidence.' " Finally, the Court finds no merit in defendant's argument that Counts 9 and 10 must be dismissed as multiplicitous because Counts 9 and 10 do not merely allege a repetition of the alleged false statement in Count 8. Rather, Count 9 references defendant's statement that Lucy Limited's investors paid her to purchase, manage and properly contain wine and Count 10 references defendant's statement that Lucy Limited's investors paid her for managing the auction of wine, while Count 8 references only defendant's statement as to the ownership of Lucy Limited. Since Counts 9 and 10 will require proof of facts that Count 8 does not, there is no multiplicity. *See United States v. Segall,* 833 F.2d 144, 146 (9th Cir. 1987)("each nonidentical false statement made ... may be charged as a separate violation of section 1001.") Whether the government will introduce sufficient evidence to prove its allegations cannot be resolved prior to the government's presentation of its case to the jury. Counts Two through Ten of the indictment are sufficient.

III. *CONCLUSION*

***8** For the foregoing reasons, it is

RECOMMENDED that the Court, after making an independent review of the record and applicable law, enter an order denying Defendant Verna Cheryl Womack's Motion to Dismiss the Indictment Pursuant to Fed.R.Crim.P. 12(b)(3)(B) (docs # 72 and # 73).

Counsel are reminded they have fourteen days from the date of receipt of a copy of this Report and Recommendation within which to file and serve objections to same. A failure to file and serve timely objections shall bar an attack on appeal of the factual findings in this Report and Recommendation which are accepted or adopted by the district judge, except on the grounds of plain error or manifest injustice.

All Citations

Not Reported in F.Supp.3d, 2015 WL 8968785

Footnotes

[1] Doc # 72 is a redacted version of the motion and doc # 73 is an unredacted version filed under seal. Defendant states she has redacted portions of the motion in accordance with the terms of the Stipulated Protective Order Concerning Subpoenaed Documents and Information (doc # 35) entered by Judge Fenner in *United States v. Allen R. Davison,* No. 08–00120–CV–W–GAF.

End of Document

2016 WL 7174610
United States Bankruptcy Court,
W.D. Texas, San Antonio Division.

In re: James and Corinne Gandy, Debtors.
United States of America, Plaintiff,
v.
James and Corinne Gandy, Defendants.

CASE NO. 14–53018–CAG
|
ADV. NO. 15–05083–CAG
|
Signed 11/04/2016

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

CRAIG A. GARGOTTA, UNITED STATES BANKRUPTCY JUDGE

***1** Came on for consideration the above-numbered adversary proceeding and, in particular, Plaintiff's (United States of America "United States" or Internal Revenue Service "IRS") Motion for Summary Judgment filed May 16, 2016 (the "Motion") (ECF[1] No. 16). Defendant Corrine Gandy filed a Response in opposition to the Motion on June 6, 2016 (the "Response") (ECF No. 20). Plaintiff filed its Reply to the Response on June 24, 2016 (the "Reply") (ECF No. 24). The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding under 28 U.S.C. § 157(b)(2)(I) (determination of dischargeability of a debt). Venue is proper under 28 U.S.C. §§ 1408(1) and 1409(a). This matter is referred to this Court under the District Court's Order of Reference. For the reasons stated in this Memorandum Opinion and Order, the Court is of the opinion that Plaintiff's Motion should be GRANTED.

PROCEDURAL BACKGROUND

On October 15, 2015, the United States filed this adversary proceeding asking the Court to determine that James and Corinne Gandy's ("the Gandys") joint $2.8 million federal income tax liability (Form 1040) for tax year 2007 is non-dischargeable, or is an exception to discharge, under 11 U.S.C. § 523(a)(1)(C). James Gandy previously waived his discharge under 11 U.S.C. § 727(a)(10) (ECF. No. 11). As such, the United States is seeking a judicial determination that Mrs. Gandy's (hereinafter "Defendant") 2007 tax liability is non-dischargeable.

The United States asserts that Defendant's 2007 tax liability is non-dischargeable due to Defendant's willful attempts to evade or defeat her tax liability. The United States alleges that Defendant took affirmative actions to defeat both the assessment and the collection of her 2007 federal income tax liability by filing a false original 2007 income tax return that omitted over $18 million in taxable income. Further, the United States alleges that Defendant's actions—such as her fraudulent transfers of assets to family members and her extravagant lifestyle with funds that should have been used to pay her federal tax debt—demonstrate a willful attempt to evade the payment of taxes.

The amount of the Gandys' individual income tax liability for 2007 is not in dispute. The Gandys' income tax debt was $2,846,453.45 as of the chapter 7 petition date of December 4, 2014. (Gov. Ex. 8; p. 2). The chapter 7 Trustee ("Trustee") paid the IRS $766,882 on or about October 28, 2015, from the sale of the Gandys' $1 million residence and another $90,800 from the Trustee's sale of the Gandys' airplane. As such, the Gandys' joint 2007 individual income tax liability is roughly $2 million.

PARTIES' CONTENTIONS

The United States contends that there is competent summary judgment evidence for the Court to find that Defendant willfully evaded the payment of her joint 2007 individual income tax liability. The United States argues that there are a number of acts that demonstrate that Defendant evaded paying her taxes by: (1) failing to disclose her ownership interest in her home and an airplane in her bankruptcy schedules; (2) complicity in the fraudulent transfer of her $1.4 million residence to her elderly mother-in-law; (3) transferring money out of joint or personal bank accounts to her mother's bank accounts to shield the funds from discovery while IRS Collections was reviewing her tax returns; (4) omitting income on her original tax return; (5) maintaining offshore bank accounts in which she had unreported income; and (6) purchasing luxury items, such as automobiles, while not paying her 2007 income taxes.

***2** Defendant argues that: (1) she did not list her home in her bankruptcy schedules because her mother-in-law owned her former residence and James Gandy's company owned the airplane; (2) she transferred money to her mother's accounts to preserve money and keep James Gandy from spending all of their cash; (3) although she signed her original and amended Form 1040 income tax returns for 2007, she did not understand all of the related documentation or the operation of James Gandy's businesses; (4) the offshore accounts were James Gandy's offshore accounts; and (6) luxury items such as automobiles were leased.

SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c); ***Celotex Corp. v. Catrett***, 477 U.S. 317, 322 (1986). Bankruptcy Rule 7056 applies Rule 56(c) of the Federal Rules of Civil Procedure to adversary proceedings. If summary judgment is appropriate, the Court may resolve the case as a matter of law. ***Celotex Corp.***, 477 U.S. at 323; ***Blackwell v. Barton***, 34 F.3d 298, 301 (5th Cir. 1994). The Fifth Circuit has stated "[t]he standard of review is not merely whether there is a sufficient factual dispute to permit the case to go forward, but whether a rational trier of fact could find for the non-moving party based upon evidence before the court." ***James v. Sadler***, 909 F.2d 834, 837 (5th Cir. 1990) (citing ***Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.***, 475 U.S. 574, 586 (1986)).

To the extent that the non-moving party asserts the existence of factual disputes, the evidence offered by the non-moving party to support those factual contentions must be of sufficient quality so that a rational fact finder might, at trial, find in favor of the non-moving party. ***Matsushita***, 475 U.S. at 585–87 (non-moving party "must do more than simply show that there is some metaphysical doubt as to material facts"); ***Anderson v. Liberty Lobby, Inc.***, 477 U.S. 242, 249–50 (1986) ("adverse party's response ... must set forth specific facts showing that there is a genuine issue for trial"). If the record "taken as a whole, could not lead a rational trier of fact to find for the non-moving party, then there is no genuine issue for trial." ***LeMaire v. Louisiana***, 480 F.3d 383, 390 (5th Cir. 2007). In determining whether a genuine issue of material fact exists, the non-moving party must respond to a proper motion for summary judgment with specific facts demonstrating that such genuine issue exists. A genuine issue of material fact is not raised by mere conclusory allegations or bald assertions unsupported by specific facts. ***Leon Chocron Publcidad Y Editoria, S.A. v. Jymm Swaggart Ministries***, 990 F.2d 1253 (5th Cir. 1993).

In an action to determine the dischargeability of a debt, the creditor has the burden of proof under a preponderance of the evidence standard. ***Grogan v. Garner***, 498 U.S. 279, 286 (1991). "Intertwined with this burden is the basic principle of bankruptcy that exceptions to discharge must be strictly construed against a creditor and liberally construed in favor of a debtor so that the debtor may be afforded a fresh start." ***FNFS, Ltd. v. Harwood (In re Harwood)***, 637 F.3d 615, 619 (5th Cir. 2011) (citing ***Hudson v. Raggio & Raggio, Inc. (In re Hudson)***, 107 F.3d 355, 356 (5th Cir. 1997)). Therefore, the United States must support its motion with credible evidence—using any of the materials specified in Rule 56(c)—that would entitle it to a directed verdict if not controverted at trial. ***Celotex***, 477 U.S. at 331. Assuming Plaintiff meets its burden and submits a properly supported Motion, Defendant must demonstrate the existence of specific facts constituting a genuine issue of material fact for which a trial is necessary. ***Anderson***, 477 U.S. at 248–49. Defendant must produce evidence demonstrating the existence of a triable issue of fact on at least one element of Plaintiff's claim. *See* ***Irby v. Bittick***, 44 F.3d 949, 953 (11th Cir. 1995).

SUMMARY OF UNDISPUTED FACTS[2]

***3** 1. In tax year 2007, the Gandys earned over $20 million, but failed to pay their 2007 federal income tax debt on that income. (Gov. Ex. 1, p. 18, lines 18–25; p. 19, lines 1–5). According to IRS Form 906, Closing Agreement on Final Determination Covering Specific Matters ("the Closing Agreement") that the Gandys signed on or about December 5, 2013, the Gandys underreported their taxable income on their original 2007 federal income tax return by $18,822,602. (Gov. Exs. 2 & 3). The Gandys' 2007 amended income tax return (Gov. Ex. 4), dated September 11, 2009, also shows that the Gandys admitted owing the IRS an additional $2,416,541 in tax for unreported income in their original 2007 income tax return. In this amended income tax return, the Gandys disclosed an additional $17,853,586 in adjusted gross income ("AGI") that they did not report in their original 2007 income tax return. (Gov. Ex. 2, p. 1; Gov. Ex. 4, p. 1).

2. In October 2015, the Trustee sold the Gandys' residence at 108 Larry Lee Drive in Kerrville, Texas for $925,000. The Trustee applied $766,882.40 of the sales proceeds to the Gandys' 2007 federal income tax debt held by the IRS, leaving a balance of $2,079,571.05. (Gov. Ex. 8, p. 2; Gov. Exs. 9 & 10). In December 2015, the Trustee sold the Gandys' airplane. On or about December 29, 2015, the United States received a check in the amount of $90,800 from the Trustee, representing the net sales proceeds from the sale of this airplane and leaving a federal income tax balance of $1,988,771.05, or approximately $2 million. (Gov. Ex. 11).

3. In 2006, the Gandys purchased a residence at 108 Larry Lee Drive in Kerrville, Texas for $1.4 million. (Gov. Ex. 13, p. 1). In 2007, Defendant paid off the $1 million mortgage on their residence on Larry Lee Drive. (Gov. Ex. 16, p. 42, lines 15–25; p. 43, lines 1–8).

4. After the IRS filed a federal tax lien against the Gandys on January 23, 2013, the Gandys gave Prem Gandy, Mr. Gandy's elderly mother, a promissory note for $1 million and signed a deed of trust in favor of Prem Gandy that allegedly encumbered the Gandys' residence. The deed of trust was recorded on January 29, 2014, but dated June 1, 2012. (Gov. Ex. 17, p. 5). The Gandys claimed that, in 2012, Prem Gandy foreclosed on the Gandys' residence and became the record owner of the residence. (Gov. Ex. 1, p. 52, lines 5–21; p. 54, lines 1–8).

5. The Gandys did not disclose their airplane in their original Schedules. (Gov. Ex. 5, p. 6). Also after the Gandys became indebted to the IRS, Defendant conveyed her interest in certain Texas real property jointly owned with Liliane Williams, her elderly mother, to Williams in exchange for a $115,009 note receivable. (Gov. Ex. 26, lines 3–20). Further, the Gandys also failed to disclose the note receivable from Liliane Williams to Defendant in their original Schedules. (Gov. Ex. 5, p. 5). On April 30, 2015, the Gandys amended their Schedule B to include this note receivable as an asset. (Gov. Ex. 23, p. 4). The Gandys did not amend their Schedules to claim as an asset their residence on Larry Lee Drive or their airplane, notwithstanding the fact that the Trustee subsequently sold the house and airplane to pay down the Gandys' 2007 tax debt.

6. After the Gandys became indebted to the Internal Revenue Service for their 2007 income tax liability, James Gandy gave his elderly mother Prem Gandy, his brother Hary Gandy and his sister Mona Gandy an interest in two of the Gandys' businesses—Gandy Engineering and Digital Werks. (Gov. Ex. 1, p. 17, lines 2–25; p. 18, lines 1–15; Gov. Ex. 16, p. 48, lines 8–22; Gov. Ex. 25).

7. In April of 2013, Defendant withdrew $170,000 from her bank account and deposited it into a bank account of her mother, Liliane Williams. Defendant, however, she continued to control these funds. (Gov. Ex. 26, p. 144, lines 24–25; p. 145, lines 1–25, p. 146, lines 1–25; p. 147, lines 1–3; Gov. Ex. 30). In her Rule 2004 examination, Defendant admitted to opening a Wells Fargo bank account, depositing $100,000 to purchase a certificate of deposit, and adding Jason and Landon Cross, her two adult sons, to be paid upon her death, without her sons knowledge of the transaction. (Gov. Ex. 26, p. 162, lines 7–25; p.163, lines 1–8).

***4** 8. After the Gandys became indebted to the IRS for their 2007 income tax, the Gandys established foreign bank accounts in tax-haven countries. The Gandys deposited large sums of money in bank accounts in the United Arab Emirates, Lichtenstein, Switzerland, Lebanon, Belgium, and Canada. The Gandys failed to report income on these accounts to the IRS and failed to file a Report of Foreign Bank and Financial Accounts (FBAR) for these accounts, despite their continued control over those funds. (Gov. Exs. 28 & 29). In the Closing Agreement with the IRS, the Gandys admitted that they "underreported federal income taxes during the period 2003 through 2008 through offshore financial arrangements (including arrangements with foreign banks, financial institutions, corporations, partnerships, trusts, or other entities) ....” (Gov. Ex. 3, p. 1). In her Rule 2004 examination, Defendant admitted wire-transferring large sums of money in and out of some of these foreign bank accounts. (Gov. Ex. 26, p. 82, lines 2–25; p. 83, line 1; p. 84, lines 1–5; p. 85, lines 1–7; Gov. Ex. 32).

9. On or about April 23, 2013, while IRS Collections was pursuing the Gandys, Defendant wrote a check to herself from her USAA bank account in the amount of $170,000 and then deposited these funds into a newly created account in her name at Wells Fargo Bank. (Gov. Ex. 30, p. 144, lines 24–25; p. 145, lines 1–25; p. 146, lines 1–25; p. 147, lines 1–3). In her Rule 2004 examination, Defendant admitted later depositing this money into yet another account in her mother's name to keep it away from her husband, that Defendant continued to control the funds, and that these actions were a “mistake.” (Gov. Ex. 26, p. 145, lines 1–25).

10. In addition, the Gandys purchased a number of planes for their business operations and seven vehicles (two Ferraris, two Porsches, a Mercedes Benz, an Audi and an Aston Martin). (Gov. Ex. 26, p. 46, lines 15–23; p. 47, lines 1–8, p. 56, lines 3–5, 18–24; p. 59, lines 12–15; p. 60, lines 14–23; Gov. Ex. 1, p. 23, lines 24–25; p. 24, lines 1–25; p. 25, lines 1–20, p. 29, lines 18–25, p. 30, lines 1–25, pp. 31–32, p. 33, lines 5–25; p. 34, lines 1–12; p. 36, lines 15–23; p. 38, lines 17–25). Shortly before they filed their chapter 7 bankruptcy case, the Gandys purchased two 2014 Volkswagens for themselves and a 2013 Fiat for one of Mr. Gandy's adult daughters. (Gov. Ex. 5; Gov. Ex. 26, p. 58, lines 7–9).

11. After this bankruptcy case was filed, Defendant purchased Gemini Aviation d/b/a Dugosh, an aircraft repair company where her husband works (Gov. Ex. 34), and failed to disclose it in her answers to the United States' interrogatories. (Gov. Ex. 24).

12. Defendant is fifty-nine years of age. (Corrine Gandy Decl., Ex. A, para. 1).[3] She first started working at the age of sixteen. *Id.* She grew up in a military family in the United States, living in at least seven different places where her father had been stationed, and joined the U.S. Air Force at the age of twenty, serving one four year term. *Id.* During that time, she married a military officer and then got out of the Air Force to pursue a degree. *Id.* She was married seven years and had two children during her first marriage but divorced from her then spouse in 1985, whereupon she took a job at Kelly AFB in San Antonio, starting as a secretary. *Id.* She worked at Kelly AFB approximately fifteen years. *Id.*

13. Defendant met James Gandy in approximately 1993–1994, and the two were married in 1997. *Id.* James was an engineer and inventor who owned a successful printing manufacturing company known as Sign Tech. *Id.*

14. After the Gandys married, James suggested that Defendant did not need to work and could help out more at the home, as James had three minor children, two of whom came to live with the Gandys within six months of their marriage. *Id.* Defendant has been a housewife since 1997 and has been entirely dependent upon Mr. Gandy for support for almost twenty years. *Id.* Defendant has worked a part-time job since the summer of 2013 as a yoga instructor at the Kroc Salvation Army in Kerrville, typically earning between $500–$1000/mo. *Id.* The Gandys are now separated and going through a divorce,[4] and Defendant states she will be requesting spousal support from James Gandy because she does not have the job skills to now re-enter the workforce and earn a living. *Id.*

***5** 15. Since Defendant first started working more than forty years ago, she has always filed her tax returns on time (including extensions James requested during her marriage to him), and alleges that she has always paid her taxes in full and on time, other than the tax assessed on the Amended 2007 return. *Id.* ¶ 4.

16. In 2007, Mr. Gandy derived all of his income from his position as CEO of a company called Gandinnovations. *Id.* ¶ 6.

17. Since the early 1990's, a CPA, David Owens, has prepared the Gandy's joint tax returns. *Id.* ¶ 8. Defendant has met Mr. Owens but has had little contact with him over the entire time period that he has prepared the Gandy's tax returns. *Id.*

18. The Gandys made voluntary payments on their 2007 tax liability from December 2011, through June 2014, paying a total of $990,145.16. *Id.* ¶ 11 & Ex. “A–2”.

DISCUSSION

An individual debtor under Chapter 7 of the Bankruptcy Code is generally granted a discharge of all debts that arose before the date of the order of relief. 11 U.S.C. § 727(a)&(b). Section 523 of the Bankruptcy Code, however, provides exceptions to such discharge. In particular, 11 U.S.C. § 523 provides, in pertinent part, that:

> (a) A discharge under section 727 ... of this title does not discharge an individual debtor from any debt (1) for a tax ...—(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

A debtor has willfully attempted to evade or defeat a tax within the meaning of § 523(a)(1)(C) of the Bankruptcy Code where the debtor: (1) has a duty under the law, (2) knew of the duty, and (3) voluntarily and intentionally violated that duty. ***Bruner v. United States***, 55 F.3d 195, 197 (5th Cir. 1995); ***In re Toti***, 24 F.3d 806, 809 (6th Cir. 1994). There is no requirement of an affirmative act or commission. ***Bruner***, 55 F.3d at 200 ("Section 523(a)(1)(C) surely encompasses both acts of commission as well as culpable *omissions*."); ***Toti***, 24 F.3d at 809. A debtor's actions are willful under § 523(a)(1)(C) if they are done voluntarily, consciously, or knowingly and intentionally. ***Toti***, 24 F.3d at 809 (citation omitted). The phrase "in any manner," is interpreted broadly and regularly includes attempts to evade payment of tax as well as actions to avoid assessment of tax. ***Bruner***, 55 F.3d at 200.

In this case, the first two prongs of the ***Bruner*** test are met because the Gandys had previously filed tax returns before and after tax year 2007. *See* ***State Farm Life Ins., Co. v. Gutterman***, 896 F.2d 116, 119 n.3 (5th Cir. 1990) (holding that the filing of tax returns supports the inference that the defendant knew he had a duty to pay federal income taxes). The third prong, the "willful attempt" standard, contains both a conduct requirement (that the debtor "attempted in any manner to evade or defeat [a] tax") and a mental state requirement (that the attempt was "willful"). ***United States v. Stanley***, 595 Fed.Appx. 314, 317–18 (5th Cir. 2014). The ability to pay is only one factor in the analysis and not the "litmus test" for determining nondischargeability under § 523(a)(1)(C). ***Grothues v. IRS (In re Grothues)***, 226 F.3d 334, 339 (5th Cir. 2000). Denying a debtor a discharge of his unpaid federal taxes is appropriate where there is a pattern of the debtor failing to pay taxes by fraudulent transfers and concealment of assets. ***Bruner***, 55 F.3d at 200.

6** Defendant's 2007 joint federal income tax is *res judicata*. This Court determined Defendant's 2007 tax liability in the Agreed Judgment (Gov. Ex. 8), between the United States and her husband, James Gandy, entered on December 4, 2015. *See* ***Matter of James Carroll Teal (United States v. Teal), 16 F.3d 619, 621 (5th Cir. 1994) (per curiam) (finding that a tax court adjudication of tax liability has binding effect). Defendant submitted no summary judgment evidence that contests the amounts of tax, interest, or penalties. By contrast, the United States' motion was supported by competent summary judgment evidence. *See* IRS Form 4340, Certificates of Assessments and Payments (Gov. Ex. 37), and Declaration of James Ashton (Gov. Ex. 38), with the attached IRS interest update (Ex. C thereto), showing the tax balance due, with interest and penalties thereon, as of June 27, 2016, is $2,143,455.83. The IRS Form 4340 is presumptive proof of the validity of a federal tax assessment. ***United States v. McCallum***, 970 F.2d 66, 71 (5th Cir. 1992) (holding that a certificate of assessment is presumptive proof of the assessment absent controverting evidence).

On or about October 14, 2008, Defendant signed, under penalties of perjury, and filed her joint 2007 federal income (Form 1040) tax return reporting a loss of $1,411,254 (negative adjusted gross income "AGI"), and seeking a refund of $33,524. (Gov. Ex. 2, pp. 1–2).

Notwithstanding Defendant's assertions that she did not understand Mr. Gandy's business operations; that she placed money into accounts with her mother to pay the IRS or preserve business assets; that she was completely dependent on James Gandy for her financial well-being; and that she did not understand the contents of her original and amended 2007 tax returns; certain facts are not in dispute because Defendant signed the following documents:

1. On or about September 11, 2009, Defendant signed, under penalty of perjury, and filed her amended joint 2007 federal income (Form 1040X) tax return. The amended 2007 Form 1040 stated positive AGI of $16,442,332; an

increase of $17,853,586 over the AGI she reported in her original (Form 1040) tax return, which disclosed income tax owing in the amount of $2,416,541. (Gov. Ex. 4, p. 1).

2. On or about January 15, 2010, Defendant signed, under penalty of perjury, Disclosures to the IRS Criminal Investigation Division, wherein she admitted: (1) a 50% ownership interest in Sarven Management, Ltd., a Swiss partnership, which had a Swiss bank account; (2) that the highest aggregate value of her offshore accounts/assets in 2003, 2004, 2005, and 2006 was between $100,000 to $1 million; (3) that the estimated total of her unreported income in 2003, 2004, 2005, and 2006 was between $0 and $100,000; (4) that she possibly had unreported income of over $10 million in 2007; and (5) that she may have a financial interest in a Citibank account in her husband's name in Dubai. (Gov. Ex. 29, pp. 1–6).

3. On October 22, 2010, Defendant signed the James Gandy Life Insurance Trust Agreement, which created the James Gandy Life Insurance Trust, the Gandy Family Trust, and the Gandy Marital Trust.

4. On December 5, 2011, Defendant signed a Closing Agreement with the IRS, wherein she admitted that she "underreported federal income taxes during the period 2003 through 2008 through offshore financial arrangements (including arrangements with foreign banks, financial institutions, corporations, partnerships, trusts, or other entities) ...." (Gov. Ex. 3, p. 1). In the same Agreement, Defendant admitted underreporting income, in tax year 2007 in the amount of $18,822,602. On page 2 of the agreement, Defendant agreed to the following statement: "For 2007 a penalty is due under 31 U.S.C. section 5321(a)(5) in the amount of $16,000 for failure to file a Report of Foreign Bank and Financial Accounts ('FBAR'), TDF 90–22.1."

Direct proof of a debtor's intent to evade taxes is generally provable by circumstantial evidence and reasonable inferences drawn from the existence of certain fact patterns, otherwise called badges of fraud. ***In re Binkley***, 176 B.R. 260, 265 (Bankr. M.D. Fla. 1994), *aff'd*, 242 B.R. 728 (M.D. Fla. 1999) (citing ***Berzon v. United States***, 145 B.R. 247, 250 (Bankr. N.D. Ill. 1992)); *see also* 4 Collier on Bankruptcy, ¶ 727.02 (15th ed. 1994) ("a finding of actual intent may be based upon circumstantial evidence or on inferences drawn from a course of conduct").

7** The United States has proven by a preponderance of the evidence that Defendant willfully attempted to evade or defeat the assessment and the collection of her 2007 income tax. *See* ***Grogan v. Garner, 498 U.S. at 287–88 (finding that dischargeability complaints may be proven by a preponderance of the evidence). Defendant clearly participated in fraudulent acts to avoid paying her taxes —the understatement of her 2007 income by $18 million; the use of offshore bank accounts in tax-haven countries; the fraudulent concealment of her interest in a $1 million home and other valuable assets in bankruptcy when she had a legal duty to fully and truthfully disclose her assets; and the submission to the IRS of two false financial statements, failing to disclose assets in her Schedules.

The Court agrees with the United States that the evidence demonstrates that Defendant concealed assets with the intent to delay and hinder the United States as a creditor. The attempted concealment of an asset (the Gandys' home) in the name of an insider (her elderly mother-in-law) is a badge of fraud. *See* ***Matter of Holloway***, 955 F.2d 1008, 1011 (5th Cir. 1992) (finding of an insider is defined by: (1) closeness of the relationship between the parties and (2) whether the transaction was at arm's length). Also, the Gandys controlled the concealed property after it was allegedly transferred to Prem Gandy—they lived in the home and paid all expenses pertaining to the home. The Gandys also concealed an airplane, a vehicle, and an account receivable in order to make it appear that they had no assets with which to satisfy their federal income tax debt.

The bank records attached to the Ashton Declaration (Gov. Ex. 38E) show Defendant made large deposits and withdrawals of funds from January 23, 2009, through September 29, 2014, which are further detailed in the chart submitted herewith as Gov. Ex. 43. These records clearly show that Defendant had the financial ability to pay her tax debt during times when she made exorbitant expenditures and preferred other creditors. Gov. Ex. 43 shows that from January 23, 2009, through September 29, 2014, Defendant had signatory authority over accounts wherein over $13.8 million was deposited and from which $14.7 million was withdrawn. As to some of these accounts, Defendant had sole signatory authority— accounts 2496, 0730, 8529, 5139, 8969, and 8529. Also, Defendant testified in her February 26, 2015, Rule 2004 examination that she was "responsible for the family finances, paying the bills." (Gov. Ex. 44).

Defendant also lived a lavish lifestyle while not paying the $2 million tax debt she admitted she knew existed. For most of the relevant time frame of 2007–2015, Defendant lived in a $1 million mansion, drove luxury vehicles, and jetted around the world to exotic countries. A number of courts have taken similar lavish lifestyles into account in denying discharge under 11 U.S.C. § 523(a)(1)(C). *See* ***United States v. Mixon (In re Mixon)***, No. 07–3257, 2008 WL 2065895 (Bankr. N.D. Tex. May 13, 2008) (Houser, C.J.) (debtors acquired expensive assets in the face of serious financial difficulties, spent money that could have been used to pay their federal taxes on vehicles and leisure activities, and enjoyed assets held in the name of a family member, thereby reducing their collection sources subject to IRS execution); ***United States v. Acker (in re Acker)***, No. 09–04165, 2010 WL 3813243 (Bankr. E.D. Tex. Sept. 28, 2010) (Rhoades, C.J.) (debtor had enough income to buy a new house when he could afford to pay his IRS debts, used a request for IRS administrative procedures to delay collection efforts, and hid assets from IRS); ***Matter of Zuhone***, 88 F.3d 469 (7th Cir. 1996) (debtor transferred money and farmland to children); ***In re Schaeffer***, 201 B.R. 282 (Bankr. D. Colo. 1996) (chapter 7 debtor's actions, in conveying marital residence to wife for no consideration to shield wife and assets from IRS, rendered taxes non-dischargeable).

8** In sum, Defendant's 2007 income taxes are non-dischargeable under 11 U.S.C. § 523(a)(1)(C), because Defendant willfully attempted to evade or defeat them in the same manner as in ***Bruner. *See* ***Bruner***, 55 F.3d at 200 (debtor's pre-petition pattern of failing to pay their taxes and attempting to hide income and assets constituted a willful attempt to evade or defeat the tax liabilities, thereby warranting excepting their taxes from discharge).

CONCLUSION

IT IS THEREFORE ORDERED that Plaintiff's Motion for Summary Judgment is hereby GRANTED; and it is further

ORDERED, that the debt Defendant owes to the United States (IRS) is a nondischargeable debt under 11 U.S.C. § 523(a)(1)(C); and it is further

ORDERED, that the debt is a liquidated debt in the amount of $2,846,453.45, subject to all payments and accrual of statutory interest; and it is further

ORDERED, that all other relief not specifically granted herein is DENIED.

IT IS HEREBY ADJUDGED and DECREED that the below described is SO ORDERED.

All Citations

Slip Copy, 2016 WL 7174610, 118 A.F.T.R.2d 2016-6475

Footnotes

[1] Unless otherwise noted, “ECF” refers to the electronic case filing in this adversary proceeding.

[2] In her Response, Defendant made a number of objections to the United States' summary judgment evidence. Rather than rule on the merits of those objections which generally allege hearsay or lack of foundation, the Court has not considered any evidence that Defendant finds objectionable because the Court can grant summary judgment on the United States' remaining summary judgment evidence that is not in dispute.

[3] The Corrine Gandy Declaration is attached to the Mrs. Gandy's Response to the United States Motion for Summary Judgment.

[4] A petition for divorce was filed on November 9, 2015. There has been no other activity in the case. (Gov. Ex. 39).

End of Document

2014 WL 1028769
United States District Court, N.D. California.

United States of America, Plaintiff,
v.
John C. Hom, Defendant.

No. C 13–03721 WHA
|
Signed March 16, 2014

Attorneys and Law Firms

Jeremy N. Hendon, United States Department of Justice, Washington, DC, Thomas Moore, Thomas M. Newman, United States Attorney's Office, San Francisco, CA, for Plaintiff.

John C. Hom, San Rafael, CA, pro se.

ORDER GRANTING MOTION TO STRIKE DEFENDANT'S AMENDED ANSWER AND COUNTERCLAIM AND VACATING HEARING

WILLIAM ALSUP, UNITED STATES DISTRICT JUDGE

***1** In this tax-penalty enforcement action, the government is seeking to collect unpaid civil penalty assessments arising from defendant's failure to report his interests in foreign banks or financial accounts. Defendant filed an answer on August 23, 2013 (Dkt. No. 6). Almost four months later, defendant filed an amended answer and asserted a counterclaim—without seeking leave pursuant to Rule 15(a). The counterclaim alleges the government improperly disclosed defendant's tax return information to the Department of Justice in violation of nondisclosure laws in the internal revenue code. The government now moves to strike defendant's amended answer and counterclaim. For the following reasons, the motion to strike defendant's amended answer and counterclaim is **GRANTED**.

Of some significance, defendant earlier sued the government in a similar action alleging that the IRS made unauthorized disclosures of his tax return information to the Department of the Treasury. That action was dismissed without leave to amend by the undersigned judge in an order dated September 30, 2013, due to futility. *John C. Hom, et al. v. United States,* No. 13–02243, 2013 U.S. Lexis 142818, at *6 (N.D.Cal.).

ANALYSIS

1. RULE 15.

Rule 15(a) of the Federal Rules of Civil Procedure provides that a party may amend its pleading once as a matter of course within 21 days after serving it, with the opposing party's written consent, or with the court's leave. A party waives a defense of insufficient service by failing to "include it in a responsive pleading or in an amendment allowed by Rule 15(a)(1) as a matter of course." FRCP 12(h)(2).

The government contends that defendant's assertion of his counterclaim almost four months after filing the answer constituted undue delay. In response, defendant contends that he was not properly served with the lawsuit because he "was not living at his residence during the time of the alleged service" and therefore "the clock never started on the original answer" (Opp. 4). Defendant further contends that there is no violation with his bringing a counterclaim because of the two-year statute of limitations for Section 6103 violations (*ibid.*).

Defendant's arguments are without merit. *First,* defendant was personally served so his residence at the time of service is irrelevant (Dkt. No. 9). *Second,* defendant waived the affirmative defense of improper service when he failed to either include it in his original answer or move to raise the defense before filing his answer. *Third,* irrespective of the statute of limitations, defendant filed his amended answer and counterclaim almost four months after filing his answer. This is well beyond the 21 days allowed as a matter of course under Rule 15(a)(1). Defendant received neither written consent from the government or leave, therefore, defendant's amended answer was not properly filed.

2. ISSUE PRECLUSION.

Even if, however, defendant had properly sought leave to file an amended answer, such leave would be denied because the counterclaim is barred by issue preclusion.

***2** Defendant's counterclaim alleges that the government, in violation of 26 U.S.C. 6103, obtained tax return information from the IRS and made unauthorized disclosures to the Department of Justice in connection with a Foreign Bank Account Report ("FBAR") investigation. Defendant is barred from relitigating that issue because it was already decided in the prior case. The September 30 order dismissing the unauthorized disclosure claim specifically stated, "Section 5314 is therefore a related statute under Section 6103 and the disclosures at issue in this action were lawful." *Hom,* 2013 U.S. Lexis 142818, at *6. The fact that in the prior action defendant addressed the Department of the Treasury and not the Department of Justice has no importance. The named parties in both actions are John C. Hom and the United States, and the asserted counterclaim—unauthorized disclosure of tax return information under Section 6103—is the same claim made by defendant in the prior action. Defendant's counterclaim is thus barred and this order need not reach whether the counterclaim was properly pled.

Accordingly, the government's motion to strike defendant's amended answer and counterclaim is **GRANTED**. The hearing is **VACATED**.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2014 WL 1028769, 113 A.F.T.R.2d 2014-1426

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444 F.Supp.2d 385
United States District Court, D. Maryland, Southern Division.

UNITED STATES of America, Plaintiff,
v.
Pradeep SRIVASTAVA, Defendant.

Criminal No. RWT 05–0482.
|
Aug. 4, 2006.

Synopsis
Background: Defendant charged with income tax evasion and false statements on tax returns moved to suppress evidence.

Holdings: The District Court, Titus, J., held that:

[1] warrant did not authorize seizure of defendant's personal and financial non-business papers;

[2] conduct of the agents who executed the warrant was so inappropriate as to warrant the exclusion of all evidence seized;

[3] evidence was not admissible under the inevitable discovery doctrine; and

[4] Internal Revenue Service (IRS) investigation was not an independent source precluding suppression of evidence seized.

Motion granted.

Attorneys and Law Firms

***388** Paula M. Junghans, DLA Piper Rudnick Gray Cary U.S. LLP, Washington, DC, for Defendant.

Stuart A. Berman, Office of the United States Attorney, Greenbelt, MD, for Plaintiff.

OPINION

TITUS, District Judge.

On March 20, 2003, Magistrate Judge William Connelly signed three search warrants that authorized the search of Defendant Pradeep Srivastava's home and two medical offices for "financial, business, patient and other records related to" his "business ... which may constitute evidence of violations of Title 18 U.S.C. § 1347," a statute prohibiting health care fraud. Execution of these warrants resulted in the seizure of extensive financial ***389** papers, both business and personal, some of which were referred to the Internal Revenue Service ("IRS") for investigation. Upon further inquiry, the IRS concluded that Dr. Srivastava had failed to properly file his personal income tax returns for tax years 1998–2000. On October 12, 2005, a grand jury returned an indictment [1] charging Dr. Srivastava with income tax evasion and false statements on tax returns. [2]

On January 21, 2006, Dr. Srivastava filed a Motion for An Evidentiary Hearing Pursuant to *Franks v. Delaware* and to Suppress Evidence [Paper No. 13], alleging that the search warrant affidavit distorted and omitted material information, misleading Judge Connelly to authorize a warrant "under which sweeping and impermissible general searches of [his] home and offices were conducted." Dr. Srivastava requested that the Court conduct an evidentiary hearing pursuant to *Franks v. Delaware,* 438 U.S. 154, 155–56, 98 S.Ct. 2674, 57 L.Ed.2d 667 (1978), and suppress the evidence seized in the searches. For reasons stated on the record on March 27, 2006, this Court denied Defendant's request for a *Franks* hearing. The Court heard further argument and testimony on the remaining issues raised in Dr. Srivastava's Motion to Suppress on June 9, 2006. For the reasons stated below, Dr. Srivastava's Motion to Suppress will be granted.

BACKGROUND

Dr. Srivastava is a cardiologist residing in Potomac, Maryland. At all times relevant to this indictment, he conducted his medical practice through his professional corporation, Pradeep Srivastava, M.D., P.C., a Subchapter S Corporation. He filed Form 1040 U.S. Individual Income Tax Returns jointly with his wife and Form 1120–S U.S. Income Tax Returns for his subchapter S corporation for his medical practice. [3] Dr. Srivastava invested a significant amount of money in the stock market, specifically in stocks and stock options. During the rapidly rising market in technology stocks of the late 1990s, Dr. Srivastava traded in stocks and stock options at a high volume and apparently earned substantial capital gains, with smaller accompanying capital losses.

The investigation that ultimately led to criminal tax charges against Dr. Srivastava initially focused on allegations that he, through his medical practice, was engaged in health care fraud. Special agents from the Department of Health and Human Services, Office of Inspector General ("HHS–OIG"), the Federal Bureau of Investigation and the Office of Personnel Management, Office of Inspector General conducted the initial stages of the health care fraud investigation of Dr. Srivastava. On March 20, 2003, Special Agent ("SA") ***390** Jason Marrero of HHS–OIG submitted a single affidavit in support of applications for three search warrants to Judge Connelly. The affidavit in support of the warrants included allegations that Dr. Srivastava billed for services not rendered to patients, billed patients for duplicate services, listed inappropriate codes on patient claims, improperly billed patients for incidental services, and/or altered medical records.

Judge Connelly approved all three warrants, two of which applied to Dr. Srivastava's medical offices in Greenbelt and Oxon Hill, and the third of which authorized a search of Dr. Srivastava's residence in Potomac. Each warrant contained identical substantive language that authorized the seizure of ten categories of records, "including but not limited to, financial, business, patient, insurance and other records *related to the business* of Dr. Pradeep Srivastava, to include Drs. Balnath Bhandary and Felipe Robinson, for the period January 1, 1998 to Present, *which may constitute evidence of violations of Title 18, United States Code, Section 1347."* [4] (emphasis added) In pertinent part, the warrants specifically authorized the seizure of:

> 2. *Financial records,* including but not limited to accounting records, tax records, accounts receivable logs and ledgers, banking records, and other *records reflecting income and expenditures of the business.*
>
> (emphasis added) Agents simultaneously executed these warrants on March 21, 2003.

Agents executing these warrants seized large volumes of information from Dr. Srivastava's offices and his home. [5] Of particular relevance to this case and the instant motion, agents seized from Dr. Srivastava's office copies of facsimile transmission ***391** letters directing wire transfers to his bank accounts with the Bank of India. Agents also seized from Dr. Srivastava's residence a facsimile transmission from a brokerage firm that appeared to list stock transactions for 1998, as well as spreadsheets from his financial records that showed capital gains of close to $40 million for tax year 1999.

After the searches were completed, SA Marrero forwarded to the United States Attorney's Office a copy of the Bank of India faxes found at Dr. Srivastava's Greenbelt location. The U.S. Attorney's office subsequently related this information to Supervisory Special Agent ("SSA") Brad Whites of the Wheaton, Maryland office of the IRS. On April 23, 2003, SSA Whites met with IRS Special Agent ("SA") Meredith Louden, and suggested to her that these faxes, which showed monies going to India, suggested a possible "FBAR" violation. [6] Acting upon this information, SA Louden contacted SA Marrero, who apprised her of the agents' discovery of the papers showing substantial wire transfers to India, [7] and informed her that, on the copies of his 1999, 2000, and 2001 personal tax returns found at his residence, Dr. Srivastava had not checked the appropriate block on the Schedules B to acknowledge these foreign accounts. SA Marrero proceeded to fax SA Louden six pages of documents, which included copies of the wire transfers found by the seizing agents. SA Louden subsequently began an investigation into possible FBAR violations, which ultimately led to a formal investigation regarding possible tax fraud committed by the Defendant.

MOTION TO SUPPRESS

[1] Under the Fourth Amendment to the United States Constitution,

> [t]he right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place

> to be searched, and the persons or things to be seized.

***392** U.S. Const. Amend. IV; *United States v. Stevenson,* 396 F.3d 538, 545 (4th Cir.2005). The so-called "Warrant Clause" of the Fourth Amendment "categorically prohibits the issuance of any warrant except one *particularly describing* the place to be searched and the persons or things to be seized." *Maryland v. Garrison,* 480 U.S. 79, 84, 107 S.Ct. 1013, 94 L.Ed.2d 72 (1987)(internal quotations omitted)(emphasis added).

[2] The particularity requirement circumscribes officers' ability to conduct a general search; "by limiting the authorization to search to the specific areas and things for which there is probable cause to search, the requirement ensures that the search will be carefully tailored to its justifications, and will not take on the character of the wide-ranging exploratory searches the Framers intended to prohibit." *Id.* at 84, 107 S.Ct. 1013. Therefore, the particularity requirement "prevents the seizure of one thing under a warrant describing another," and prevents "a general, exploratory rummaging" into a person's property by leaving nothing to the discretion of executing officers. *United States v. Janus Industries,* 48 F.3d 1548, 1553–54(10th Cir.1995); *see also Marron v. United States,* 275 U.S. 192, 196, 48 S.Ct. 74, 72 L.Ed. 231 (1927).

[3] **[4]** Subject to the exceptions discussed below, evidence seized outside the scope of a warrant must be suppressed. *See Weeks v. United States,* 232 U.S. 383, 392–94, 34 S.Ct. 341, 58 L.Ed. 652 (1914)(overruled on other grounds). In those circumstances where officers "grossly exceed the scope of a search warrant in seizing property," a search will be invalidated in its entirety, and all evidence seized will be suppressed. *United States v. Uzenski,* 434 F.3d 690, 706 (4th Cir.2006). Such "blanket suppression is warranted where the officers engage in a 'fishing expedition for the discovery of incriminating evidence.' " *Id.*

I. Do the financial documents seized from Dr. Srivastava's residence and offices fall within the scope of the warrant?

[5] Dr. Srivastava asserts that agents exceeded the scope of the warrant in conducting their searches and seizing certain financial documents. Noting that there must be some logical nexus between the items named in the warrant and any unnamed evidence seized during the search, *see, e.g., United States v. Gentry,* 642 F.2d 385, 387 (10th Cir.1981), Dr. Srivastava asserts that the documents seized that the government now seeks to use against him in its tax prosecution had no nexus to the business records listed in the warrant or to health care fraud. The government's position, taken in its opposition to Dr. Srivastava's motion and again at the evidentiary hearing before the undersigned, is that the warrant authorized agents to seize financial records that *either* related to the defendant's business *or* constituted evidence of violations of 18 U.S.C. § 1347.

The government's view of the scope of the warrants is simply untenable. The "Items to be Seized" listed by the warrant were defined as various categories of records *"related to the business of Dr. Pradeep Srivastava ... which may constitute evidence of violations of Title 18, United States Code, Section 1347."* (emphasis added) As such, agents were not entitled to seize *any* financial record of any kind, but rather could only seize documents that related to Dr. Srivastava's business *and* that may show in some way that health care fraud had been committed. This view is further supported by the fact that SA Marrero provided Judge Connelly with an affidavit supporting his suspicions that Dr. Srivastava, through his medical practice, ***393** had engaged in health care fraud. These possible violations were the only things for which the government had probable cause to search. Accordingly, the warrants specifically delineated that they authorized the search and seizure of evidence *related to this subject matter* by specifying in the introduction of the warrant that agents were authorized to seize ten categories of documents "including but not limited to, financial, business, patient, insurance and other records related to the [medical practice] ... *which may constitute evidence of violations of ... Section 1347."* (emphasis added) Therefore, in order to fall within the scope of the warrant, a financial record not only had to have some relationship to Dr. Srivastava's business, but it also was subject to the requirement that it may constitute evidence that health care fraud had been committed.

This is not an overly-technical view of this warrant.[8] In *United States v. Debbi,* 244 F.Supp.2d 235 (S.D.N.Y.2003), the District Court for the Southern District of New York reached such a conclusion in a case involving strikingly similar facts. In *Debbi,* a magistrate judge approved a warrant that authorized the seizure of various treatment records, claim records, financial records, etc., limited to items "in furtherance of: (1)

obstruction of justice; (2) the commission of health care fraud and which relate to patients who are covered by Medicare and Medicaid insurance or patients who reside at adult homes." *Id.* at 236. In executing the warrant, the officers seized "numerous personal files (both electronic ***394** and paper), general correspondence, financial records, and records relating to Debbi's private patients, i.e., non-Medicare patients who do not reside in adult homes, not to mention numerous records of Mrs. Debbi." *Id.* at 236–37 (internal quotations omitted). Evaluating the Defendant's motion to suppress, the court observed

[G]ood faith reliance on a Magistrate's determination of probable cause is no basis to ignore

> the plain language of a warrant describing, as required by the Fourth Amendment, what is to be searched and seized; and what here saved the otherwise very broad warrant issued by the Magistrate Judge from overbreadth was its explicit command that the items to be seized be limited to evidence of either obstruction of justice or the commission of health care fraud.

Id. at 237. The court concluded that the materials seized from the Defendant's home, including "personal and religious files, general correspondence, family financial records, private patient records, etc .... plainly fell outside these parameters." *Id. Accord United States v. Duong,* 156 F.Supp.2d 564, 572 (E.D.Va.2001)(search warrant authorizing evidence relating to robbery plans didn't authorize seizure of personal financial and other papers). So too here, Defendant's brokerage statements, financial spreadsheets, faxes to his CPA, faxes to his bank, and other documents do not in any way relate to the subject matter of the warrant—health care fraud. [9]

[6] The affidavit submitted in support of the warrants in this case detailed suspected health care fraud. This is the only subject for which the police had probable cause to search and seize evidence. *Accord Janus Industries,* 48 F.3d at 1553–54 (noting that the particularity requirement "ensures that a search is confined in scope to particularly described evidence relating to a specific crime for which there is demonstrated probable cause."). As the court in *Debbi* suggested, in a case where there is probable cause only to suspect health care fraud, a search warrant lacking this subject matter limitation would run afoul of the Fourth Amendment particularity requirement by allowing the seizure of *any* business record. *See Debbi,* 244 F.Supp.2d at 237; *see also United States v. Hickey,* 16 F.Supp.2d 223, 240 (E.D.N.Y.1998)(in RICO case, the "unstructured mandates" of warrants authorizing officers to "search all of the business records of each of the defendant corporations and to seize any items that constituted evidence of *any* crime regardless of its nature" were "clearly violative of the Fourth Amendment."); *Coolidge v. New Hampshire,* 403 U.S. 443, 467, 91 S.Ct. 2022, 29 L.Ed.2d 564 (1971) (particularity requirement is designed to prevent "a general exploratory rummaging in person's belongings" by focusing the officer conducting the search on the items that are authorized to be seized at a designated location).

[7] The fact that officers executing the search warrants in this case were faced with many personal records does not excuse them from complying with the restrictions and qualifications listed in the warrant. Other courts have observed that "the wholesale seizure for later detailed examination of records not described in a warrant is significantly more intrusive, and has been characterized as 'the kind of investigatory dragnet that the fourth amendment was designed to prevent.' " *United* ***395** *States v. Tamura,* 694 F.2d 591, 595 (9th Cir.1982)(citing *United States v. Abrams,* 615 F.2d 541, 543 (1st Cir.1980)); *accord United States v. Shilling,* 826 F.2d 1365, 1369 (4th Cir.1987)(acknowledging substantial practical problems presented by task of examining "the mass of [defendant]'s records," but noting that "we cannot easily condone the wholesale removal of filing cabinets and documents not covered by the warrant"). *Compare United States v. Sawyer,* 799 F.2d 1494, 1509 (11th Cir.1986)(in executing warrant for business records indicating scheme to defraud investors, agents carefully confined the search to scope of warrant; agents were instructed that personal records of individuals and other businesses should not be seized; during the search, agent reviewed items seized and determined a quantity of records not covered by the warrant and left them on the premises; employees were allowed to segregate and remove their personal items; documents seized consisted only of business records likely to reveal a pervasive scheme to defraud investors, as specified in the warrant). [10]

To be abundantly clear, the Court finds that the personal financial documents seized from Dr. Srivastava, including his personal bank accounts, spreadsheets reflecting his stock transactions, 1099 forms, etc., *see* Footnote 5, neither tended to show violations of the health care fraud statute, nor related to the business of Dr. Srivastava. At least one document arguably may have related to the business of Dr. Srivastava—the fax to the Bank of India that was recovered from Dr. Srivastava's Greenbelt medical office. However, nothing about this document on its face connotes or suggests evidence of health care fraud. The only suggestion offered by the government that this fax fell within the scope of the warrant can be reduced to the argument that someone who commits health care fraud has to put the money *someplace,* therefore the document *could* show something related to the crime for which the warrant was sought. This justification is unacceptable, as there is no limiter to this interpretation. Under this view, *any* receipt, purchase order, bank statement, might be seized because it might show what Dr. Srivastava may have done with his allegedly illicit funds. This Court is unwilling to accept this limitless interpretation, which would allow the seizure of receipts showing the purchase of a family vacation, a motorcycle, even new articles of clothing as "evidence tending to show violations of 18 U.S.C. § 1347."

Additionally, the government's purported explanation that the agents were interested in the Bank of India faxes because they could possibly show "proceeds" of the alleged health care fraud is unavailing. The affidavit swore out facts suggesting that Dr. Srivastava billed for procedures that were not actually performed, engaged in "double billing" (billing separately for two procedures which should be billed under one code), and falsely diagnosed allegedly healthy individuals with certain cardiac ***396** conditions that justified unnecessary treatment. There is not a single word in SA Marrero's affidavit relating to what Dr. Srivastava may have done with the monies he received as payment for his procedures, nor does the affidavit discuss how Dr. Srivastava handled his banking. In fact, the affidavit provided no probable cause to search for anything regarding how Dr. Srivastava's personal finances were handled. Furthermore, as counsel for the Defendant noted at the suppression hearing, concerns for proceeds of Dr. Srivastava's alleged crimes would involve *money laundering activities,* activities distinct from health care fraud, and evidence of which was not authorized by the warrant here.

This Court therefore finds that the seizure of the Bank of India faxes was not authorized by the warrant. While these documents may have legitimately appeared to be records of the business since they were found on the fax machine of one of Dr. Srivastava's medical offices and were sent on business letterhead, nothing about them could be seen as suggesting possible violations of 18 U.S.C. § 1347. Proceeds handling is not a crime that § 1347 describes, and the warrant simply did not authorize agents to seize anything related to money on the hope that it could show evidence of health care fraud.

Under the facts of this case, the government is stuck between the proverbial rock and a hard place. On one hand, if the warrant is read true to all of its terms and limitations, the agents were only allowed to seize records of the business that tended to evidence health care fraud violations—which Dr. Srivastava's personal and financial papers clearly did not. If, on the other hand, this Court were to accept the government's suggestion that the warrant should be read broadly to allow the seizure of virtually *any* financial document of the Defendant (business or otherwise), the scope of the warrant would become overbroad and violate the particularity requirement of the Fourth Amendment. This Court should construe a warrant in the most commonsense way, which limits the search/seizure to business records that tend to show health care fraud was committed. *Accord Debbi,* 244 F.Supp.2d at 237. This view is not only proper because it is the most sound reading of the warrant, but also because it is the only reading of the warrant that would allow it to be particular enough to avoid problems of overbreadth. Read in this way, the seizure of personal and financial non-business papers of Dr. Srivastava was not authorized by the terms of the warrant, and such evidence therefore must be suppressed unless it is within the scope of one of the exceptions discussed below. [11]

II. Did seizing agents grossly exceed the scope of the warrant?

[8] **[9]** **[10]** **[11]** Even if this Court were to find that some of the documents at issue here were within the scope of the warrant, these documents would be excluded as well ***397** because the conduct of the agents who executed this warrant was so inappropriate as to warrant the exclusion of *all* evidence seized on March 21, 2003. As discussed above, the particularity requirement of the Fourth Amendment is designed to "prevent the seizure of one thing under a warrant describing another." *Marron,* 275 U.S. at 196, 48 S.Ct. 74. The Fourth Amendment also extends to the *execution* of search warrants, "such that officers cannot 'grossly exceed the scope of the search warrant in *seizing* property.' " (emphasis in original) *Uzenski,* 434 F.3d at 706, quoting *United States v. Foster,* 100 F.3d 846, 849–50 (10th Cir.1996)(internal citations and quotations omitted). "As a general rule, if officers executing a search warrant exceed the scope of the warrant, only the improperly-seized evidence will be suppressed...." *United States v. Squillacote,* 221 F.3d 542, 556 (4th Cir.2000). However, "[i]n extreme circumstances even properly seized evidence may be excluded when the officers executing the warrant exhibit a flagrant disregard for its terms." *Id.,* citing *United States v. Ruhe,* 191 F.3d 376, 383 (4th Cir.1999) (internal quotation marks omitted). "When law enforcement officers grossly exceed the scope of a search warrant in seizing property, the particularity requirement is undermined and a valid warrant is transformed into a general warrant thereby *requiring suppression of all evidence* seized under that warrant." *United States v. Medlin,* 842 F.2d 1194, 1198–99 (10th Cir.1988)(emphasis added); *see also Uzenski,* 434 F.3d at 706 ("Blanket suppression is ... appropriate where the warrant application merely serves as a general subterfuge masking the officers' lack of probable cause for a general search ... or *where the officers 'flagrantly disregard[ ]' the terms of the warrant.*")(emphasis added).

SA Marrero clearly testified at the suppression hearing that he did not consider himself to be bound by the language of the warrant specifying that agents were to seize only evidence which tended to show violations of § 1347 *and* was a record of Dr. Srivastava's business. When questioned about his view of the warrant, and why he did not consider himself bound by the substantive introductory language that clearly circumscribed the legal scope of the agents' search, SA Marrero provided astonishing testimony in which he indicated that he inserted this boilerplate language merely as a "go by," and that he did not consider it to limit his actions in any way.[12] When asked if it was true that he "didn't give much thought to what this meant" and whether he "just thought it was something some boilerplate that ought to be" in the warrant, SA Marrero agreed "for the most part," stating only that he "knew it was used before so it was appropriate language." Marrero Tr. 39:11–19.

Throughout his testimony, SA Marrero was unequivocal in his belief that he did not consider himself to be limited to seizing business items only, or records that tended to show evidence of violations of the health care fraud statute. In fact, SA Marrero indicated that he *intended* to seize personal financial records and "didn't intend to limit the financial records to business records." Marrero Tr. 42:1–2. Responding to cross examination inquiring about whether he thought the limiting language of the warrant had any meaning, SA ***398** Marrero stated "being here I didn't mean to limit the items to just items relating to the business. Otherwise I would not have included the items in paragraph five that's clearly not related to the business."[13] Marrero Tr. 34:18–21. At the suppression hearing, SA Marrero even went so far as to suggest that the warrant language limiting the search to business records that showed health care fraud was "just an expression," and that "after reading [the warrant] over and over again [he] [still] d[id]n't believe after reading it it limits it to items related to the business." *Id.* 35:7–10. It is clear that SA Marrero was unequivocal in his belief that the limiting ***399** words of the warrant were meaningless to him and that he "did not intend to limit [the search or the warrant] to just business records." *Id.* 36:1–3.

For SA Marrero, the "go by" may have only existed for consistency's sake or as a mere formality, but for the judge who issued the warrants and for this Court, this language is certainly not meaningless. As discussed above, the subject matter limitation of evidence related to health care fraud and the limitation that financial papers seized be related somehow to the medical practice of Dr. Srivastava were limitations necessary to make the warrant comport with the particularity requirement of the Fourth Amendment. Nevertheless, SA Marrero approached, and counseled other agents to approach, the search in a way that authorized the seizure of virtually any document of Dr. Srivastava. Simply stated, his view was "whatever financial records if it has [Dr. Srivastava's] name on it ... the judge gave us the authority to seize financial records [and] we could take it." Marrero Tr. 44:2–4.[14]

SA Marrero's view that he had limitless power to seize virtually anything from Dr. Srivastava's home and business is, at best, troublesome.[15] SA Marrero's expansive view of the warrants and his related approach to the searches, which he imparted to all agents who participated, created a situation where executing agents grossly exceeded the scope of the search warrants. [16] This Court is mindful that it is a ***400** rare situation indeed where agents are found to be so excessive in their execution of a search warrant that blanket suppression is warranted, but in light of SA Marrero's alarming testimony, the undersigned finds inexorable the conclusion that this rare remedy is appropriate in this case. *Accord United States v. Robinson,* 275 F.3d 371, 382 (4th Cir.2001)(blanket suppression appropriate when "searching officers may be said to have flagrantly disregarded the terms of a warrant [by] engag[ing] in 'indiscriminate fishing' for evidence"). This is not a case where "some seized items were not identified in the warrant," or where "agents exceeded the limits of their authority under the warrant based on practicality considerations or mistake." *Uzenski,* 434 F.3d at 707 (citing *Robinson,* 275 F.3d at 382 (finding no flagrant disregard where most items seized that were outside scope of warrant were found within items of greater evidentiary value—e.g., a grocery list found within an address book authorized under the warrant)); *United States v. Chen,* 979 F.2d 714, 718 (9th Cir.1992)(finding no flagrant disregard where agents installed additional surveillance camera based on their mistaken belief that the warrant permitted an extra camera and practicality concerns that the first camera could not capture the entire area).

Authority cited by the government itself supports this proposition. In *United States v. Rettig,* 589 F.2d 418, 421 (9th Cir.1978), a search warrant authorized the seizure of marijuana and related paraphernalia, as well as documentary evidence containing "indicia of the identity of the residents" of the house to be searched. In executing the warrant, officers seized more than 2,000 documents, including "numerous United States government publications, blank applications for various credit cards, bank brochures, medical and dental records, drug store receipts for a period extending over two years prior to the search, photograph slides, undeveloped film, extensive financial records, credit cards and travel documents." *Id.* at 421. Observing that "[a]n examination of the books, papers and personal possessions in a suspect's residence is an especially sensitive matter," the court concluded that "the record establishes that the agents did not confine their search in good faith to the objects of the warrant, and that while purporting to execute it, they substantially exceeded any reasonable interpretations of its provisions." *Id.* at 422–23. So holding, the *Rettig* court concluded that *all* evidence seized during the search must be suppressed. *Id.* at 423. *See also Foster,* 100 F.3d. at 850; *Medlin,* 842 F.2d at 1198 (finding flagrant disregard and granting blanket suppression where officers seized 667 items not specified by the warrant).

Unlike many other cases, this Court believes that the facts here provide "probative indicia of flagrant disregard or bad faith," and therefore finds that the agents' seizure of the many items outside the warrant transformed what should have been a particularized search into a general, unrestricted fishing expedition. *Uzenski,* 434 F.3d at 708. The "rule of excluding all evidence seized in a general search is designed to combat the very mind set displayed by [SA Marrero]. The belief that a search warrant gives an officer free rein to search and seize cannot be tolerated." *United States v. Larson,* 1995 WL 716786, at *7 (D.Kan. Nov.16, 1995). Condoning SA Marrero's conduct would be "to invite a government official to use a seemingly precise and legal warrant only as a ticket to get into a man's home, and, once inside, to launch forth upon unconfined searches and indiscriminate seizures as if armed with all the unbridled and illegal power of a general warrant." *Stanley v. Georgia,* 394 U.S. 557, 572, 89 S.Ct. 1243, 22 L.Ed.2d 542 (1969)(Stewart, J. concurring). Such an unconfined search and indiscriminate ***401** seizure is precisely what happened here. Because this Court concludes that SA Marrero approached the searches of Dr. Srivastava's home and offices in a way that flagrantly exceeded the specific limitations of the warrants, and that the agents grossly exceeded the scope of the warrants in their execution, [17] all evidence seized in the March 21, 2003, searches must be suppressed, unless saved by an applicable exception to the exclusionary rule.

III. Can the illegally seized documents nevertheless be admitted under any exception to the exclusionary rule?

If the evidence taken from Dr. Srivastava's home was not in fact properly seized—either because it was not within the scope of the warrant, or because the searches as a whole were so grossly overbroad as to make all documents seized inadmissible-all fruits derived therefrom must be suppressed. *Wong Sun v. United States,* 371 U.S. 471, 485–86, 83 S.Ct. 407, 9 L.Ed.2d 441 (1963). However, in some cases evidence derived from an illegal search may avoid exclusion if it is sufficiently attenuated to dissipate the taint of the initial violation. *United States v. Ceccolini,* 435 U.S. 268, 274–75, 98 S.Ct. 1054, 55 L.Ed.2d 268 (1978)(declining to adopt a "per se" or "but for" rule making inadmissible any evidence that came to light through a chain of causation beginning with a constitutional violation). As the Supreme Court recently observed in *Hudson v. Michigan*,

> The exclusionary rule generates "substantial social costs," *United States v. Leon,* 468 U.S. 897, 907, 104 S.Ct. 3405, 82 L.Ed.2d 677 (1984), which sometimes include setting the guilty free and the dangerous at large. We have therefore been "cautio[us] against expanding" it, *Colorado v. Connelly,* 479 U.S. 157, 166, 107 S.Ct. 515, 93 L.Ed.2d 473 (1986), and "have repeatedly emphasized that the rule's 'costly toll' upon truth-seeking and law enforcement objectives presents a high obstacle for those urging [its] application," *Pennsylvania Bd. of Probation and Parole v. Scott,* 524 U.S. 357, 364–365, 118 S.Ct. 2014, 141 L.Ed.2d 344 (1998) (citation omitted). We have rejected "[i]ndiscriminate application" of the rule, *Leon, supra,* at 908, 468 U.S. 897, 104 S.Ct. 3405, 82 L.Ed.2d 677, and have held it to be applicable only "where its remedial objectives are thought most efficaciously served," *United States v. Calandra,* 414 U.S. 338, 348, 94 S.Ct. 613, 38 L.Ed.2d 561 (1974)-that is, "where its deterrence benefits outweigh its 'substantial social costs,' " *Scott, supra,* at 363, 524 U.S. 357, 118 S.Ct. 2014, 141 L.Ed.2d 344 (quoting *Leon*, supra, at 907, 468 U.S. 897, 104 S.Ct. 3405, 82 L.Ed.2d 677).

547 U.S. 586, 126 S.Ct. 2159, 2163, 165 L.Ed.2d 56 (2006). In this case, the government contends that even if the Court finds that agents exceeded the scope of the warrant, such evidence could still be admissible under either the "independent source" or "inevitable discovery" doctrines. Each of these two doctrines will be discussed in turn.

A. Inevitable discovery

[12] [13] [14] Under the inevitable discovery doctrine, information obtained by unlawful ***402** means is nonetheless admissible "[i]f the prosecution can establish by a preponderance of the evidence that the information ultimately or inevitably would have been discovered by lawful means." *Nix v. Williams,* 467 U.S. 431, 444, 104 S.Ct. 2501, 81 L.Ed.2d 377 (1984). "[T]he exception requires the district court to determine, viewing affairs as they existed at the instant before the unlawful search, what would have happened had the unlawful search never happened." *United States v. Eng,* 997 F.2d 987, 990 (2d Cir.1993) (citations and quotations omitted). Such a finding of "inevitable discovery involves no speculative elements but focuses on demonstrated historical facts capable of ready verification or impeachment." *Nix,* 467 U.S. at 444–45, 104 S.Ct. 2501.

Although the government initially asserted that the inevitable discovery exception might save the evidence at issue in this case, it conceded at oral argument that such an exception is not applicable here. This concession was wise. Although some may envision a behemoth IRS computer that meticulously checks every person's 1099s against income reported on their returns (1040s), this is simply not the case, as the government now concedes.[18] SA Louden of the IRS testified at the evidentiary hearing that to expect the IRS to automatically notice even extremely large discrepancies would be "giving the IRS too much credit as far as what their capabilities are. No offense on the civil side but, I mean, it's—the program is not perfect. The database is not perfect." Louden Tr. 41:18–21.[19] SA Louden later acknowledged that at the time that she began looking into Dr. Srivastava's affairs, there was a lot of discussion in the IRS about the fact that the audit rate was so low, a fact attributable in part to the fact that "[t]he IRS was short staffed." Louden Tr. 45:7–15.

In light of this, the government cannot point to any historical and demonstrable facts that justify admitting the documents gathered in the IRS investigation pursuant to the inevitable discovery exception. The government does not, and indeed cannot, make the argument that there was any (much less a sufficiently developed) tax evasion investigation in existence prior to the search of Dr. Srivastava's home and office, and that this investigation would have inevitably gleaned the evidence that the government now seeks to offer against him. This is not, therefore, a situation where "the fact making discovery inevitable ... arise[s] from circumstances other than those disclosed by the illegal search itself." *United States v. Thomas,* 955 F.2d 207, 211 (4th Cir.1992).

Furthermore, it cannot be credibly claimed that the improper seizure of Dr. Srivastava's personal and financial documents "played no real part" in the subsequent IRS investigation and discovery of evidence supporting criminal tax evasion charges. *See* ***403** *United States v. Whitehorn,* 813 F.2d 646, 649 n. 4

(4th Cir.1987), *cert. denied* 487 U.S. 1234, 108 S.Ct. 2898, 101 L.Ed.2d 931 ("the premise of the inevitable discovery doctrine is that the illegal search played no real part in discovery of incriminating evidence. Only then, if it can be shown that the taint did not extend to the [subsequent investigation] would the product of the [subsequent investigation] be admissible.") This key limitation, which prevents the government from profiting from its own wrongdoing, is noticeably absent here. The government does not point to any facts supporting the contention that absent the documents seized from Dr. Srivastava's home and business, the IRS would have inevitably investigated him and uncovered all of the evidence at issue. The mere fact that the IRS *might* have audited Dr. Srivastava at some point in the future is insufficient, as the inevitable discovery doctrine requires proof that the evidence *would* have, not merely could have, been discovered.[20] *Morris,* 684 F.Supp. at 416; *see also United States v. Ford,* 184 F.3d 566, 578 (6th Cir.1999)(rejecting inevitable discovery exception when testimony showed that IRS was not actively investigating defendant's tax records or was otherwise "hot on the trail of the disputed evidence"); *Thomas,* 955 F.2d at 211 (finding inevitable discovery doctrine did not permit admission of evidence seized after surveillance had been set up following illegal entry into defendant's hotel room; "the bank money found in the illegal search changed the whole nature of the investigation that followed.").

B. Independent Source

[15] **[16]** The independent source doctrine provides another exception to the exclusionary rule. The Supreme Court has held that merely because evidence is unlawfully acquired, "this does not mean that the facts thus attained become sacred and inaccessible. If knowledge of them is gained from an independent source, they may be proved like any others...." *Silverthorne Lumber Co. v. United States,* 251 U.S. 385, 392, 40 S.Ct. 182, 64 L.Ed. 319 (1920). The independent source doctrine rests "upon the policy that, while the government should not profit from its illegal activity, neither should it be placed in a worse position than it would otherwise have occupied." *Murray v. United States,* 487 U.S. 533, 542, 108 S.Ct. 2529, 101 L.Ed.2d 472 (1988). As the Supreme Court observed in *Nix,*

> [T]he interest of society in deterring unlawful police conduct and the public interest in having juries receive all probative evidence of a crime are properly balanced by putting the police in the same, not a *worse,* position than they would have been in if no police error or misconduct had occurred.... When the challenged evidence has an independent source, exclusion of such evidence would put the police in a worse position than they would have been in absent any error or violation.

467 U.S. at 443, 104 S.Ct. 2501. This doctrine saves from exclusion evidence that has been discovered by means "wholly independent of any constitutional violation." *Id.* Put another way, where agents engage in investigative activity that is later determined to be illegal, evidence is still admissible if discovered through a source independent of the illegality. *See Murray,* 487 U.S. at 537, 108 S.Ct. 2529.

[17] **[18]** **[19]** **[20]** To evaluate whether the independent source exception applies, the Court must determine "whether, granting establishment of the primary illegality, the ***404** evidence to which the instant objection is made has been come at by exploitation of that illegality or instead by means sufficiently distinguishable to be purged of the primary taint."[21] *Wong Sun,* 371 U.S. at 488, 83 S.Ct. 407. Relevant factors include (1) the time between any illegal action and the later acquisition of evidence, (2) intervening circumstances and (3) the purpose and flagrancy of the official misconduct. *Brown v. Illinois,* 422 U.S. 590, 603–04, 95 S.Ct. 2254, 45 L.Ed.2d 416 (1975); *United States v. Seidman,* 156 F.3d 542, 548 (4th Cir.1998). Courts must "careful[ly] sift[ ] [through] the unique facts and circumstances" of each case to make a finding with respect to whether the alleged "independent" source is sufficiently attenuated. *Schneckloth v. Bustamonte,* 412 U.S. 218, 233, 93 S.Ct. 2041, 36 L.Ed.2d 854, (1973). The ultimate burden of proving admission of tainted evidence rests on the government. *Seidman,* 156 F.3d at 548 (citing *Schneckloth,* 412 U.S. at 238, 93 S.Ct. 2041).

1. The development of the allegedly "independent" IRS investigation

[21] As discussed above, agents executing the search of Dr. Srivastava's Greenbelt office came upon faxes confirming the transfer of funds to an account at the Bank of India. Elton Malone, the search warrant team leader at the Greenbelt site, called SA Marrero on his cell phone while Marrero was conducting the search at Dr. Srivastava's Oxon Hill office and informed him that one of the agents located faxes showing transactions overseas involving foreign bank accounts. Marrero Tr. 9:17–22. Agent Malone indicated that the transactions appeared to involve a substantial amount of money, and asked SA Marrero if he was aware of this. SA Marrero informed him that he was not, but would inform the Assistant United States Attorney handling Dr. Srivastava's case; he did so the same day.

On April 23, 2003, the United States Attorneys' Office related this information to SSA Bradley Whites, the IRS agent in charge of the agency's Wheaton, Maryland office. Specifically, the United States Attorneys' Office informed SSA Whites that there was some evidence of significant money going overseas and that it did not appear that the appropriate box on Dr. Srivastava's Schedule B had been checked. Louden Tr. 2:21–3:1. SSA Whites met with SA Louden, related this information, provided her with SA Marrero's name and phone number, and asked her to follow up with Marrero. Louden Tr. 4:21–22. This same day, SA Louden spoke with SA Marrero regarding the faxes showing the transfer of money to the State Bank of India, and later that same day SA Marrero faxed SA Louden these papers. After receiving this information, SA Louden requested information on Dr. Srivastava using the IRS' Integrated Data Retrieval System (“IDRS”), a database that allows the agency to view online tax return information. Louden Tr. 6:13–17. SA Louden also testified that she looked into the treasury enforcement communication system to verify if Dr. Srivastava had disclosed any foreign bank accounts, and observed that he had not. Louden Tr. 8:1–8.

***405** SA Louden received Dr. Srivastava's IDRS information on April 25, and certain information on the IDRS summary sheet caught her eye. SA Louden testified that the summary sheet on the IDRS printout normally displays how many dollars in interest income the taxpayer earned, but in this case, the section of the report that displayed income from 1099B activity (stock and bond activity), displayed only stars (“ * * * * * ”) and no numerical data. After consulting with someone more familiar with the IDRS system, SA Louden learned that the stars represented an extremely large number that was too big to print on the summary form. Louden Tr. 9:15–24. To receive further information, on April 25, 2003, SA Louden requested a second round of IDRS so that she could examine the detailed information from Dr. Srivastava's 1099 B forms (which show capital gains). SA Louden testified that she received the 1099 B information relating to the capital gains on June 12, 2003. Louden Tr. 11:25. On July 10, 2003, SA Louden began to do a comparison with the Dr. Srivastava's 1099Bs and his reported tax returns.

On May 19, 2003, the United States Attorneys' Office formally invited the IRS to join the existing grand jury investigation into Dr. Srivastava. Once the tax and health care fraud investigations were joined, SA Louden requested (through the United States Attorneys' Office) that the grand jury issue several subpoenas to banks with whom Dr. Srivastava did business; these were issued on June 2, 2003. She testified that in determining what subpoenas to request, “generally the schedule B is a good place” because it gives accounts; SA Louden also indicated that “in this particular case [she] believe[d] that Jason [Marrero] had faxed [her] over some bank accounts that he had identified from the search warrant evidence.” [22] Louden Tr. 14:10–19.

Three days after these subpoenas were issued, SA Louden traveled on June 5, 2003, with IRS SA Grytzer to meet SA Marrero at the Rockville office of HHS. SA Louden testified that during that meeting, the agents examined evidence that Marrero and his team had recovered from the search of Dr. Srivastava's home and businesses. Specifically, she indicated that she and the other agents “went into a ***406** room, and then these boxes were pulled, and [they] basically just looked through the boxes to see kind of what he had and make heads or tails of it.” [23] Louden Tr. 25:1–4. During her review of the documents in SA Marrero's possession, SA Louden examined a fax relating to Dr. Srivastava's Bentley Lawrence accounts. SA Louden testified that this 12 page fax related to the 1998 tax year and showed account transactions and short term capital gains and losses. Louden Tr. 26:12–16. SA Louden further testified that she also reviewed certain spreadsheets in SA Marrero's possession concerning Dr. Srivastava, which contained a record of Dr. Srivastava's financial transactions and “showed few capitol *[sic]* losses but overall capitol *[sic]* gains.” Louden Tr. 27:10–15.

Upon finding these documents, SA Louden testified that her "original thoughts were, I have to validate they're accurate so I had to go through each transaction and make sure it was a legitimate transaction .... using the statements." Louden Tr. 27: 25–28:6. Comparing these documents and spreadsheets against Dr. Srivastava's tax returns, SA Louden found what appeared to be over $40 million in unreported capital gain income. Louden Tr. 28:10–11. As her investigation continued, SA Louden met with Dr. Srivastava's CPA and stockbroker to further her tax investigation. SA Louden then spent several months doing capital gains calculations to recalculate the true gains and losses realized by Dr. Srivastava. Louden Tr. 32:24–33:5. Her efforts culminated in the present indictment alleging income tax evasion and the filing of a false income tax return.

2. Application of the independent source doctrine

Considering the factual development of the IRS investigation, the government contends that this Court need not exclude the financial records seized from Dr. Srivastava's home and business. In addressing the factors set forth in *Brown,* the government asserts that while the IRS investigation was close in time to the execution of the search warrant, it was completely separate and proper. The government explains that:

> days, weeks and months passed between the execution of the warrants and the acquisition of all of the IRS's documentary evidence. There were numerous intervening circumstances, particularly SA Louden's lawful use of IRS investigative resources and grand jury subpoenas. Finally, defendant does not even allege that SA Louden's investigation—the investigation that led to the indictment—involved any official misconduct, let alone intentional or flagrant misconduct. Accordingly, copies of seized documents that were obtained from independent sources during the subsequent IRS investigation should not be suppressed.

As such, the government asserts that notwithstanding any constitutional violations committed in the execution of the warrant, the fruits of the IRS investigation should not be excluded. *See United States v. Watson,* 950 F.2d 505, 508 (8th Cir.1991)("where a law enforcement officer merely recommends investigation of a particular individual based on suspicions arising serendipitously from an illegal search, the causal connection is sufficiently attenuated so as to purse the later investigation of any taint from the original illegality.").

Dr. Srivastava, on the other hand, suggests that in order to be truly independent of evidence seized during an illegal search, there must be *no* causal connection between ***407** the second source of the contested material and the illegal search. *See Segura v. United States,* 468 U.S. 796, 815, 104 S.Ct. 3380, 82 L.Ed.2d 599 (1984)(holding that the independent source exception applied because information possessed by the agents *before* they illegally entered and searched an apartment constituted an independent source for the discovery and seizure of the evidence later challenged). In this case, Dr. Srivastava asserts that the IRS had no knowledge, much less independent knowledge, of Dr. Srivastava's personal financial situation before the HHS agents executed their searches and provided certain items to the IRS. Therefore, he maintains that the tax investigation was not truly "independent."

As is often the case, the truth lies somewhere between these two interpretations. Although the independent source rule can save from suppression evidence that would not have been uncovered "but for" an illegal search (evidence that therefore has *some* causal connection), the doctrine is not as broad as the government asserts. As this Court, Judge Murray presiding, observed in *United States v. Morris,*

> [w]here courts have applied the independent source doctrine to admit evidence arguably tainted by unlawful police conduct, there has been a showing that the evidence *was in fact obtained through an independent source and not through exploitation of the unconstitutional behavior.*

684 F.Supp. 412, 416 (D.Md.1988)(emphasis added). This comports with the Supreme Court's view of the

independent source doctrine. *See e.g., Murray,* 487 U.S. at 542, 108 S.Ct. 2529 (holding that evidence seized pursuant to a subsequently issued warrant, although initially discovered during an illegal search, is admissible so long as "the search pursuant to the warrant was in fact a genuinely independent source of the information and tangible evidence at issue").

An examination of cases where evidence has been admitted under the independent source doctrine illustrates the critical point that, to be admissible under this exception, the so-called independent source must retain a critical degree of separation from the tainted source. In *Segura,* for example, the Supreme Court held that this exception applied because no information obtained during the initial (illegal) entry into the defendant's apartment was needed or used by the agents to secure the warrant under which the disputed evidence was ultimately seized. 468 U.S. at 815, 104 S.Ct. 3380 (1984). The Court concluded that "[t]he illegal entry into the [defendants] home did not contribute in any way to discovery of the evidence ..." because it was "beyond dispute that the information possessed by the agents *before* they entered the apartment constituted an independent source for the discovery and seizure of evidence now challenged." *Id.* at 815–16, 104 S.Ct. 3380. (emphasis added). *See also United States v. Williams,* 400 F.3d 1023, 1025 (7th Cir.2005)(independent source doctrine applied because there was no causal link between the warrantless search of defendant's residence and decision to seek a warrant); *United States v. Walton,* 56 F.3d 551, 554 (4th Cir.1995)(reasoning that a lengthy prior investigation of the defendant demonstrated the necessary attenuation and independent basis of probable cause to apply the independent source doctrine); *United States v. Curtis,* 931 F.2d 1011, 1014 (4th Cir.1991), *cert. denied,* 502 U.S. 881, 112 S.Ct. 230, 116 L.Ed.2d 186 (1991)(denying motion to suppress because the information used to secure a search warrant was independent of any evidence found during the warrantless search); *United States v. Palumbo,* 742 F.2d 656, 661 (1st Cir.1984)(valid search warrant based entirely ***408** on probable cause learned prior to original, putatively unlawful, entry into defendant's premises), *cert. denied,* 469 U.S. 1114, 105 S.Ct. 799, 83 L.Ed.2d 792 (1985).

[22] These cases suggest that courts apply the independent source doctrine when *untainted evidence* does, in fact, provide an *independent* basis for the discovery of evidence. It is therefore essential that there must have been *an independent basis for the discovery of challenged evidence,* not merely that the information merely *had* an independent existence. *Accord United States v. Brainard,* 690 F.2d 1117, 1126 (4th Cir.1982)(list of defendant's clients and employees improperly obtained by SEC investigator admissible because information in list was independently obtained by materials subpoenaed by the grand jury *prior to* receipt of tainted documents from other investigation); *United States v. David,* 943 F.Supp. 1403, 1417 (finding agents' decision to further investigate defendant was not prompted by discovery of a firearm in the allegedly unlawful search). This view of the independent source rule protects its integrity and prevents this exception from swallowing the exclusionary rule. [24]

[23] In order to be admissible under the independent source doctrine, the connection between the original illegality and the evidence at issue must be sufficiently attenuated so as to dissipate the taint of the illegal search. *See Nardone v. United States,* 308 U.S. 338, 341, 60 S.Ct. 266, 84 L.Ed. 307 (1939). Here, the primary taint has not been purged because the evidence procured by SA Louden clearly "has been come at by exploitation of (the primary) illegality." *Wong Sun,* 371 U.S. at 488, 83 S.Ct. 407. Indeed, the primary illegality was not attenuated, but rather was repeatedly exploited. Only after she received the Bank of India faxes and analyzed those money transfers did SA Louden request the IDRS information on Dr. Srivastava and begin to delve into his tax returns. In fact, SA Marrero specifically informed SA Louden that the boxes on Dr. Srivastava's Schedules B (copies of which SA Marrero seized from his residence) were not checked to reflect his ownership of any foreign bank accounts. This sharing of information is particularly salient in tax cases:

> The unique circumstances of an income tax investigation make a decision to focus intensively of critical importance. As opposed to crimes like assault or robbery, tax evasion is hidden. There are at least hundreds of thousands of tax violators whose criminality has not been revealed. One of the chief problems for the government is to decide how it is going to utilize its limited tax investigation forces. The main hope of a tax

> violator is that the Internal Revenue Service will remain unaware of his existence. Once the government begins to concentrate all its enormous resources on a citizen, the chance of its discovering that he has violated the tax laws is greatly multiplied. It is difficult to perceive how the government could receive any more valuable information than the name of a probable tax violator.

United States v. Schipani, 289 F.Supp. 43, 62–63 (E.D.N.Y.1968)(overruled on other grounds). SA Louden exploited the information provided to by SA Marrero by using it to seek IRDS information, and later recover copies of Dr. Srivastava's tax returns and other financial papers. This ***409** evidence therefore cannot be considered independent.

The government cites to the Eighth Circuit case of *United States v. Watson* for the proposition that "where a law enforcement officer merely recommends an investigation of a particular individual based on suspicions arising serendipitously from an illegal search, the causal connection is sufficiently attenuated so as to purge the later investigation of any taint from the original illegality." 950 F.2d 505, 508 (8th Cir.1991). Another district court later recognized, however, that the *Watson* Court did not explicitly apply the *Wong Sun* standard. *See Larson,* 1995 WL 716786 at *8. *Larson* is factually similar to this case; there, officers reviewed illegally seized documents which revealed that defendant had transacted with numerous financial institutions using various aliases, and discovered the names of several financial instructions dealing with the defendant. Acting on this information, law enforcement visited the financial institutions and subpoenaed their records listing defendant and his aliases; the government later sought to admit this evidence against defendant at trial. Considering this factual development, the *Larson* court concluded that the evidence was not sufficiently attenuated because "the information in the illegally seized documents was exploited to obtain the financial records for which the government seeks admission." *Id.* at *9. The government attempted to argue that the financial records were obtained by sufficiently distinguishable means because they were secured through grand jury subpoenas. The court disagreed, noting that at least some of the documents produced to the grand jury were copies of the very documents that were illegally seized. The court concluded that "the government's choice to use the documents produced in response to the grand jury subpoena does not render perforce those documents 'obtained by means sufficiently distinguishable from the prior illegality.' "[25] *Id.*

Such is the case here. Although the evidence illegally seized from Dr. Srivastava's home and offices subsequently has been obtained through SA Louden's investigation and grand jury subpoenas, this is not sufficiently attenuated to justify its admission. As in *Larson,* SA Louden exploited the information in the illegally seized documents to obtain the financial records that the government now seeks to admit. It is only because of the exploitation of the information displayed in the Bank of India faxes and taxpayer copies of Dr. Srivastava's tax forms (which were examined by seizing agents) that SA Louden initiated her IDRS request. Furthermore, SA Louden twice admitted at the suppression hearing that she received specific bank names from SA Marrero indicating which financial institutions she should subpoena for further information. *See* Louden Tr. 14:10–19 (stating that to determine what subpoenas to request the U.S. Attorneys office issue, "in this particular case I believe that Jason [Marrero] had faxed me over some bank accounts that he had identified from the search warrant evidence."); Louden Tr. 16:6–15 ("Some of this information [used to determine what financial institutions to subpoena] came from Jason [Marrero]"). Finally, SA Louden also testified that once her investigation began she actually met with SA Marrero and reviewed the seized documents in HHS custody. In perusing these boxes, SA Louden uncovered a fax regarding capital gains from 1998 and several spreadsheets showing capital gain income ***410** *which she then utilized to compare against Dr. Srivastava's filed tax returns and uncover discrepancies.*

In this case, there is not just an initial taint; instead, the taint here is *continuous.* In light of this initial and continual taint, the Court is nonplussed by the government's suggestion that because the IRS investigation secured copies of the documents initially seized, the documents need not be suppressed. The financial and tax documents that the government seeks to introduce at trial, even if they are later-acquired *copies* of the documents illegally seized during the March 20th search, are off limits because they were not obtained by means sufficiently distinguishable from the prior illegality.[26]

Although the government cited *United States v. Najjar* only parenthetically in its opposition to Dr. Srivastava's motion, it sought to rely primarily on this case at the suppression hearing to support the proposition that the independent source doctrine saves the documents at issue here from exclusion. 300 F.3d 466 (4th Cir.2002). In *Najjar,* a defendant sought suppression of evidence obtained through two warrants, arguing that much of the evidence used to secure these warrants derived from the execution of an invalid search. Officers investigating a chopshop had conducted a search that was later found to be illegal; those officers shared automobile salvage certificates found during the first illegal search with another law enforcement officer, who began an internal investigation ***411** into another officer. These salvage certificates were ultimately dead ends because the investigating officer found no log records or incident reports to trace the certificates to activities of the person under investigation. The investigator then had to regroup and approached his investigation from another angle, broadening his inquiry into other illicit activities similar to those suggested by the illegally seized certificates. In light of these facts, the *Najjar* court rejected defendant's contention that suppression was necessary merely because "the illegally obtained evidence tended significantly to direct the evidence in question." *Id.* at 479.

Several critical distinctions emerge between the facts of *Najjar* and the facts of this case. First, in *Najjar,* the government did not seek to introduce the illegally seized salvage certificates, but rather sought the admission of *other* evidence that came to light through later independent investigation. In comparison, here the government seeks to introduce *the very evidence that was illegally seized in the first instance.* Second, in this case there was no impediment that caused the IRS to reach a dead end and begin a new investigative chain. In *Najjar,* the court explicitly found that the "investigation was not a simple matter of looking at salvage certificates and obtaining new evidence from their use, rather it was a substantial investigative effort unconnected to the seized documents themselves once [the investigating officer] encountered the impediment at the Maryland State Police barracks." *Id.* at 479. Here, SA Louden's investigation *was* "a simple matter of looking at [the Bank of India faxes] and obtaining new evidence from their use." *Id.* There was no impediment leading to a totally new investigative focus; rather, each piece of evidence was acquired in direct response to analysis of the previous information. All of this is directly traceable, with no attenuation, to the evidence illegally seized.

SA Louden's testimony revealed a third, fatal, factor that by itself completely removes this case from *Najjar* and the independent source doctrine. She testified that she based her subpoena requests both on Schedule B information she recovered from the IDRS system *and* on names that SA Marrero provided to her as institutions that would be of interest to her tax investigation. Additionally, nearly two months after her tax investigation commenced, she traveled to an HHS office and met with SA Marrero to review the documents that this Court now holds were illegally seized from Dr. Srivastava. SA Louden perused the documents in SA Marrero's possession, and used spreadsheets and a fax found there to help further flesh out the alleged tax fraud committed by Dr. Srivastava. Using these statements, she discovered an apparent underreporting of $40 million in capital gain income. Louden Tr. 28:6–11. SA Louden's investigation therefore not only started as the fruit of the poisonous tree, but also she returned to the proverbial tree for additional tainted fruit.

Thus, attenuation is not present here because unlike in *Najjar,* there was further significant contact and interaction between the supposedly "independent" investigation and the tainted source. It is one thing to say that a later investigation is sufficiently independent and attenuated when the illegally seized evidence does not directly generate any information for the "independent" source, and there is no continued contact between the "independent" source and the tainted evidence. It is quite another thing to suggest that so long as another government agency secures the same evidence as the tainted evidence, such evidence need not be excluded, even if the "independent" source continued to interact with the tainted evidence. Application ***412** of the independent source doctrine and *Najjar* is unavailing where the illegally seized evidence is used directly and repeatedly to generate the evidence at issue, and the supposedly independent agent returns to the poisonous tree for yet more helpings of the forbidden fruit. *Accord United States v. Pope,* at *4 ("Because the traffic stop was fruit and thus contaminated with illegitimacy, the evidence subsequently secured as a result was thus also unlawfully acquired.").

The Court therefore concludes that the IRS investigation is too closely connected to the initial illegal seizure, and is not "so attenuated as to dissipate the taint" of the illegal seizure. *Nardone,* 308 U.S. at 341, 60 S.Ct. 266. Application of the *Brown* factors supports this conclusion. Here, as a result of the sharing of financial information seized from Defendant, SA Louden of the IRS was conducting a full blown criminal tax investigation within *six weeks* (factor one: time between investigations). SA Louden's investigative techniques detailed by the government cannot possibly be considered to be "intervening circumstances" because they were done in direct response to the information received from SA Marrero. Indeed, SA Louden admitted that she based her subpoena requests in part on SA Marrero's suggestions, and even met with him during her investigation to discuss the evidence and review other documents that were impermissibly seized. Investigating agents here therefore did substantially more than in the cases relied upon by the government, in that SA Marrero recommended an investigation, provided the IRS with documents to start such an investigation, provided the IRS with specific account names, and met with the IRS during the course of its investigation (factor two: intervening circumstances). *Accord Larson,* 1995 WL 716786 at *8 (rejecting application of *Watson* when information in illegally seized documents was pursued and exploited to obtain financial records that government sought to use against defendant). Although there are no allegations of official misconduct on the part of SA Louden, this absence does not make an otherwise closely-related investigation sufficiently attenuated for the purposes of this exception to the exclusionary rule (factor three: official misconduct).

Because all of the investigative steps taken by the IRS were taken, directly or indirectly, as a result of the illegal search, and because the taint of the illegal seizure was reinforced by the continued interaction between SA Marrero and SA Louden, this Court concludes that all documents generated by the IRS investigation are tainted, not independent, and must be excluded.

CONCLUSION

The exclusionary rule has exacted a mighty toll in this case. Although this Court is troubled by its determination that the motion to suppress should be granted, this conclusion was driven by precedent and compelled by the facts of this case. Although it is no doubt unsettling that Dr. Srivastava may escape criminal accountability because of the blunders of law enforcement, this is the rare and unfortunate case where such a price must be paid. As Justice Clark acknowledged, "In some cases, this will undoubtedly be the result. But ... 'there is another consideration—the imperative of judicial integrity.' The criminal goes free, if he must, but it is the law that sets him free. Nothing can destroy a government more quickly than its failure to observe its own laws, or worse its disregard of the charter of its own existence." *Mapp v. Ohio,* 367 U.S. 643, 659, 81 S.Ct. 1684, 6 L.Ed.2d 1081 (1961) (citation omitted). With great disappointment, and for the reasons discussed above, the Court will, by separate order, grant Dr. Srivastava's Motion to Suppress.

*413 *ORDER*

Upon consideration of the Plaintiff's Motion for An Evidentiary Hearing Pursuant to *Franks v. Delaware* and to Suppress Evidence [Paper no. 13], the opposition thereto, the arguments presented by counsel at hearings before the undersigned on March 27, 2006, and June 19, 2006, for the reasons stated on the record on March 27, 2006, and for the reasons stated in the accompanying opinion, it is this 4th day of August, 2006, by the United States District Court for the District of Maryland,

ORDERED, that Plaintiff's Motion for an Evidentiary Hearing Pursuant to *Franks v. Delaware* and to Suppress Evidence [Paper no. 13] is **GRANTED IN PART** and **DENIED IN PART;** and it is further

ORDERED, that Plaintiff's Motion for an Evidentiary Hearing Pursuant to *Franks v. Delaware* and to Suppress Evidence [Paper no. 13] is **DENIED** to the extent it seeks an evidentiary hearing pursuant to *Franks v. Delaware;* and it is further

ORDERED, that Plaintiff's Motion for an Evidentiary Hearing Pursuant to *Franks v. Delaware* and to Suppress Evidence [Paper no. 13] is **GRANTED** to the extent that it seeks the suppression of evidence; and it is further

ORDERED, that all evidence seized by government agents on March 21, 2003, pursuant to three search warrants signed by Magistrate Judge Connelly on March 20, 2003, including but not limited to

1. Spreadsheet detailing options transactions on Bentley–Lawrence ("BL") Account;

2. Spreadsheet detailing stock transactions on BL Account, labeled "Corporate;"

3. Spreadsheet detailing options transactions on Speer Leeds account;

4. Spreadsheet detailing stock transactions;

5. Schedule of realized gains and losses;

6. Form 1099 activity detail for BL account;

7. Form 1099 activity detail for BL account;

8. Form 1099 activity detail for BL account;

9. Fax from CPA requesting information to prepare tax return;

10. Tax reporting statement to support capital gains;

11. Form 1099 activity detail supporting capital gains;

12. Handwritten bank interest and payments statement;

13. Tax reporting statement to support capital gains;

14. Form 1099 activity detail to support capital gains;

15. Fax to CPA detailing BL accounts;

16. Form 1099 activity detail supporting capital gains;

17. Tax reporting statement to support capital gains;

18. Form 1099 activity detail to support capital gains;

19. Tax reporting statement to support capital gains;

20. Fax from CPA requesting items to complete tax return;

21. Handwritten list of dividends and interest from bank accounts;

22. Tax reporting statement to support capital gains;

23. Tax reporting statement to support capital gains;

24. Spreadsheet for capital gains;

***414** 25. Email from stock broker detailing stock activity;

is hereby **SUPPRESSED.**

All Citations

444 F.Supp.2d 385, 98 A.F.T.R.2d 2006-5932

Footnotes

[1] Count I of the indictment alleges that Dr. Srivastava filed an individual income tax return for 1998 on which Schedule D, Capital Gains and Losses, claimed a short-term capital loss of approximately $(826,591) rather than actual short-term capital gains totaling approximately $779,397.00, and filed an income tax return misstating the amount of taxable income and tax due. Count II of the indictment alleges that Dr. Srivastava filed a tax return in 1999 on which Schedule D, Short Term Capital Gains and Losses, reflected a short-term capital loss of $(990,288.00) rather than the actual short-term capital gain of $41,408,740, and accordingly filed a false income tax return that year reflecting a much diminished taxable income and amount of tax due. Finally, Count III of the indictment alleges that Dr. Srivastava filed an individual income tax return for 2000 that omitted certain short-term capital losses.

[2] The government ultimately chose to proceed with civil enforcement regarding the health care fraud issues.

[3] As required by law, Dr. Srivastava included income from his medical practice professional corporation on his joint individual tax returns.

[4] Section 1347 provides that, "[w]hoever knowingly and willfully executes, or attempts to execute, a scheme or artifice—

(1) to defraud any health care benefit program; or

(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any of the money or property owned by, or under the custody or control of, any health care benefit program, in connection with the delivery of or payment for health care benefits, items, or services,

shall be fined under this title or imprisoned not more than 10 years, or both. If the violation results in serious bodily injury (as defined in section 1365 of this title), such person shall be fined under this title or imprisoned not more than 20 years, or both; and if the violation results in death, such person shall be fined under this title, or imprisoned for any term of years or for life, or both." 18 U.S.C. § 1347.

5 The government lists 25 financial records it plans to introduce into evidence at trial: (1) spreadsheet detailing options transactions on Bentley–Lawrence ("BL") account; (2) spreadsheet detailing stock transactions on BL account, labeled "corporate"; (3) spreadsheet detailing options transactions on Speer Leeds account; (4) spreadsheet detailing stock transactions; (5) schedule of realized gains and losses; (6) form 1099 activity detail for BL account; (7) form 1099 activity detail for BL account; (8) form 1099 activity detail for BL account; (9) fax from CPA requesting information to prepare tax return; (10) tax reporting statement to support capital gains; (11) form 1099 activity detail supporting capital gains; (12) handwritten bank interest and payments statement; (13) tax reporting statement to support capital gains; (14) form 1099 activity detail to support capital gains; (15) fax to CPA detailing BL accounts; (16) form 1099 activity detail supporting capital gains; (17) tax reporting statement to support capital gains; (18) form 1099 activity detail to support capital gains; (19) tax reporting statement to support capital gains; (20) fax from CPA requesting items to complete tax return; (21) handwritten list of dividends and interest from bank accounts; (22) tax reporting statement to support capital gains; (23) tax reporting statement to support capital gains; (24) spreadsheet for capital gains; (25) email from stock broker detailing stock activity. *See* Paper No. 14 at 24.

6 "FBAR" stands for Foreign Bank and Financial Accounts Report, a document that is required to be filed with the IRS if: (1) the filer was a U.S. person, defined as a citizen, a resident or a person in and doing business in the United States; (2) the U.S. person had a financial account or accounts that exceeded $10,000 during the calendar year; (3) the financial account was in a foreign country; and (4) the U.S. person had a financial interest in the account or signatory or other authority over the foreign financial account. *See* IRS Form TD F 90–22.1; 31 C.F.R. 103.

7 SA Louden testified during the suppression hearing that when she spoke with SA Marrero on April 23, 2003, he indicated that when he found the remittance slips to the State Bank of India "he wasn't sure what they meant or how to even read them." Louden Tr. 5:9–10. *See also* Louden Tr. 47:1–4 ("I mean it was very confusing[,] the HHS agent was not familiar with what a remittance slip looked like. He wasn't even sure if this was in rupees or dollars...."); Louden Tr. 56:11–17 ("They were really unsure of even what it was ... they had never really—I got the impression they had never seen anything like this before and, you know, they were trying to let me know how do you read something like this."). This alleged confusion is somewhat belied by the memorandum prepared by Special Agent Louden for purposes of this hearing, however, as this memorandum indicates that during her April 23rd conservation with SA Marrero, he indicated that after he observed the Bank of India faxes, the Schedule Bs of Dr. Srivastava's 1999, 2000, and 2001 tax returns were consulted, and he noted that Dr. Srivastava failed to check the Schedule B to acknowledge the foreign bank accounts. This Court finds curious the fact that an individual allegedly uneducated and confused about the significance of overseas wire transfers would have the wherewithal to compare the remittance slips against tax forms to see if the taxpayer's Schedules B acknowledged the foreign bank accounts.

8 It is true that courts in some cases courts have allowed the seizure of items not specifically described or delineated in the warrant. Many of these cases involve situations where the warrant(s) authorized the search for and seizure of drugs and/or weapons, and in the course of such searches, officers seized personal papers and effects. *See, e.g., United States v. Wardrick,* 350 F.3d 446, 453–54 (4th Cir.2003)(search warrant authorized seizure of firearms and related items; seizure of defendant's bills and other papers); *Armstrong v. State,* 548 S.W.2d 334, 336 (Ct.Crim.App.Tn.1977)(warrant for drugs; seizure of checks, bank documents, personal letters); *State v. McGuinn,* 268 S.C. 112, 232 S.E.2d 229, 230 (1977)(warrant for marijuana and drugs only; seizure of letters and photographs). In these cases, courts upheld the seizures of the personal documents on the theory that they were relevant in establishing proof of the defendants' residence in the location where contraband was found. *See, e.g., Wardrick,* 350 F.3d at 453(seizure of a utility bill, refund notice, and operator's license was proper because such items "constitute[d] evidence linking Wardrick to the premises where the illegal firearms were found."); *Armstrong,* 548 S.W.2d at 336 ("the personal documents were relevant in establishing proof of possession of the premises and ultimately the drugs."); *McGuinn,* 232 S.E.2d at 230 (*"Warden [v. Hayden,* 387 U.S. 294, 87 S.Ct. 1642, 18 L.Ed.2d 782 (1967)] requires that there be a nexus between the items seized and some criminal behavior. The letters and photographs helped the police initially establishing who resided at the address ... [and] ... served as evidence of actual residency, which was essential in establishing possession and control of the marijuana.").

In this case, there is no such nexus between the financial documents seized from Dr. Srivastava's home and the items described by the warrant. *See Marron,* 275 U.S. at 198, 48 S.Ct. 74 (seizure of ledger and bills for gas, electric, etc., held not authorized by warrant to search for intoxicating liquors and articles for their manufacture). There is no suggestion on the government's behalf that the personal documents were seized to prove possession or ownership of the premises, as was the case in the above-mentioned cases. Furthermore, the government fails to illustrate how these personal financial documents in any way relate to the objects sought in the warrant. *Compare Gentry,* 642 F.2d at 387 (documents describing production of illegal drug seized during search but not listed in warrant had sufficient nexus to warrant, when warrant specifically named the illegal drug as the object of the search). Lacking this nexus, the Defendant's personal financial papers must be excluded as beyond the scope of the warrant. *See United States v. Jones,* 31 F.3d 1304, 1314 (4th Cir.1994).

9 These items certainly had nothing to do with the facts sworn to in the affidavit and therefore should not have been seized. *See id.* ("[S]eized evidence arguably falling within the broad language [of the warrant] but unrelated to facts stated in the affidavit must be suppressed.").

10 Even if this Court were sympathetic to the government's assertions that Defendant's business and personal records were commingled, this only gets the government past the first qualification listed in ¶ 2 of the warrant (that the records must relate to the business). As discussed above, the government utterly fails to provide a plausible explanation for how the records seized in any way suggested that they related to or suggested evidence of *health care fraud.* Furthermore, initial confusion about the relevance of the documents does not justify their subsequent use against Dr. Srivastava when they are in fact outside the terms of the warrant. *See United States v. Altiere, III,* 2006 WL 515609 (N.D.Ohio March 1, 2006)(while initial seizure of documents not specifically delineated by the warrant may have justified initial seizure for review, the documents are not admissible against the defendant if they are beyond the scope of the warrant).

11 This Court is aware that officers may also seize articles of an incriminating character that they come across while performing a search in a given area pursuant to a valid search warrant. *See Uzenski,* 434 F.3d at 707. However, the government does not argue, nor can it be contended, that the personal, financial, and other documents seized from Defendant's home were of a readily incriminating nature. *See Horton v. California,* 496 U.S. 128, 136, 110 S.Ct. 2301, 110 L.Ed.2d 112 (1990)("It is ... an essential predicate to any valid warrantless seizure of incriminating evidence that the officer did not violate the Fourth Amendment in arriving at the place from which the evidence could be plainly viewed. There are, moreover, two additional conditions that must be satisfied to justify the warrantless seizure. First, not only must the item be in plain view; its incriminating character must also be 'immediately apparent.' "); *see also United States v. Wells,* 98 F.3d 808, 809–10 (4th Cir.1996).

12 Marrero testified "this introductory paragraph I used from—in many of our cases health care cases we use go byes and this introductory paragraph is a paragraph that I received or got from another attachment to—for another health care fraud search warrant. My intention when I wrote this affidavit was to get the items listed in the numbers but as far as the legalese and the wording, I just wanted to stay consistent with what the court generally got and received and reviewed for attachments and search warrants." Marrero Tr. 33:18–34:2.

13 Paragraph five of the warrant authorized the seizure of Dr. Srivastava's passports and visas. SA Marrero's testimony indicated that this is "something that [he] do[es] in pretty much all of [his] investigations" because a passport may show that "he could not have performed [a] service at P.G. hospital because he wasn't there[,] he was overseas," for example. Marrero Tr. 7:15–23. On cross examination, defense counsel probed SA Marrero's logic:

> Q: You thought that [Dr. Srivastava] wasn't billing for [heart catheterization procedures] in a correct manner?
>
> A: I thought he was billing for a service that he wasn't providing.
>
> Q: That had to do with the issue of whether he was invading or getting into both chambers of the heart as opposed to just one, right?
>
> A: That's correct.
>
> Q. But that allegation didn't have to do with him billing for wholly fictitious procedures where he was in India and there was no patient in the hospital.
>
> A: No. That allegation had nothing to do with that.
>
> Q: Right. Okay. And in fact, there was no allegation in the affidavit that had to do with him billing for people on days where he wasn't present.
>
> A: No.
>
> Q: All right. So, your indication that you wanted to get passports or visas because that might be the case was something that you just do as a matter of routine not because it was a specific concern in this case, right?
>
> A: That's correct. I do that in most of my cases.

Marrero Tr. 23:7–24:4

This paragraph of the warrants also authorized the seizure of pictures, and SA Marrero's view on how virtually limitless he saw the warrants' provisions was further borne out in cross examination regarding the authorization to seize photographs.

> Q: You told them what they should look for and what they could take.
>
> A: Correct

* * * * * *

> Q: Pictures [?]

A: That's what I said. I hope I got that right. I thought that pictures were in here. Yes. Yes, it is.

Q: Okay well pictures of what?

A: This goes back to the same thing. If there's a picture of the doctor on a cruise in the Bahamas on a certain day, that's evidence of—and then I have a bill for service in P.G. Hospital that would be evidence that he was or even a picture at another state that would be evidence that he wasn't there on that day.

A: Well, okay but attachment A doesn't say photographs of Dr. Srivastava anywhere else than being in Prince George's County it just says photographs, doesn't it?

Q: That's?

A: That's correct.

Q: Are you telling me that your oral instructions to the agents were you can seize photographs that show Dr. Srivastava in exotic locations if you can figure out where they are and if you can figure out what the date is?

A: I didn't get into that specificity but that was the purpose and intent of putting that in the attachments and the agents should be aware of that.

Marrero Tr. 29:20–31:4.

SA Marrero's attitude towards the seizure of passports, visas, and photographs of Dr. Srivastava further supports this Court's conclusion that he took an extremely broad, inappropriate view of the warrant. In fact, he admitted that with respect to these items that “it wouldn't matter to [him] whether [Dr. Srivastava's] activities were of a family nature or whether his activities were of a business nature.” Marrero Tr. 46:3–8.

14 SA Marrero admitted that he told the agents responsible for executing the three warrants that they could take any financial records, stating “I told them financial records and then I may have—I may have indicated you know tax records or the specific wording that's here, but that's it.” Marrero Tr. 32:17–19. When asked whether he informed agents that they were only to take financial records related to Dr. Srivastava's business, which may constitute evidence of violations of 18 U.S.C. § 1347, SA Marrero indicated that he did not inform the agents of this limitation. *Id.* at 32:25–33:10.

15 The search inventory log, Marrero Exh. 1, reveals that agents seized items including wallets, papers regarding Dr. Srivastava's summer home, uncashed checks, unopened mail, and information regarding his new house. In fact, several large boxes of personal documents voluntarily returned by SA Marrero shortly after the execution of the search were displayed to the Court by Dr. Srivastava's counsel at the suppression hearing. The returned documents included an invitation to a cultural gala, Dr. Srivastava's “CV S ExtraCare” card, his AAA card, and checks from several bank accounts. *See* Marrero Tr. 15:2–5.

16 This conclusion is further supported in light of volume of documents eventually returned to Dr. Srivastava. Following the execution of the search warrant, an attorney representing Dr. Srivastava contacted SA Marrero and the United States Attorneys' Office expressing his belief that agents exceeded the scope of the search warrant and seized items that were outside its scope. Beginning on March 24, 2003, SA Marrero began to return documents to Dr. Srivastava; on March 24, SA Marrero returned a wallet with three credit cards, some Indian currency, and a patient chart, and on March 26, SA Marrero returned licensing information, a CV S pharmacy card, a AAA card, and various checks. On April 3, 2003, SA Marrero returned computer hard drives to Dr. Srivastava, and on April 24, 2003, SA Marrero returned “many of the boxes and their contents.” Marrero Tr. 13:7–14:6. The chain of custody log introduced as an Exhibit at the suppression hearing reveals that “Boxes 1, 2, 3, 18, 5, 16, 7, 4, 15, 6, 10, 17 and items from other boxes” were returned. *See* Marrero Exh. 2. The government's own opposition concedes that “approximately 80 percent of the documents seized from [Dr. Srivastava's] home were returned to him by the investigating agents.” *See* Paper no. 14 at 24. It is this Court's conclusion that this large-scale return of information seized from Dr. Srivastava further bears out how SA Marrero's cavalier attitude towards the limitations of the warrant caused agents to grossly exceed its scope.

17 SA Marrero's approach taints the execution of all three search warrants. Each warrant contained the same qualifying language and detailed the same items to be seized, and each warrant was supported by a single affidavit detailing allegations of health care fraud. SA Marrero made clear throughout his testimony that he imparted his overly broad view of the warrant to the entire search team, and agreed that he shared his perceptions with the team at the preparatory meeting. *See* Marrero Tr. 47:5–48:5; Marrero Tr. 53:1–21; Marrero Tr. 74:16–22; *see also* Footnote 14, *supra.*

18 Moreover, capital gains from options trading is not reported to the IRS.

19 On cross examination, defense counsel probed the reality of the IRS' ability to verify the submission of all taxpayers:

Q: ... There is something call[ed][the] IDRS matching program. Do you know about that?

A: No. I don't think I know it called matching program if you explain it to me I might say, oh yes.

Q: Let me try. I've had it happen to me. If you get a 1099 from a bank for interest for $100 and it doesn't appear on your tax return, the computer will notice that and spit out a notice to you and say, you know, why isn't this on your tax return? That's the IDRS matching program. [A]re you aware of that?

A: I've never known it to work that efficiently.

Q: Exactly.

Louden Tr. 38:18–39:5.

20 Indeed, SA Louden's testimony indicated that the statute of limitations had already run for several of the tax years at issue.

21 “The exclusionary rule does not require the exclusion of evidence ‘when the causal connection between [the] illegal police conduct and the procurement of [the] evidence is “so attenuated as to dissipate the taint” of the illegal action.’ ” *United States v. Liss,* 103 F.3d 617, 620 (7th Cir.1997); *see also United States v. Najjar,* 300 F.3d 466, 477 (4th Cir.2002)(“not all evidence conceivably derived from an illegal search need be suppressed if it is somehow attenuated enough from the violation to dissipate the taint.”). In other words, under the “independent source” doctrine, suppression of physical evidence under the Fourth Amendment does not convey derivative use immunity.

22 This testimony is consistent with her explanation of where the specific account information came from for the individual subpoenas of the financial institutions. SA Louden testified “I can't exactly remember. Some of this information came from Jason [Marrero] I believe who had located some information and I believe what I—when he sent me that fax, I verified it to my Schedule B and said, oh, yes I see there is Bentley Lawrence or National—you know City Corp. And then also the actual 1099 Bs later the—the 1099 Bs actually show the account number on them as well and I can't remember if the 1099 dividends show the account number but they definitely show the bank....” Louden Tr. 16:6–15.

It bears special emphasis, and will be discussed later, that SA Louden *twice* admitted that some of the information she received regarding what subpoenas to issue was given to her by SA Marrero. While SA Louden indicated that she also relied on Dr. Srivastava's Schedules B of his tax returns to uncover the names of financial institutions she wished to subpoena, this Court notes that some of the financial institutions subpoenaed on June 2, 2003, do not appear to be listed in Dr. Srivastava's Schedules B. *Compare* Hearing Exhs. Louden 1 and Louden 3 (Dr. Srivastava's 1998 and 1999 Federal Income Tax Returns) *with* Hearing Exhs. Louden 5–Louden 16 (subpoenas for various financial institutions). This strongly suggests to this Court that SA Marrero did in fact provide additional information that would not have been otherwise known to SA Louden, specifically, the names of financial institutions with which Dr. Srivastava did business, and that this information helped to guide SA Louden's investigation. If this is true, it only further supports this Court's conclusion that the independent source exception does not apply in this case.

23 SA Marrero had previously returned many documents taken during the searches. *See* Footnote 16, *supra.*

24 Treatises recognize that “the independent source limitation operates even where there is a de facto causal connection between the proffered evidence and the initial illegality to render the proffered evidence admissible where it is also the product of a *concurrent investigative process in no way dependent upon information learned through lawless official acts.”* 43 A.L.R.3d 485. (emphasis added)

25 The *Larson* court ultimately concluded that there was an independent source for the documents, however, because the bank manager conducted his own investigation into defendant and his accounts.

26 It is also problematic for the government's position that where courts have applied the independent source doctrine to admit evidence arguably tainted by unlawful police conduct, they “have emphasized the necessity of showing that the evidence *would* have been uncovered independently; not merely that it *could* have been.” *Morris,* 684 F.Supp. at 416 (evidence supporting conviction would not have been independently or inevitably discovered and should have been suppressed)(emphasis added); *see also Wardrick,* 350 F.3d. at 451 (applying independent source doctrine where officer “had an *earlier,* independent source for th[e] information”). Here, Defendant asserts that there is no evidence that the IRS had, could have, or would have initiated a criminal tax investigation of Dr. Srivastava absent information and documents passed on by SA Marrero, and that therefore this exception should not apply. As was the case in *Morris,* nothing supports a finding that the IRS *would have* commenced the investigation before it received the financial information that was illegally-obtained. 684 F.Supp. at 415 (no evidence that officers intended to or actually would have searched vehicle where contraband was found before they discovered a pistol in defendant's purse in an unconstitutional search).

In *United States v. Guarino,* 610 F.Supp. 371 (D.R.I.1984), the government, pursuant to a warrant issued for materials that violated the obscenity laws, seized “all printed material from the [defendant's] offices including records of various companies run by the Defendant ... pension files, [and] personal papers....” *Id.* at 375. Records of the defendant's various businesses were turned over to the IRS, which, unlike the instant case, had been investigating the defendant prior to the illegal search. Notwithstanding the previously initiated IRS investigation, the *Guarino* court rejected the government's “general assertion that the ‘natural progression’ of the IRS investigation would have uncovered those business documents” seized in the illegal search because “[t]he record fails to indicate ... that the Government had sufficient knowledge, prior to the search, regarding the various companies apparently controlled by the defendant, to be able to subpoena those particular documents.” *Id.* at 379–80. Like *Guarino,* here the subsequently obtained documents were summonsed only after the illegal search; the government's own chronology demonstrates that SA Louden's ‘standard investigative techniques' were dormant until awakened by impermissibly seized evidence. In fact, this case is even more clear cut than *Guarino,* as in that case the IRS *already had begun* an investigation into the defendant. As previously discussed, here, no such investigation existed, making the independent source exception even more illusory.

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2017 WL 4021551
United States District Court, N.D. Indiana, Fort Wayne Division.

James A. SIMON, et al., Plaintiffs,
v.
Special Agent Paul MUSCHELL, et al., Defendants.
James A. Simon, et al., Plaintiffs,
v.
United States of America, Defendant.

CIVIL NO. 1:09cv301 and 1:10cv58
|
Signed 09/13/2017

Attorneys and Law Firms

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Sabrina Underwood, US Department of Justice, Washington, DC, for Defendants.

OPINION AND ORDER

William C. Lee, Judge

***1** This matter is before the court on a motion for judgment on the pleadings, filed by defendants Special Agent Paul Muschell ("SA Muschell"), Special Agent in Charge Alvin Patton ("SAC Patton"), and Special Agent Linda Porter ("SA Porter")(collectively "Special Agents"), on December 17, 2016. The plaintiffs, James A. Simon ("Simon"), individually and as parent and guardian of R.S., and the Estate of Denise J. Simon, filed their response on January 20, 2017. The Special Agents filed their reply on February 6, 2017. For the following reasons, the motion will be granted.

The procedural history of this case is as follows. On November 6, 2007, IRS employees conducted a search, pursuant to a federal search warrant, of the residence belonging to James and Denise Simon, who were suspected of possible violations of the Internal Revenue Code. Complaint at ¶¶ 13, 18, 30, *James A. Simon v. Special Agent Paul Muschell,* No. 1:09-CV-301 ("Dkt. No. 1") (N.D. Ind. Oct. 29, 2009), Dkt No. 1 ("Complaint"). Simon filed two civil actions challenging the IRS search. The first civil action sought damages from the Special Agents, unnamed IRS employees, and others for alleged violations of the Simons' Fourth and Fifth Amendment rights during the search. *Id.* at ¶¶ 10, 46-72. The second civil action alleged that the United States was responsible for the officers' alleged negligence during the IRS's tax investigation of the Simons under the Federal Tort Claims Act ("FTCA"). Complaint, *James A. Simon v. United States*, No. 1:10-CV-058-RL (N.D. Ind. Feb. 19, 2010), FTCA Dkt No 1 ("FTCA Complaint").

In April 2010, while the two civil actions were pending, Simon was indicted by a federal grand jury on twenty-three criminal counts related to the IRS investigation. Indictment at pp. 2-17, *United States v. Simon*, No. 3:10-CR-56(01) RM (N.D. Ind. April 15, 2010), CR Dkt No. 1 (hereinafter "Indictment"). This Court consolidated the civil actions and stayed the civil proceedings pending resolution of the ongoing criminal case. Opinion and Order at pp. 2, 14, Dkt No 40. On November 9, 2010, after a six-day jury trial, Simon was convicted by a jury of nineteen of the twenty-three felony counts, including filing false federal income tax returns, failing to file foreign bank account and financial account reports, mail fraud, and fraud involving federal financial aid. His conviction was affirmed by the Seventh Circuit on August 15, 2013. Simon has served his sentence.

Simon had filed a Motion to Vacate on November 13, 2014, which was denied on July 5, 2016. Simon appealed the denial of his motion to vacate his criminal sentence on October 24, 2016. The Seventh Circuit denied Simon's request for certificate of appealability on June 7, 2017, stating that there was no showing of denial of constitutional rights.

This Court lifted its stay of the consolidated civil proceedings for the limited purpose of briefing and disposition of the United States' motion to dismiss the FTCA actions. On February 24, 2015, this Court dismissed the FTCA Complaint on the ground that there was no waiver of sovereign immunity under the FTCA where Plaintiffs' claims arose out of the assessment or collection of taxes. *See* 28 U.S.C. § 2680(c). Opinion and Order at pg.19, Dkt No 51.

***2** This Court next lifted the stay of the civil proceedings for the limited purpose of allowing the individually-named Special Agents to file a motion for judgment on the pleadings raising a purely legal issue, the Judgment Bar of 28 U.S.C. § 2676. Opinion and Order, pg. 3 Dkt No. 57. After the Special Agents' motion had been briefed, but before a decision was rendered, this Court granted a stay pending a ruling in *Simmons v. Himmelreich*. The Supreme Court held on June 6, 2016, that the dismissal of an FTCA claim against the United States does not bar a subsequent action by the claimant against the same federal employees whose acts gave rise to the FTCA claim. *Simmons v. Himmelreich*, ––– U.S. ––––, 136 S.Ct. 1843, 195 L.Ed.2d 106 (2016). Accordingly, the Special Agents withdrew their motion for judgment on the pleadings (Dkt 70, November 29, 2016).

As the stay of proceedings entered on December 15, 2015 expired with the Supreme Court's final ruling in *Himmelreich*, the defendants, on December 17, 2016, filed a new Motion for Judgment on the Pleadings, which is presently before this Court. The defendants claim that the Plaintiffs fail to state a claim upon which relief can be granted and that the action is barred by the qualified immunity of the defendants.[1] Finally the Defendants claim that all claims against SAC Patton should be dismissed on the basis that he may not be held liable for damages based solely on the actions of individuals he supervised. Defendants request the dismissal of all of the plaintiffs' claims against defendants Muschell, Patton and Porter.

Rule 12(c) of the Federal Rules of Civil Procedure permits a party to move for judgment on the pleadings on a ground set forth in Rule 12(b) after the complaint and answer have been filed. *Northern Indiana Gun & Outdoor Shows v. South Bend*, 163 F.3d 449, 452 (7th Cir. 1998). In reviewing a motion made pursuant to Rule 12(c) on the ground of failure to state a claim upon which relief can be granted, the Court applies the same standard that it applies when reviewing a motion to dismiss made pursuant to Rule 12(b)(6). *Pisciotta v. Old Nat. Bancorp*, 499 F.3d 629, 633 (7th Cir. 2007). Consequently, "[a] court will grant a Rule 12(c) motion only when it appears beyond a doubt that the plaintiff cannot prove any facts to support a claim for relief and the moving party demonstrates that there are no material issues of fact to be resolved." *Brunt v. Serv. Employees Int'l Union,* 284 F.3d 715, 718–19 (7th Cir. 2002).

In reviewing a 12(c) motion, the Court may consider the contents of the pleadings, including any attached exhibits. *Northern Indiana Gun & Outdoor Shows*, 163 F.3d at 452. The Court may also take judicial notice of matters of public record, including public court documents, without converting a motion for judgment on the pleadings into a motion for summary judgment. *Harrison v. Deere & Co.*, 533 Fed.Appx. 644, 647 n.3 (7th Cir. 2013); *Hallie v. Wells Fargo Bank, N.A.*, No. 2:12-cv-235, 2013 WL 1835708, *1-2 (N.D. Ind. May 1, 2013); *Winters v. Illinois State Bd. of Elections*, 197 F.Supp.2d 1110, 1113 (N.D. Ill. 2001). "When deciding a motion to dismiss pursuant to Rule 12(b)(6), the court must ... decide whether it is plausible that plaintiffs have a valid claim for relief." *Diaz-Bernal v. Myers*, 758 F.Supp.2d 106, 115-16 (D. Conn. 2010) (citing *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009)). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678, 129 S.Ct. 1937 (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)) (" '[The] factual allegations [in the complaint] must be enough to raise a right to relief above the speculative level[.]' ")

***3** Although well-pled allegations are assumed true for purposes of a Rule 12(b)(6) motion, "allegations [that] are conclusory ... [are] not entitled to be assumed true." *Iqbal*, 556 U.S. at 681, 129 S.Ct. 1937. "The plausibility standard ... obligates the plaintiff to 'provide the grounds of his entitlement to relief' through more than 'labels and conclusions, and a formulaic recitation of the elements of a cause of action.' " *Diaz-Bernal*, 758 F.Supp.2d at 116 (quoting *Twombly*, 550 U.S. at 555, 127 S.Ct. 1955); *see Iqbal*, 556 U.S. at 679, 129 S.Ct. 1937 ("While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations.").

The basic background facts in this case are supported by the record and are not disputed. Since at least January 2007, the Simons were under investigation by the IRS for possible violations of the Internal Revenue Code. Complaint at ¶ 13; *United States v. Simon*, 727 F.3d 682, 683-84 (7th Cir. 2013). On November 2, 2007, IRS SA Muschell submitted an Application and Affidavit for Search Warrant[2]. Complaint at ¶¶ 16, 18; Exhibit B to the Motion to Dismiss the FTCA Complaint, Dkt No 46-2, Application and Affidavit for Search Warrant, *United States of America v. Search of Residence*, No. 1:07-MJ-00048-RBC (N.D. Ind. Nov. 2, 2007), ECF No. 1 (hereinafter "Affidavit"). In the supporting Affidavit, SA Muschell stated that probable cause existed to believe that the Simon residence contained evidence of the following criminal offenses: conspiracy to commit offenses or defraud the United States by violating federal tax laws; willful tax evasion; willful failure to file a federal income tax return; and fraud and false statements. Affidavit, at pp. 17-29. As Plaintiffs admit in the Complaint, SA Muschell "listed in the Affidavit, a number of what he refers to as tax offender characteristics, such as sham transactions; assigned income; shell corporations; concealing income; artificial business losses; and artificial investments...." Complaint, at ¶ 20.15. In fact, SA Muschell stated that it was his belief that "James A. and Denise J. Simon have devised a scheme ... for the purpose of evading and defeating federal income taxes legally owed by James A. and Denise J. Simon." Affidavit, at p. 17.

On November 2, 2007, United States District Judge Theresa L. Springmann found that SA Muschell's affidavit established probable cause, and issued a warrant authorizing the IRS to search the Simon residence. Complaint at ¶ 18; Search Warrant, *United States of America v. Search of Residence*, No. 1:07-MJ-00048-RBC (N.D. Ind. Nov. 7, 2007), ECF No. 5. On November 6, 2007, IRS personnel, including SAs Muschell and Porter, executed a search of the Simon residence. Complaint at ¶ 30; *see also* Opinion and Order at pp. 1-3, CR Dkt No 74. SAC Patton was not present during the search at the Simon residence. Answer, ¶ 12, Dkt No 21(office in Chicago); Complaint, *passim*, Dkt No 1(no reference to SAC Patton's presence at residence).

***4** On April 15, 2010, a Grand Jury sitting in South Bend, Indiana, returned twenty-three counts of indictment against Simon, including a count for filing false income tax returns, 26 U.S.C. § 7206(1), failure to file reports of foreign bank and financial accounts ("FBARs"), 31 U.S.C. §§ 5314 & 5322, mail fraud involving private financial aid, 18 U.S.C. § 1341, and fraud involving federal financial aid, 20 U.S.C. § 1097. Indictment at pp. 1-16.

Simon challenged the validity of the search warrant and accompanying affidavit through a motion to suppress. By Opinion and Order dated October 8, 2010, Judge Robert L. Miller, Jr., denied Simon's motion to suppress, except he reserved decision with respect to the reasonableness of the warrant's execution and scheduled a hearing on that issue. Opinion and Order at pg. 34, CR Dkt No 62. Judge Miller noted that Simon's motion to suppress was based on a variety of arguments that are repeated in this civil case, including that, SA Muschell's affidavit contained false and misleading statements of fact and omitted facts that were material to the probable cause finding; the affidavit didn't establish probable cause for the offenses listed; the search warrant lacked sufficient specificity, and resulted in a "general search" of the Simon residence, in violation of the Fourth Amendment; the warrant was unreasonable because it authorized intrusion into the defendant's residence and was issued contrary to guidelines contained in the Internal Revenue Service Manual for search and seizure; and, the warrant was executed in an unreasonable manner (because the agents allegedly exceeded scope of the warrant and seized unauthorized items). *Id.*, pg. 3.

Judge Miller held that the search warrant affidavit "set forth enough facts to lead a responsible person to believe that the search of the residence would produce evidence that Mr. and Mrs. Simon had filed tax returns that were false because they omitted taxable income and that Mr. and Mrs. Simon were required to file 'FBARs' that they hadn't filed." *Id.*, pg. 9. Judge Miller further held that the alleged omissions "weren't material to the probable cause finding." *Id.*, pg. 13. Judge Miller also held that the warrant, with an attachment specifying what types of documents and other evidence could be seized, was sufficiently particularized and not overbroad. *Id.*, pp. 15-16. Finally, Judge Miller determined that even if the agents departed from IRS administrative guidelines in obtaining the warrant and conducting the search, those guidelines did not confer any rights on the target of the search that would render the search unreasonable. *Id.*, pp. 17-18.

Judge Miller then conducted an October 19, 2010 evidentiary hearing to consider Simon's challenges to the reasonableness of the warrant's execution. There, Simon claimed that evidence seized in the November 6, 2007, search should be suppressed because the agents used excessive force by executing the search through eleven armed agents wearing body armor and flak jackets, and conducting the search in the morning when his wife and his minor child were present. In an Opinion and Order dated October 20, 2010, Judge Miller denied the remaining portion of the motion to suppress. Opinion and Order, at pg.5, CR Dkt No 74. Judge Miller found that the agents did not act unreasonably under the Fourth Amendment. He observed that the agents allowed the child to leave for school, and then, at Mrs. Simon's request, waited about an hour for her attorney to arrive, and allowed Mrs. Simon to consult with her attorney during the day and leave the house for lunch. *Id.*, pg. 2. Judge Miller also recognized that the agents obtained consent from Mrs. Simon to remove some computers and computer-related devices and image them elsewhere in order to limit the disruption to the Simon family. *Id.* Examining the totality of the circumstances and balancing the Simons' need for privacy with the need for the promotion of legitimate governmental interests, Judge Miller held that there was nothing facially unreasonable about the search or the retention of the seized items, and denied the motion to suppress based on the alleged Fourth Amendment violations. *Id.*, pg. 4-5.

***5** As noted above, a jury found Simon guilty on 19 of the 23 counts, including filing false federal income tax returns, failing to file foreign bank account and financial account reports, mail fraud, and fraud involving federal financial aid, but excluding several of the mail fraud counts. *See* Opinion and Order at pp. 1-2, CR Dkt No 139 (Jan. 3, 2011). *See also* Sentencing Memorandum, CR Dkt No 159 (Mar. 29, 2011); Judgment in a Criminal Case at pp. 3-4, 7, CR Dkt No 160 (Mar. 29, 2011). The Seventh Circuit affirmed the conviction on August 15, 2013. *United States v. Simon*, 727 F.3d 682 (7th Cir. 2013). Simon failed to petition for a writ of certiorari with the Supreme Court within ninety days, exhausting his direct appeal rights. Simon was released from prison in June, 2016. *See* Notice of Anticipated Release Date, CR Dkt No 212.

Upon his release from prison, Simon renewed his civil litigation efforts. In his Complaints he has raised three bases for civil damages, all arising out of the search warrant: (1) a claim alleging that the agents acted in violation of the Fourth Amendment in obtaining a search warrant (Complaint, Count 1, ¶¶ 46-54); (2) a claim alleging that the agents violated the Fourth Amendment in the manner by which they executed the search warrant (Complaint, Count 2, ¶¶ 55-64); and (3) a due process claim under the Fourth and Fifth Amendments alleging that the defendants obtained and executed an improper search warrant," (Complaint, Count 3, ¶¶ 65-72). Specifically, plaintiffs allege in Count 1 that: SA Muschell, intentionally or negligently made false and/or misleading statements in the affidavit in support of the request for a search warrant of plaintiffs' home. *Id.* at ¶ 19; these false and/or misleading statements misled the judge that reviewed the request for a search warrant. *Id.* at ¶ 27; the affidavit was negligently reviewed and/or approved by SA Muschell and other IRS agents prior to being submitted to the court. *Id.* at ¶ 22; several government tax offices failed to review the affidavit for completeness and accuracy. *Id.* at ¶ 23; the defendants improperly, unlawfully, and negligently tendered the request for a search warrant, including SA Muschell's affidavit, when they knew or should have known there was no probable cause to support a search warrant. *Id.* at ¶ 24; and defendants failed to follow several internal IRS regulations during the acquisition and execution of the search warrant for plaintiffs' home. *Id.* at ¶ 25.

In Count 2, plaintiffs allege that on November 6, 2007, defendant Muschell and unknown agents searched plaintiffs' residence pursuant to the search warrant. *Id.* at ¶ 30. At the initiation of the search warrant, only R.S., the Simons' minor daughter, and Denise Simon were at the Simon residence. *Id.* at ¶ 32. Plaintiff James Simon was not in the United States at that time. *Id.* Despite the fact that neither James Simon nor Denise Simon owned a gun, several IRS agents executing the search warrant wore bulletproof vests and had their guns visible during the search of plaintiffs' home. *Id.* at ¶¶ 33-34. The IRS agents executing the search warrant allegedly violated IRS procedures by putting R.S., who was ten years old at the time, in harm's way. *Id.* at ¶¶ 35-36.

Count 3 contends that during the search, IRS agent Linda Porter made comments to Denise Simon implying violations of law not addressed in the affidavit or warrant, causing emotional stress and harm to Mrs. Simon. *Id.* at ¶ 37. On November 9, 2007, three days after the execution of the search warrant, Denise Simon committed suicide. *Id.* at ¶ 40. Several hours before her death, Denise Simon wrote a letter expressing her concern regarding the armed IRS agents coming into her home, her concern for her children's safety after the search, and her distrust of the federal government. *Id.* at ¶ 41.

***6** In support of their motion for judgment on the pleadings, the defendants claim that they are entitled to qualified immunity and that the plaintiffs have failed to allege sufficient factual allegations to state a claim and are barred by collateral estoppel.

"[T]he defense [of qualified immunity] is meant to give government officials a right, not merely to avoid 'standing trial,' but also to avoid the burdens of 'such pretrial matters as discovery.' " *Behrens v. Pelletier*, 516 U.S. 299, 308, 116 S.Ct. 834, 133 L.Ed.2d 773 (1996); *Pearson v. Callahan*, 555 U.S. 223, 231, 129 S.Ct. 808, 172 L.Ed.2d 565 (2009) ("[Q]ualified immunity is an immunity from suit rather than a mere defense to liability[.]"). For that reason, "qualified immunity questions should be resolved at the earliest possible stage of a litigation." *Anderson v. Creighton*, 483 U.S. 635, 646 (n.6, 107 S.Ct. 3034, 97 L.Ed.2d 523 1987). Qualified immunity therefore may be raised in a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). *Lanigan v. Vill. of East Hazel Crest, Ill.*, 110 F.3d 467, 471 (7th Cir. 1997) ("[Q]ualified immunity may be raised in a motion to dismiss, but at that stage, we consider only the facts in the complaint which we are obligated to accept as true."); *see also Iqbal*, 556 U.S. at 673, 129 S.Ct. 1937 ("[T]he sufficiency of [the] pleadings is ... directly implicated by the qualified immunity defense.").

"[Q]ualified immunity ... shields Government officials 'from liability for civil damages insofar as their conduct does not violate clearly established statutory or constitutional rights." *Iqbal*, 556 U.S. at 672, 129 S.Ct. 1937 (quoting *Harlow v. Fitzgerald,* 457 U.S. 800, 818, 102 S.Ct. 2727, 73 L.Ed.2d 396 (1982)). Whether a right is clearly established is a question of law for the court to decide." *McGrath v. Gillis*, 44 F.3d 567, 570 (7th Cir. 1995). In the context of a motion to dismiss, "qualified immunity protects government officials from liability for civil damages 'unless a plaintiff pleads facts showing (1) that the official violated a statutory or constitutional right, and (2) that the right was 'clearly established' at the time of the challenged conduct.' " *Wood v. Moss*, ––– U.S. ––––, 134 S.Ct. 2056, 2066-67, 188 L.Ed.2d 1039 (2014).

"[U]ntil a particular constitutional right has been stated so that reasonably competent officers would agree on its application to a given set of facts, it has not been clearly established." *Henderson v. DeRobertis*, 940 F.2d 1055, 1059 (7th Cir. 1991) That is, "a defendant cannot be said to have violated a clearly established right unless the right's contours were sufficiently definite that any reasonable official in the defendant's shoes would have understood that he was violating it." *Plumhoff v. Rickard*, ––– U.S. ––––, 134 S.Ct. 2012, 2023, 188 L.Ed.2d 1056 (2014). In that regard, the Supreme Court has admonished courts not to "define clearly established law at a high level of generality ... since doing so avoids the crucial question whether the official acted reasonably in the particular circumstances that he or she faced." *Id.* (internal citation omitted). Indeed, "[q]ualified immunity gives government officials breathing room to make reasonable but mistaken judgments, and protects all but the plainly incompetent or those who knowingly violate the law." *Ashcroft v. al-Kidd*, 563 U.S. 731, 743, 131 S.Ct. 2074, 179 L.Ed.2d 1149 (2011).

With respect to the alleged Fourth Amendment warrant violation related to IRS procedures, the defendants argue that the allegations fail to overcome qualified immunity, as they do not allege the violation of a clearly established Constitutional right. Moreover, the IRS Manual is solely for internal agency use and does not confer any substantive rights on other parties. *United States v. Peters*, 153 F.3d 445, 452 n.9 (7th Cir. 1998).The Court agrees with the defendants on this point.

***7** With respect to the search, the plaintiffs allege that the execution of the search warrant was unreasonable because the Special Agents first failed to take reasonable efforts to determine that the Affidavit was accurate and supported by probable cause and also because the Special Agents used excessive force in executing the warrant.

A search incident to a validly-issued warrant does not violate the Constitution, even when the warrant may contain incorrect information. *Maryland v. Garrison*, 480 U.S. 79, 84, 107 S.Ct. 1013, 94 L.Ed.2d 72 (1987). As noted, qualified immunity ... shields Government officials 'from liability for civil damages insofar as their conduct does not violate clearly established statutory or constitutional rights." *Iqbal*, 556 U.S. at 672, 129 S.Ct. 1937. That is, "qualified immunity protects government officials from liability for civil damages 'unless a plaintiff pleads facts showing (1) that the official violated a statutory or constitutional right, and (2) that the right was 'clearly established' at the time of the challenged conduct.' " *Wood*, 134 S.Ct. at 2066-67.

The second prong asks whether the constitutional right that the officer allegedly violated was "clearly established" at the time of the incident such that it would "be clear to a reasonable officer that his conduct was unlawful in the situation he confronted." *Saucier v. Katz*, 533 U.S. 194, 202, 121 S.Ct. 2151, 150 L.Ed.2d 272 (2001). "Reasonable notice does not require that there be a case 'fundamentally similar' to the present case, and indeed an officer can be on notice that his conduct violates constitutional rights even in novel factual circumstances." *Hope v. Peltzer*, 536

U.S. 730, 741, 122 S.Ct. 2508, 153 L.Ed.2d 666 (2002); *see also Narducci v. Moore*, 572 F.3d 313, 318 (7th Cir. 2009) (quoting *Anderson v. Creighton*, 483 U.S. 635, 640, 107 S.Ct. 3034, 97 L.Ed.2d 523 (1987)).

In the present case qualified immunity applies because the conduct alleged would not constitute the violation of clearly established constitutional law. As Judge Miller found, in light of the pre-existing law concerning execution of search warrants, the Special Agents would not have been aware that their actions entering the residence and searching for evidence listed in the search warrant were unlawful on November 6, 2007. They entered with a sufficient number of agents to secure the premises and were wearing clothing that protected them from potential harm. As the Second Circuit recently explained "there is no clearly established right ... to be free from the deployment of a tactical team in general." *Terebesi v. Torreso*, 764 F.3d 217, 233 (2d Cir. 2014). The agents did not restrain Mrs. Simon, but allowed her to meet with her attorney, go to lunch and have private discussions with her attorney sitting in her car.

Plaintiffs, in their response brief, argue that they have alleged facts in their complaint that necessitate a closer look at the facts and that they should be allowed to conduct discovery and revisit the question of qualified immunity at a later stage. Clearly, plaintiffs misunderstand the nature of the doctrine of qualified immunity. As noted above, qualified immunity provides immunity *from suit.*

Moreover, as noted in the recent case of *Green v. Newport*, No. 16-1536, 7th Cir. Aug. 22, 2017, the Supreme Court has instructed that "clearly established law should not be defined at a high level of generality." *White v. Pauly*, ––– U.S. ––––, 137 S.Ct. 548, 552, 196 L.Ed.2d 463 (2017) (per curiam) (citation and quotation marks omitted). While a case directly on point is not required, "the clearly established law must be 'particularized' to the facts of the case." *Id.* at 551 (citation omitted). The Court has found that "[s]uch specificity is especially important in the Fourth Amendment context, where ... 'it is sometimes difficult for an officer to determine how the relevant legal doctrine ... will apply to the factual situation the officer confronts.' " *Mullenix*, 136 S.Ct. at 308 (citation and alterations omitted). In the case at bar, Plaintiffs have failed to present any case, even slightly on point, that would show that the clearly established law indicated that the Special Agents were violating the plaintiffs' constitutional rights. Clearly, the allegations of the complaint simply do not raise a Fourth Amendment violation of which these defendants should have known. Accordingly, defendants are entitled to qualified immunity for their actions in executing the search warrant.

***8** Plaintiffs further assert a due process claim arising from the suicide of Denise Simon three days after execution of the search warrant. Plaintiffs allege that "upon information and belief, during the Search, Porter made comments to the decedent that were improper by implying violations of law not specified or addressed in the Affidavit or Warrant causing unnecessary emotional stress and harm to Decedent." Complaint. ¶ 37. Defendants argue that this statement is too vague to pass muster under the specific pleading requirements of *Iqbal*. This Court agrees that the plaintiffs have failed to allege any facts that set forth the existence of a clear due process violation. The facts plead do not have facial plausibility enabling the court to draw a reasonable inference that the defendants are liable for the alleged misconduct. Plaintiffs do not allege what comments were made or how they caused harm to Denise Simon. Moreover, the defendants are entitled to qualified immunity on this claim because Denise Simon's suicide does not implicate a clearly established constitutional right in 2007. As noted, Plaintiffs have not alleged that one of the defendants took specific actions that directly caused Denise Simon's death. Nor have the plaintiffs pointed to any case law suggesting that there is a clearly constitutional right that was implicated by the alleged misconduct.

Next, the defendants claim that plaintiffs claims are barred by the doctrine of collateral estoppel. Under the doctrine of collateral estoppel or claim preclusion, "once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 59 L.Ed.2d 210 (1979). However, collateral estoppel applies only when the party against whom the earlier decision is being asserted had a "full and fair opportunity" to litigate the issue in question. *Id.*; *Parklane Hoisery Co., Inc. v. Shore*, 439 U.S. 322, 333-34, 99 S.Ct. 645, 58 L.Ed.2d 552 (1979) (offensive use of collateral estoppel permitted to bar relitigation of whether a proxy statement was materially false and misleading). Collateral estoppel may apply in a *Bivens* case where the plaintiff had unsuccessfully challenged the same allegedly unconstitutional behavior in a prior criminal case preliminary hearing or motion to suppress. *See Allen v. McCurry*, 449 U.S. 90, 102, 101 S.Ct. 411, 66 L.Ed.2d 308 (1980)(Issue preclusion applies to bar relitigation of validity of search and seizure in subsequent action brought pursuant to § 1983).

Through a motion to suppress brought by his counsel in his criminal case, Simon fully, but unsuccessfully, litigated the claims that there was no probable cause for issuance of the search warrant and that the execution of the search warrant was unreasonable; therefore he is estopped from challenging those decisions in this case. (Compare Complaint with Motion to Suppress Evidence, CR Dkt No 37; and the Opinion and Order denying motion to suppress in part, CR Dkt No 62; and Opinion and Order, CR Dkt No 74. Denying, after a hearing, the remaining portion of the motion to suppress). Because the allegations of Fourth and Fifth Amendment violations raised in the suppression motion mirrored those raised in this *Bivens* case and the Court in the criminal case denied the motion to suppress in full, Simon is estopped from challenging those findings in this case. *Guenther v. Holmgreen*, 738 F.2d 879 (7th Cir. 1984) (determining plaintiff was precluded from relitigating the issue of the validity of his arrest because the state court ruling at his preliminary hearing determined the officers had probable cause to arrest him); *Donovan v. Thames*, 105 F.3d 291, 297-98 (6th Cir. 1997) (determining suppression hearing did not bar excessive force claim but it did bar relitigation of the validity of arrest because the state court ruling determined the officer had probable cause to arrest plaintiff); *Cameron v. Patterson*, 2012 WL 1204638, at *3 (N.D. Ill. Apr. 10, 2012) (determining that plaintiff was collaterally estopped from pursuing false arrest claim because he had challenged, in his motion to quash arrest and suppress evidence in the state criminal case, whether there was probable cause for the stop); *see also Wright and Miller*, 18B Fed. Prac. & Proc. Civ. 3d § 4474 (West 2004 & Supp. 2016).

***9** As noted earlier, Simon's request to file a motion to vacate sentence was denied by the Seventh Circuit on July 5, 2016. Thus, Simon's appeals have been exhausted and he is barred from pursuing his claims by reason the doctrine of collateral estoppel. Plaintiffs, however, assert that the claims of James A. Simon as Parent and Guardian of R.S. and the Estate of Denise J. Simon are not barred by the doctrine of collateral estoppel. Plaintiffs claim that these plaintiffs were not parties to the criminal case and had no opportunity to litigate the issue in question.

The law is clear that collateral estoppel may be applied to the claims of third parties who are in privity with a party to the prior litigation, even when the prior action is criminal in nature. *Studio Art Theatre v. Evansville, Inc. v. Gann*, 76 F.3d 128 (7th Cir. 1996). Where a non-party to a prior action is so closely aligned with the interests of the party to the prior litigation, they may be bound by the ruling from a suppression hearing in the prior litigation. *Id.* at 131; *Allen v. United States*, 964 F.Supp.2d 1239 (D. Nev. 2013)(suppression hearing is grounds for collateral estoppel in subsequent *Bivens* case and non-party to the prior action may be bound); *Beets v. County of Los Angeles*, 669 F.3d 1038, 1046-47(9th Cir. 2012) (criminal conviction precluded a Section 1983 claim brought by the parents of an individual convicted for resisting arrest); *Kray v. City of Tacoma*, 2012 WL 2062397 (W.D. Wash 2012) (brother of a man who was criminally convicted was barred from alleging a Section 1983 claim that would undermine the validity of his brother's conviction).

In the present case, the Estate of Denise Simon and minor R.S. seek to hold the Special Agents individually liable for violations of their constitutional rights allegedly arising from the unlawful issuance and execution of a search warrant at their home. Defendants argue that these two plaintiffs are so closely connected with the criminal defendant [3], Mr. Simon, that they are bound by the decision on the motion to suppress. Defendants point out that Mr. Simon had every reason to vigorously litigate the motion to suppress and this Court notes that the record shows that the motion was, in fact, vigourously litigated. Notably, plaintiffs have not cited any case law in support of their assertion that collateral estoppel should not apply. Plaintiffs merely opine that it is "contrary to common sense that collateral estoppel would bar the claims of the Plaintiffs in this case." As the law clearly supports the defendants' position, this court holds that the doctrine of collateral estoppel bars all of the plaintiffs' claims.

Next, the defendants argue that SA Patton must be dismissed from this case for lack of personal involvement. It is well established that "[t]o establish a *Bivens* claim, a plaintiff must demonstrate the defendant's direct or personal involvement in the actions that are alleged to have caused the constitutional deprivation." *Vance v. Rumsfeld*, 701 F.3d 193, 203 (7th Cir. 2012); see also Iqbal, 556 U.S. at 677, 129 S.Ct. 1937 ("[E]ach Government official, his or her title notwithstanding, is only liable for his or her own misconduct."). In that regard, "purpose rather than knowledge is required to impose *Bivens* liability on ... an official charged with violations arising from his or her superintendent responsibilities." *Iqbal*, 556 U.S. at 677, 129 S.Ct. 1937. It has long been held that the doctrine of *respondeat superior* does not apply to *Bivens* cases. Thus to be held individually liable, "a defendant must be 'personally responsible for the deprivation of a constitutional right.' " *Sanville v. McCaughtry*, 266 F.3d 724, 740 (7th Cir. 2001)(quoting *Chavez v. Ill. State Police*, 251 F.3d 612, 651 (7th Cir. 2001)) (quotation omitted). Prior to *Iqbal*, a defendant could "be deemed to have sufficient personal responsibility if he directed the conduct causing the constitutional violation, or if it occurred with his knowledge or consent." *Chavez*, 251 F.3d at 652. The plaintiffs do not allege that SA Patton had personal responsibility for conducting the search, but allege only that he "had actual knowledge of and acquiescence in Muschell's, Porter's, and Unknown Agents' conduct by adopting and maintaining a practice, custom or policy that contributed to the violation of Plaintiffs' constitutional rights."

***10** In their Complaint, Plaintiffs specifically allege that SAC Patton is the Special Agent in Charge of Defendant Paul Muschell. *See* Complaint ¶¶ 5, 7. In his duties as the Special Agent in Charge, SAC Patton was responsible for Mr. Muschell's training and supervision. *See id.* at ¶ 7. The Complaint further alleges that as Special Agent in Charge, SAC Patton improperly reviewed and/or approved the Affidavit supporting the request for a search warrant prior to it being submitted to the Court, failed to review said Affidavit for completeness and accuracy, and improperly and unlawfully tendered the Affidavit to the Court, procuring the issuance of the Warrant, when he knew that there was no probable cause for said Warrant. *See id.* at ¶¶ 22-24. Plaintiffs thus conclude that SAC Patton was directly involved in supervising and training agents in their activities here in the state of Indiana and that SAC Patton's supervision and training of SA Muschell led to the constitutional violations at issue.

However, as noted above, a supervisor may not be liable in a *Bivens* action for the conduct of those under him unless he *intended* those actions to occur. *Iqbal*, 655 U.S. at 677. As the defendants note, there are no allegations in the complaint that SAC Patton intended the other Special Agents to act in a way that would have violated Plaintiffs' constitutional rights. Rather, all the Plaintiffs argue is that SAC Patton had knowledge or acquiesced in unspecified practices, customs and polices because he has adopted and maintained practices, customs and/or polices that contribute to the violations. Complaint at ¶¶ 51, 61, 69. Importantly, none of the factual allegations in the complaint assert that SAC Patton acted in a way that would lead a reasonable fact finder to hold that he intended any violation of Plaintiffs' constitutional rights. Accordingly, this Court must dismiss the claims against SAC Patton on this basis also.

Conclusion

On the basis of the foregoing, the defendants' motion for judgment on the pleadings is hereby GRANTED.

All Citations

Slip Copy, 2017 WL 4021551, 121 A.F.T.R.2d 2018-374

Footnotes

[1] Defendants also initially argued that plaintiffs' Fourth Amendment claims challenging probable cause to issue the search warrant are barred by *Heck v. Humprey*, 512 U.S. 477, 114 S.Ct. 2364, 129 L.Ed.2d 383 (1994), However, in their reply brief, the defendants noted that they are not "advancing an argument at this time that a finding that the search warrant was invalid would necessarily imply that James Simon's conviction was unlawful ...". *See Copus v. City of Edgerton*, 151 F.3d 646, 648 (7th Cir. 1998)(*Heck* does not bar all Fourth Amendment claims for unlawful search and seizure); *Wallace v. City of Chicago*, 440 F.3d 421, 427 (7th Cir. 2006)(many search and seizure claims do not render a conviction invalid because of doctrines like independent source and inevitable discovery). As it appears that the defendants have abandoned their *Heck* argument, this Court will not address it further.

[2] "Documents that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim." *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429,

431 (7th Cir. 1993); *see also PharMerica Chicago, Inc. v. Meisels*, 772 F.Supp.2d 938, 947 (N.D. Ill. 2011). Here, the Plaintiffs made numerous references to the Affidavit in the Complaint. *See* Complaint at ¶¶ 16, 20-24, 26-27, 37, 44-45. In addition, the Affidavit is central to Plaintiffs' claims. *Id.* at ¶¶ 47-48, 50, 56. Thus, the Affidavit is considered part of the pleadings. This Court takes judicial notice of the Affidavit.

[3] Denise Simon was deceased prior to the issuance of the indictment. However, the Court’s sentencing memorandum found that Denise was a “knowing partner” in the tax fraud scheme. Thus, it is clear that the interests of the Estate are not substantially different from Mr. Simon’s interests.

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T.C. Memo. 2016-27
United States Tax Court.

Bonnie J. ANGLE, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent [*]

Docket Nos. 29418–11, 435–12L
|
Filed February 22, 2016

Synopsis
Background: Taxpayer petitioned for review of IRS determinations to deny innocent-spouse relief and proceed with collection by levy and lien. Cases were consolidated and IRS conceded taxpayer's entitlement to innocent-spouse relief. Taxpayer moved for award of reasonable litigation costs. The Tax Court, Laro, J., 2015 WL 2180481, denied motion, then entered decision in innocent-spouse case and dismissed collection case. Taxpayer moved for reconsideration of denial of costs and to vacate decision and dismissal.

Holdings: The Tax Court, Laro, J., held that:

[1] Court of Appeals' opinion constituted intervening change in law warranting Tax Court's reconsideration of its denial of taxpayer's motion for award of prevailing-party litigation costs in innocent-spouse case, but not in collection review case;

[2] IRS's concession of taxpayer's request for innocent-spouse relief did not constitute settlement that precluded taxpayer from obtaining award of litigation costs under qualified offer rule; but

[3] taxpayer's net worth was in excess of $2 million, and thus she was ineligible for award of litigation costs as prevailing party.

Motions granted in part and denied in part.

Attorneys and Law Firms

William E. Taggart, Jr., for petitioner.

Audra M. Dineen, for respondent.

SUPPLEMENTAL MEMORANDUM OPINION

LARO, Judge:

***1** Currently before the Court are petitioner's motions under Rule 161 [1] to reconsider our opinion in *Angle v. Commissioner* (*Angle I*), T.C. [*2] Memo.2015–92 and under Rule 162 to vacate the decision and the dismissal entered on May 14, 2015, in docket No. 29418–11 and docket No. 435–12L, respectively. In *Angle I* we held that petitioner is not entitled to recovery of litigation costs under section 7430. The motions were filed timely on June 11, 2015.

On July 15, 2015, during the pendency of the motions, the U.S. Court of Appeals for the Ninth Circuit—to which these cases would be appealable—reversed and remanded a decision of this Court in *Knudsen v. Commissioner (Knudsen II),* 793 F.3d 1030 (9th Cir.2015), *rev'g and remanding* T.C. Memo. 2013–87 (*Knudsen* I). Petitioner requested leave of the Court to supplement her pending motions because of the developments in the *Knudsen* case. We granted the request for leave and instructed the parties to file supplemental briefs addressing the following issues: (1) how *Knudsen II* affects the decision in the cases herein, if at all, and (2) whether petitioner should be considered a "prevailing party" in view of petitioner's prior filings and the *Knudsen II* decision.

After considering the arguments made by the parties, we will deny the motions to vacate under Rule 162 for both cases. We will deny the motion to [*3] reconsider under Rule 161 for the case at docket No. 435–12L (collection due process (CDP) case). We will grant the motion to reconsider under Rule 161 for the case at docket No. 29418–11 (innocent spouse case), but for the reasons stated below we will not alter the result of our opinion in *Angle I.*

Background

We incorporate our findings of fact in *Angle I* and set forth additional facts below for purposes of this opinion.

On April 15, 1996, petitioner and her now deceased husband, Cloyd F. Angle, filed a joint Federal income tax return for 1995. Petitioner's 1995 tax liability has given rise to no fewer than four cases, three of which we described in detail in our opinion in *Angle I.* [2]

To briefly reiterate the facts, after the Court resolved the initial deficiency case in *Estate of Angle v. Commissioner,* T.C. Memo.2009–227, and entered the appropriate decision, petitioner initiated two separate actions requesting relief from her 1995 Federal income tax liability pursuant to section 6015 (innocent [*4] spouse case) and seeking redetermination of the results of a collection due process hearing based on the deficiency case (CDP case). After going through the appropriate administrative procedures, petitioner ended up litigating both the innocent spouse case and the CDP case in this Court. On January 11, 2011, after filing the petition in the innocent spouse case but before filing the petition in the CDP case, petitioner sent the IRS Office of Appeals (Appeals) a letter offering to settle the innocent spouse case for $1,000. Because Appeals did not reply to the offer, it lapsed.

***2** Both cases were scheduled for trial on October 21, 2013. Meanwhile, on the basis of the new information that petitioner provided, respondent determined that the 1995 return was a valid joint return but petitioner was entitled to relief under section 6015(c). On September 27, 2013, respondent informed petitioner of this determination and faxed draft decision documents reflecting a settlement. On September 28, 2013, petitioner acknowledged receipt of the decision documents but refused to sign them because they did not allow litigation costs.

On October 21, 2013, when these cases were called for trial, the parties informed the Court that respondent conceded the innocent spouse case, but respondent maintained that the CDP case was not resolved or rendered moot by the granting of the section 6015 relief. The Court continued the case until [*5] November 18, 2013, to give the parties an opportunity to resolve the remaining issues.

On November 18, 2013, the parties informed the Court that a resolution with respect to the issue of attorney's fees could not be reached. That same day, the Court issued an order directing petitioner to file a motion for costs under section 7430 by January 17, 2014, and the Court denied respondent's motion for summary judgment in the CDP case as moot.

On May 14, 2015, after considering petitioner's motion for litigation costs and respondent's response, we entered an order and decision in docket No. 2941811 and an order and order of dismissal in docket No. 435–12L, denying the award of litigation costs to petitioner in both cases. On June 11, 2015, petitioner timely filed motions to reconsider our opinion and vacate the decision and the dismissal. During the pendency of the motions we instructed the parties to file supplemental briefs addressing the issues raised by the Court of Appeals in *Knudsen II.* On October 16, 2015, we instructed petitioner to file supplemental affidavits addressing the issue of her net worth and litigation costs. On November 25, 2015, respondent filed objections to the supplemental affidavits. On December 15, 2015, we granted petitioner's motion for leave to file a response to respondent's [*6] objections. Petitioner filed said response in two memoranda on December 15, 2015, and on December 28, 2015.

Discussion

I. *Rule 161 and 162 Motions*

[1] **[2]** **[3]** **[4]** The decision to grant a motion to reconsider an opinion or vacate a decision rests within the discretion of the Court. *See Vaughn v. Commissioner,* 87 T.C. 164, 166–167 (1986); *CWT Farms, Inc. v. Commissioner,* 79 T.C. 1054, 1057 (1982), *aff'd,* 755 F.2d 790 (11th Cir.1985). Motions to vacate or reconsider are generally not granted absent a showing of unusual circumstances or substantial error. *See Seiffert v. Commissioner,* T.C. Memo. 2014–61, at *6 (citing *Half Tr. v. Commissioner,* 62 T.C. 145, 147 (1974), *aff'd on this ground,* 510 F.2d, 43, 45 n.1 (1st Cir.1975)); *Mitchell v. Commissioner,* T.C. Memo. 2013–204, at *7, *aff'd,* 775 F.3d 1243 (10th Cir.2015); *Kun v. Commissioner,* T.C. Memo. 2004–273, *aff'd,* 157 Fed.Appx. 971 (9th Cir. 2005). Motions to reconsider an opinion are generally intended to correct "substantial errors of fact or law and allow [ ] the introduction of newly discovered evidence that the moving party could not have introduced, by the exercise of due diligence, in the prior proceeding." *Estate of Quick v. Commissioner,* 110 T.C. 440, 441–442

(1998). Motions to vacate a decision are generally not granted absent a showing of unusual circumstances or [*7] substantial error, including mistake, inadvertence, surprise, excusable neglect, newly discovered evidence, fraud, or other reason justifying relief. *Seiffert v. Commissioner,* at *6–*7 (discussing application of the Federal Rules of Civil Procedure in the context of motions to vacate a decision).

***3** **[5]** An intervening change in law may also warrant granting a motion to reconsider an opinion or vacate a decision. *See, e.g., Mitchell v. Commissioner,* T.C. Memo. 2013–204 (regarding a change in conservation easements law interpretation by a Court of Appeals); *Alioto v. Commissioner,* T.C. Memo. 2008185 (regarding a change in law due to congressional change to section 6015).

[6] Where the Court of Appeals to which an appeal lies has decided an issue that is presently before us, we will follow the decision of that court. *Golsen v. Commissioner,* 54 T.C. 742, 757 (1970), *aff'd,* 445 F.2d 985 (10th Cir.1971). The Court of Appeals for the Ninth Circuit has recently held that whether a concession by the Commissioner should be treated as a settlement for purposes of section 7430 depends on the facts and circumstances of the case and general principles of contract law. *See Knudsen II,* 793 F.3d at 1035. When the Commissioner conceded that case because of the change in the internal litigation strategy after it had been submitted fully stipulated for decision, the concession was not a settlement and the taxpayer was entitled to recover litigation costs. *Id.* [*8] Petitioner argues that the holding in *Knudsen II* is an intervening change in law that may warrant reconsidering our prior opinion or vacating decisions in these cases. Respondent disagrees.

[7] We relied on the reasoning in *Knudsen I,* which was later reversed by the Court of Appeals' opinion in *Knudsen II,* in denying the award of attorney's fees and costs in *Angle I.* Under *Golsen,* we follow the holding of the Court of Appeals in *Knudsen II* because it discusses the same issue that we are dealing with here: whether a unilateral concession by the Commissioner should be treated as a settlement. Thus, *Knudsen II* represents an intervening change in law and warrants reconsideration of certain portions of our opinion in *Angle I.*

[8] The discussion of *Knudsen I* and *Knudsen II,* however, is relevant to only one of the consolidated cases, the innocent spouse case. Because we found in *Angle I* that no qualifying offer has been made in the CDP case, *Knudsen II* does not affect our analysis and conclusions as to the CDP case, and we will deny petitioner's motions to reconsider that part of the opinion in *Angle I* and to vacate the related decision. [3] Under *Golsen,* we, however, must consider the issue of [*9] whether the holding in *Knudsen II* affects, if at all, the innocent spouse case. Thus, we will grant the motion to reconsider our opinion in the innocent spouse case for this limited purpose. For the reasons stated below, granting the motion to reconsider does not alter the result of *Angle I.*

Because petitioner did not provide us with substantial proof that there are reasons justifying vacating our prior decision such as those enumerated in *Seiffert,* and our reconsideration of *Angle I* as related to the innocent spouse case does not lead us to different results, we will deny petitioner's motion to vacate the decision related to the innocent spouse case.

II. *Legal Standard for Reasonable Litigation Costs Award*

***4** **[9]** Under section 7430(a), a prevailing taxpayer in a court proceeding against the United States may be awarded "reasonable litigation costs incurred in connection with such court proceeding." The decision whether to award attorney's fees under section 7430 is within a trial court's sound discretion. *See Pac. Fisheries, Inc. v. United States,* 484 F.3d 1103, 1106 n.2 (9th Cir.2007); [*10] *Huffman v. Commissioner,* 978 F.2d 1139, 1143 (9th Cir.1992), *aff'g in part, rev'g in part* T.C. Memo. 1991–144.

In order for this Court to award reasonable litigation costs under section 7430, certain requirements must be met. The record must show the following:

(1) The moving party filed a timely motion for reasonable litigation costs. Rule 231(a). We excused petitioner's minor delay in filing the motion for reasonable litigation costs, as discussed in *Angle I.*

(2) The moving party did not unreasonably protract the court proceedings. Sec. 7430(b)(3).

(3) The moving party exhausted any administrative remedies available to him or her within the IRS. Sec. 7430(b)(1).

(4) The moving party has a net worth that did not exceed $2 million at the time the petition was filed in the case. Sec. 7430(c)(4)(A)(ii).

(5) The moving party is a prevailing party in the Court proceeding. Sec. 7430(a), (c)(4)(A), (B), (E).

(6) The amount of costs claimed is reasonable. Sec. 7430(a), (c)(1).

These six requirements are in the conjunctive; each requirement must be met before this Court may order an award of litigation costs to a taxpayer under section 7430. *See Beecroft v. Commissioner,* T.C. Memo. 1997–23, slip op. at 11 [*11] (citing *Minahan v. Commissioner,* 88 T.C. 492, 497 (1987)). Except as provided in section 7430(c)(4)(B), the taxpayer bears the burden of proving that he or she meets each of the requirements of section 7430. Rule 232(e). Failure to meet any of the requirements of section 7430 will preclude an award of costs. *Minahan v. Commissioner,* 88 T.C. at 497.

Respondent conceded that petitioner complied with requirements set out in items (2) and (3) above. Respondent, however, disagrees that petitioner met the remaining statutory requirements. For the reasons set forth below, we agree that petitioner failed to meet the net worth requirement. Because petitioner failed to meet the net worth requirement, we deny the award of litigation costs related to the innocent spouse case. *See id.* (stating that failure to meet any of the requirements of section 7430 precludes an award of costs).

III. *Prevailing Party Under the Qualifying Offer Rule and Knudsen*

A. *Qualified Offer in the Innocent Spouse Case*

Petitioner argues that she is entitled to recover litigation costs under the qualified offer rule, *see* sec. 7430(c)(4)(E), and (g), because her January 11, 2011, letter was a qualified offer.

[*12] Section 7430(c)(4)(E)(i) provides:

> A party to a court proceeding * * * shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted a qualified offer of the party [as defined] under subsection (g).

[10] Under the qualified offer rule of section 7430(c)(4)(E) and (g), a taxpayer may be deemed to be a prevailing party regardless of whether the taxpayer substantially prevailed in the proceeding or of whether the Commissioner's position in the proceeding was substantially justified. *Haas & Assocs. Accountancy Corp. v. Commissioner,* 117 T.C. 48, 59 (2001), *aff'd,* 55 Fed.Appx. 476 (9th Cir. 2003).

***5** In *Angle I* we held that petitioner's January 11, 2011, letter is a qualified offer with respect to the innocent spouse case but no qualified offer has been made in the CDP case. *Angle I,* at *9–*11. Thus, petitioner may be entitled to reasonable litigation costs incurred in connection with the innocent spouse case if all other requirements for being a prevailing party are satisfied.

B. *Settlement Exception to the Qualified Offer Rule and Knudsen*

Where the taxpayer makes a qualified offer under section 7430(g), the qualified offer rule does not apply to "any judgment issued pursuant to a [*13] settlement". Sec. 7430(c)(4)(E)(ii)(I); *see also* sec. 301.7430–7(a), Proced. & Admin. Regs. ("An award of reasonable administrative and litigation costs under the qualified offer rule only includes those costs * * * attributable to the adjustments * * * that were included in the court's judgment other than by reason of settlement.").

[11] Whether a concession constitutes a settlement under section 7430(c)(4)(E)(ii)(I) depends on whether, under the facts of the case, the concession can be construed as a contract to settle between the parties. *Knudsen* II, 793 F.3d at 1035. In the Ninth Circuit, courts consider timing of the concession as well as the usual elements of a valid contract such as offer, acceptance, and consideration. *Id.*

In *Knudsen II,* 793 F.3d at 1035, the Court of Appeals for the Ninth Circuit held that a unilateral concession is not a settlement within the meaning of section 7430 when the

Commissioner conceded as a result of a change in internal policies and when there was no evidence of negotiations regarding a settlement. The Commissioner informed the taxpayer that he would concede the case after the case had been submitted fully stipulated but more than a month before the filing deadline for submitting opening briefs in the case. *Id.* at 1033.

[*14] In another similar case, *Estate of Lippitz v. Commissioner,* T.C. Memo. 2007–293, this Court has held that when the Commissioner waited to concede the case until after the taxpayer had actively litigated to the point of filing a dispositive motion, the concession was not a settlement. In *Estate of Lippitz v. Commissioner,* T.C. Memo. 2007–293, the Commissioner denied the taxpayer's right to relief from joint and several liability under section 6015 despite the prior administrative determination that the taxpayer was entitled thereto. After the Commissioner refused the taxpayer's qualified offer, the taxpayer moved for partial summary judgment, prompting the Commissioner to concede that the taxpayer was entitled to the requested relief.

In both *Knudsen II* and *Estate of Lippitz* the courts considered the timing of the concession. *Knudsen II,* 793 F.3d at 1035 (citing *Estate of Lippitz v. Commissioner,* T.C. Memo. 2007–293). Both courts did not believe that Congress intended to allow the Commissioner to benefit from the settlement exception of section 7430(c)(4)(E) after waiting until just before the resolution of a dispositive motion or the end of a trial to concede a matter. *Id.* The underlying purpose of the qualified offer rule "is to encourage settlements by imposing litigation costs on the party not willing to settle." *Id.* (quoting *Gladden v. Commissioner,* 120 T.C. 446, 450 (2003)).

[12] [*15] Petitioner argues that *Knudsen II* is an intervening authority warranting a change in the reasoning and conclusions of our prior opinion in *Angle I.* Petitioner made a qualifying offer for the innocent spouse case at the very beginning of the offer period. Respondent did not accept the offer, and it expired. After that, respondent continued to pursue his litigation strategy and ultimately came to the conclusion that he was ready to concede the innocent spouse case. Similar to the facts in the *Knudsen* case, less than a month before the scheduled trial date respondent informed petitioner that he intended to concede the innocent spouse case.

***6** Respondent attempts to distinguish this case from the *Knudsen* case on the basis that petitioner made an implicit offer to settle by making herself available for depositions and providing information pursuant to respondent's requests, which respondent accepted by conceding. Respondent argues that, unlike in the *Knudsen* case, where the concession was based on the institutional-level change of litigation strategy, the concession here was in response to petitioner's providing more information on her case.

We find respondent's argument unpersuasive. The litigation process is inherently adversarial, but it necessarily involves exchange of information between the parties. We are reluctant to hold that whenever a party cooperates in [*16] this process, it is making an offer to settle and loses the right to litigation costs. Respondent's argument suggests that taxpayers can be entitled to litigation costs only when the Commissioner decides to make an institutional change in his policies or abandons a prior litigation strategy. We do not think this is the result intended by Congress.

Respondent also distinguishes the current case from *Estate of Lippitz,* where the Commissioner chose to litigate the section 6015 relief issue even after the Internal Revenue Service Cincinnati Centralized Innocent Spouse Operations unit (CCISO) recommended that such relief should be granted. This factual distinction would be important if petitioner argued that respondent's position was unjustified at the time the case was commenced. This is not the case here. Petitioner argues only that she is a prevailing party under the qualified offer rule. This rule operates regardless of whether the taxpayer substantially prevailed in the proceeding or of whether the position of the Commissioner in the proceeding was substantially justified. *See Haas & Assocs. Accountancy Corp. v. Commissioner,* 117 T.C. at 59.

When respondent sent the stipulation documents to petitioner in September 2013, she refused to sign them. In later filings respondent stated that he conceded the issue of innocent spouse relief under section 6015. Moreover, even after the [*17] concession, respondent continued to assert that the CDP case was not moot up until the trial in November 2013.

In terms of contract law analysis, respondent's proposed contract terms-conceding only the innocent spouse case—were rejected by petitioner on September 28, 2013. Petitioner's counteroffer—that respondent should concede both the CDP and the innocent spouse case —was rejected by respondent in his subsequent filings. Under the facts of this case, we conclude that respondent's concession in the innocent spouse case does not constitute a settlement under section 7430(c)(4)(E)(ii)(I). There was no manifestation of mutual assent and exchange of consideration pursuant to a bargain between the parties. Thus, there was no settlement, and petitioner may qualify as the prevailing party with respect to the innocent spouse case under the qualifying offer rule as interpreted in *Knudsen II.*

IV. *Net Worth Requirement*

[13] Section 7430(c)(4)(A)(ii) incorporates the net worth requirement of 28 U.S.C. sec. 2412(d)(1)(B) in the definition of a "prevailing party." To meet the net worth requirement, an individual's net worth must not exceed $2 million at the time the petition was filed. Sec. 7430(c)(4)(A)(ii); 28 U.S.C. sec. 2412(d)(1)(B). [*18] Rule 231(b)(5) requires a statement, supported by an affidavit executed by the moving party (and not counsel therefor), that the moving party meets the net worth requirement. If a taxpayer fails to sufficiently establish net worth and the Commissioner challenges whether the taxpayer has met the net worth requirement, the taxpayer must provide additional evidence. *Park v. Commissioner,* T.C. Memo. 2002–232; *see also Estate of Hubberd v. Commissioner,* 99 T.C. 335, 341 (1992); *Dixson Int'l Serv. Corp. v. Commissioner,* 94 T.C. 708, 719 (1990). In *Dixson,* this Court denied the award of litigation costs when the taxpayers failed to provide adequate proof of their net worth when they were put on notice that the Commissioner had specifically objected to granting the motion for that reason.

***7** **[14]** Petitioner made the required statement and filed a supplemental affidavit providing a list and the values of her assets as of the date she filed the petition in the innocent spouse case. Petitioner stated that her net worth at that time was $1,586,994. Respondent points out that petitioner did not include certain assets in the calculation, including shareholder loans to foreign entities wholly owned by her (Canadian corporations) [4] and cash deposited in foreign bank accounts.

[*19] Respondent argues that if the omitted items are added into the calculation, petitioner fails to meet the net worth requirement. We agree with respondent.

Respondent first raised the issue of net worth in the response to petitioner's motion for reasonable litigation or administrative costs filed on March 20, 2014. Petitioner failed to substantively address the issue of net worth in the pre-*Angle I* filings. This alone would be sufficient for the Court to deny petitioner's motion under *Dixson.* Petitioner first addressed the concerns raised by respondent in the first supplement to affidavit of William E. Taggart, Jr., in support of the motion for reasonable litigation or administrative costs filed on November 13, 2015. In his response to that first supplement to affidavit, respondent pointed out that the net worth calculations omitted loans by petitioner to the Canadian corporations totaling $3,508,009.47. [5] Petitioner argues that these loans were worthless at the time the petition in the innocent spouse case was filed because the corporations to which petitioner made loans did not have sufficient assets to repay them. We note [*20] that petitioner did not introduce any evidence that she treated these loans as worthless on her tax returns for 2011 or any prior years.

This Court has previously held that net worth, for purposes of the Equal Access to Justice Act, 28 U.S.C. sec. 2412(d)(2)(B) (1994), as incorporated by section 7430(c)(4)(A)(iii), is determined on the basis of the cost of acquisition under generally accepted accounting principles (GAAP) rather than the fair market value of assets. *Swanson v. Commissioner,* 106 T.C. 76, 96 (1996); *see also* H.R. Rept. No. 96–1418, 96th Cong., 2d Sess. 15 (1980); *Am. Pac. Concrete Pipe Co. v. NLRB,* 788 F.2d 586, 591 (9th Cir.1986) (holding that generally accepted accounting principles apply in calculation of net worth under 28 U.S.C. sec. 2412(d)(2)(B) and allowing the taking into account of depreciation).

Notes receivable are assets under GAAP. *See* U.S. GAAP Codification of Accounting Standards, Topics 310. The cost of acquisition of a note receivable exchanged for cash is the amount of cash received in exchange for the note. *Id.,* Topic 310–10–30–2. If the interest on the note is unstated, it is recorded in the books as having value in an amount that reasonably approximates the fair value of the note. *Id.,* Topic 310–10–30–5.

The parties do not argue that petitioner's loans to the Canadian corporations are in fact an investment in equity. Petitioner maintains that the loans are bona [*21] fide business loans. Petitioner also does not argue that the notes were exchanged for goods or services. Thus, we conclude that the notes were exchanged for cash loans from petitioner to the Canadian corporations. Further, because the notes did not state interest or a maturity date, we conclude that they were initially recorded on the books at values that reasonably approximated the fair values of the notes. Because the Canadian corporations did not make any payments on the loans, the values of the notes remained the same at least until the filing of petitioner's petition in the innocent spouse case. Thus, the face values of the loans reported on the Canadian corporations' books represent acquisition values for the notes receivable held by petitioner.

***8** We next address petitioner's argument that she did not have to report the loans as assets because they had become worthless by the time she filed the petition in the innocent spouse case. Petitioner argues that the amounts she reported as the values of her interest in the Canadian corporations represent the value of her equity and debt investments combined. Because the corporations did not have sufficient assets to repay the debts to petitioner on demand, she treated these loans as worthless in calculating her net worth. Financial difficulties of a debtor, however, do not always indicate worthlessness of a debt. *See Prod. Steel, Inc. v. Commissioner,* T.C. Memo. 1979–361. Petitioner did not introduce any [*22] evidence besides corporate financial statements that would give us any basis to conclude that petitioner's loans were indeed worthless and should be disregarded in the computation of petitioner's net worth. Petitioner also did not produce any evidence that she and the debtor corporations treated the loans as worthless for tax or any other purposes for 2011 or prior tax years.[6] To the contrary, in 2011 both Canadian corporations still listed the loans made by petitioner as outstanding.

Thus, we conclude that the costs of acquisition for the notes representing the loans made by petitioner equal the values of the loans reported on the books of the Canadian corporations. Contrary to petitioner's assertion, there is no evidence that the loans were indeed worthless at the time of filing the petition in the innocent spouse case. On the basis of the notes alone, petitioner's net worth far exceeds the $2 million limit set by the Equal Access to Justice Act, 28 U.S.C. sec. 2412(d)(2)(B), as incorporated by section 7430(c)(4)(A)(iii).

[*23] Next, respondent also introduced evidence showing that petitioner had two bank accounts with the Bank of Montreal in 2011. The maximum value of these accounts according to the Report of Foreign Bank and Financial Accounts (FBAR) petitioner filed for the 2011 tax year totaled $360,237. We do not express any opinion on whether the maximum value of bank accounts reported on the FBAR fairly represented the amounts in these accounts as of December 23, 2011, the filing date of the petition in the innocent spouse case. We note, however, that this evidence casts serious doubt on the veracity of the information petitioner provided to prove she met the net worth requirements.

Under the circumstances, we find that petitioner's net worth exceeded the $2 million statutory limit. Thus, petitioner's motion for litigation or administrative costs in the innocent spouse case must be denied. *See Minahan v. Commissioner,* 88 T.C. at 497 (stating that failure to meet any of the requirements of section 7430 precludes an award of costs).

V. *Conclusion*

In reaching our holdings, we have considered all arguments made, and to the extent not mentioned above, we conclude they are moot, irrelevant, or without merit.

[*24] To reflect the foregoing,

Appropriate orders will be entered.

All Citations

T.C. Memo. 2016-27, 2016 WL 702320, 111 T.C.M. (CCH) 1111, T.C.M. (RIA) 2016-027, 2016 RIA TC Memo 2016-027

Footnotes

[*] This opinion supplements our previously filed opinion *Angle v. Commissioner,* T.C. Memo. 2015–92.

[1] Unless otherwise indicated, section references are to the Internal Revenue Code in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure.

[2] The fourth case pertained to respondent's collection efforts for petitioner and Mr. Angle's excise tax liability under sec. 1491 for 1995. On August 13, 2012, petitioner filed a petition in this Court seeking review of respondent's collection activities, which was assigned docket No. 20240–12L. On September 12, 2013, the Court entered a stipulated decision setting forth the parties' agreement that respondent's determinations regarding the collection of petitioner's excise tax liability would not be sustained.

[3] Petitioner seems to raise the issue that she substantially prevailed for the purposes of sec. 7430(c)(4)(A) for the first time in the reply to response to second supplemental affidavit of William E. Taggart, Jr., filed on December 28, 2015. We note that motions to reconsider or vacate are not an appropriate forum for advancing new legal theories to reach the end result desired by the movant. *See Estate of Quick v. Commissioner,* 110 T.C. 440, 441–442 (1998). Petitioner's argument is untimely, and thus we will not consider it.

[4] The names of the corporations are 482019 British Columbia LTD and Bonn & Graff LTD.

[5] Financial statements of 482019 British Columbia LTD for 2011 show that petitioner lent the company 3,121,294 Canadian dollars (CAD). Financial statements of Bonn & Graff LTD for 2011 show that petitioner lent the company 455,576 CAD. After converting these amounts to U.S. dollars at the rates specified in the respective financial statements, we arrive at the total of $3,508,009.47.

[6] It is not likely petitioner could have claimed a deduction for worthless securities because the loans did not satisfy the requirements of sec. 165(g)(2)(c) as they were not in registered form and did not have any interest stated. It is also not likely petitioner could have claimed a deduction for worthless debt under sec. 166 because there is no indication she tried to collect on the debts at all. *See Brewer v. Commissioner,* T.C. Memo. 1992–530.

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142 F.Supp.3d 37
United States District Court,
District of Columbia.

United States of America Plaintiff,
v.
All Assets Held at Bank Julius Baer & Company, Ltd., Guernsey Branch, Account Number 121128, in the name of Pavlo Lazarenko et al., Defendants in Rem.

Civil Action No. 04–798 (PLF/GMH)
|
Signed 11/03/2015

Synopsis
Background: Government brought civil forfeiture action against assets in various foreign bank accounts of claimant, the former Prime Minister of Ukraine, alleging that the assets were traceable or otherwise related to criminal activity that occurred at least in part in the United States. Government moved to compel production of claimant's tax records and other financial documents.

Holdings: The District Court, G. Michael Harvey, United States Magistrate Judge, held that:

[1] claimant's tax returns were relevant;

[2] statutory prohibition on disclosure of tax returns by government employees does not govern government's attempt to obtain tax returns from private litigants in civil discovery;

[3] claimant's tax returns were not protected from discovery by any common-law qualified privilege; and

[4] claimant's pretrial services records and presentence investigation report were not discoverable.

Motion granted in part and denied in part.

Attorneys and Law Firms

***38** Daniel Hocker Claman, Della Grace Sentilles, Hector G. Bladuell, Teresa Carol Turner–Jones, U.S. Department of Justice, Washington, DC, Nalina Sombuntham, U.S. Attorney's Office, Miami, FL, for Plaintiff.

Bryant Everett Gardner, Winston & Strawn LLP, Washington, DC, Doron Weinberg, Weinberg & Wilder, San Francisco, CA, for Defendants In Rem.

MEMORANDUM OPINION

G. MICHAEL HARVEY, United States Magistrate Judge

On March 26, 2015, this case was referred to the undersigned for purposes of management of discovery and resolution of any discovery-related disputes. Currently ripe for resolution by the undersigned is plaintiff's motion to compel Claimant Pavel Lazarenko to produce certain tax records and other financial documents. After a thorough review of the parties' briefs and the entire record herein, the Court will grant in part and deny in part plaintiff's motion. [1]

BACKGROUND

The factual background concerning this eleven-year-old *in rem* asset forfeiture action has been described in multiple opinions by Judge Friedman. *See, e.g.,* ***39** *United States v. All Assets Held at Bank Julius Baer & Co., Ltd.,* 772 F.Supp.2d 191, 194 (D.D.C.2011). [2] This Court will not repeat that lengthy history here. The facts that are pertinent to the adjudication of Claimant's motion are summarized below.

In its First Amended Complaint, the United States seeks the forfeiture of more than $250 million deposited in over twenty bank accounts located in Guernsey, Antigua and Barbuda, Switzerland, Lithuania, and Lichtenstein. First Amended Complaint [Dkt. 20] at ¶¶ 1, 5. The government alleges that the money in those accounts is traceable to a "variety of acts of fraud, extortion, bribery, misappropriation, and/or embezzlement" committed by Claimant, the former Prime Minister of the Ukraine, or by his associates, between 1992 and 1999. *Id.* at ¶¶ 6, 8, 10. The United States asserts its right to the funds pursuant to federal statutes that provide for the forfeiture to the government of funds traceable, or otherwise related to or involved in, criminal activity that occurred at least in part in the United States. *Id.* at ¶ 1.

On October 16, 2014, plaintiff propounded several requests for production on Claimant. Mot. at 7. Request No. 28 requested that Claimant:

> Produce all documents and communications relating to personal income tax returns, business tax returns, and Reports of Foreign Bank and Financial Accounts (FBARs) filed with or submitted to the United States Government or any State of the United States of America by or on your behalf or any legal entity in which you claim an interest for the years 1992 to date.

Id. Similarly, Request No. 29 requested that Claimant:

> Produce all documents and communications submitted to the Government of the United States of America, any State of the United States of America or any other foreign or domestic government office concerning your income or assets, including but not limited to any financial disclosure documents, tax returns, or other statements of income you have submitted to any government between January 1, 1992 and the present.

Id.

Claimant responded to the government's requests with several general objections, which stated that Claimant objected "to any and all Document Requests to the extent that they are overly broad, seek information that is irrelevant, ... are unduly burdensome, ... are not reasonably calculated to lead to the discovery of admissible evidence, are oppressive, and are propounded merely to harass or annoy Claimant." Opp. at 2. Further, Claimant objected "to any and all Document Requests to the extent they purport to require the disclosure of material or information that exceeds the scope of discovery permitted under the Federal Rules of Civil Procedure" and "to the extent they seek information and documents from before January 1, 1993 or after October 19, 1999." *Id.*

Claimant also made several specific objections. With respect to Request No. 28, Claimant responded, "Claimant objects to this request to the extent that it requires the production of records subject to 26 U.S.C. § 6103. Claimant is not in possession of any FBAR records." *Id.* at 8. As to Request No. 29, Claimant responded,

> Claimant objects to this request to the extent it is duplicative of Request No. ***40** 28. Claimant also objects to this request to the extent it seeks confidential information provided to the U.S. Probation Office, Pretrial Services and the IRS. Claimant further objects to the extent that this request requires him to contact the U.S. Courts to obtain records that he does not possess.
>
> The following privileged documents are in Claimant's possession and otherwise not governed by 26 U.S.C. § 6103:

Date	Description
August 2013	Financial Statement to U.S. Probation Office
October 2013	Financial Statement to U.S. Probation Office

*Id.*After unsuccessfully attempting to resolve its dispute with Claimant, plaintiff brought the instant motion. *See id.* at 8–11.

In its motion, the government makes three arguments. First, it argues that Claimant has waived any objection based on the relevance of the requested records because he did not assert a relevance objection specifically in response to either request. Mot. at 12–13. Second, plaintiff claims that even if relevance was at issue, Claimant's tax records are relevant as to numerous issues, including: (1) whether Claimant can establish an interest in the defendant assets; (2) whether Claimant can offer a legitimate source for the portions of the assets he claims; (3) whether Claimant obtained any claimed assets illegally; and (4) whether forfeiture of the defendant assets is appropriate. *Id.* at 17–18. Finally, plaintiff contends that section 6103 does not bar discovery here because it governs only government employees who are involved in tax administration, not Claimant. *Id.* at 14. Plaintiff further argues that no other common-law privilege protects Claimant's tax records from disclosure. *Id.* at 15.

Claimant opposes the motion, arguing that his tax records are not discoverable. First, Claimant represents that he has no financial records for fiscal years 1992 to 1999 and so he cannot respond to that portion of plaintiff's requests. Opp. at 3. Second, Claimant argues that any records from 2000 to present are not relevant in this action. *Id.* at 3. As part of this argument, Claimant appears to suggest that his general relevance objections are sufficient to preserve his relevance objections as to the specific requests at issue here. *See id.* at 2.

On the substance of the requests, Claimant argues that he has no tax records for years 2000 to present except his tax returns, his statements in his criminal case to United States Pretrial Services, and his Presentence Investigation Report. *Id.* at 3. As to the Pretrial Services records and Presentence Investigation Report, Claimant refuses to produce them because he believes they are confidential under 18 U.S.C. § 3153(c)(2) and Local Rule 32–7 of the United States District Court for the Northern District of California. *Id.* at 4. Further, Claimant argues that any of his tax returns from 2000 to present are irrelevant here because: (1) he does not need them to establish his standing to intervene in this case, *id.* at 5–8; (2) the fact that he did not file tax returns for certain years is not necessarily evidence of illegality, *id.* at 10–16; (3) disclosure of such records by the IRS to the government would violate section 6103, *id.* at 16–18; and (4) Claimant has a qualified, common-law privilege to withhold his tax returns, *id.* at 8–10. Finally, Claimant contends that section 6103 prohibits disclosure of his tax records ***41** to plaintiff in this civil forfeiture action because the statute requires that the records be relevant before they can be released. *Id.* at 16–17.

In its reply, the government reiterates its argument that Claimant has waived any relevance objections by failing to make them specifically in reference to the requests at issue. Reply at 3–4. Additionally, plaintiff claims that Claimant should be compelled to obtain his Ukrainian tax records from 1992 to 1999 from the relevant Ukrainian authorities for production to plaintiff. *Id.* at 4–6. Plaintiff further demands that if Claimant has not filed tax returns for the relevant years, he must affirmatively state as much. *Id.* at 5. Moreover, the government argues that even if Claimant enjoyed a qualified privilege to withhold his tax returns, the government has met its burden to overcome that privilege—namely, by establishing that the records are relevant and are not available from another source. *Id.* at 6–12. Finally, the government observes that many of Claimant's arguments go to merits of the government's forfeiture claim or Claimant's intervention and not to whether the records at issue meet the low bar required for discovery. *Id.* at 14–19.

LEGAL STANDARD

[1] **[2]** **[3]** It has long been recognized that, "[u]nder the broad sweep of Rule 26(b)(1) of the Federal Rules of Civil Procedure, a party 'may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved.' " *Friedman v. Bache Halsey Stuart Shields, Inc.,* 738 F.2d 1336, 1348–49 (D.C.Cir.1984) (quoting Fed.R.Civ.P. 26(b)(1)). If a party objects to a request for production of documents under Federal Rule of Civil Procedure 34(a)(1), the requesting party may move for an order compelling disclosure of the withheld material. Fed.R.Civ.P. 37(a). The party that brings the motion to compel "bears the initial burden of explaining how the requested information is relevant." *Jewish War Veterans of the United States of America, Inc. v. Gates,* 506 F.Supp.2d 30, 42 (D.D.C.2007). The burden then shifts to the non-moving party "to explain why discovery should not be permitted." *Id.* If a party has withheld documents on the grounds that they are privileged, the withholding party "bears the burden of proving the communications are protected." *In re Lindsey,* 158 F.3d 1263, 1270 (D.C.Cir.1998).

DISCUSSION

Plaintiff has met its burden in establishing that the tax and other financial records requested in Requests for Production Nos. 28 and 29 are discoverable for fiscal years 1992 to 1999. Consistent with the Court's prior orders, the Court finds that plaintiff has also met that burden with respect to records relating to fiscal years

2000 to the present, but only for the limited purpose of discovering information relating to Claimant's standing to intervene in this case. Additionally, the Court finds that 26 U.S.C. § 6103 and common-law protections for tax records do not shield Claimant from the government's discovery requests. Nevertheless, the undersigned will not order Claimant to produce his Pretrial Services records and Presentence Investigation Report from the Northern District of California, as those documents are subject to special statutory and court-imposed protections.

A. Relevance Objections and Waiver

As a threshold matter, the government argues that Claimant has waived any relevance objections to Requests for Production No. 28 and 29. Federal Rule of Civil Procedure 34(b)(2)(B) requires a party responding to a request for production to state objections within 30 days of service. Fed.R.Civ.P. 34(b)(2)(A)-(B). Plaintiff ***42** claims that Claimant's general, blanket relevance objection, stated at the beginning of his responses, is insufficient under Rule 34 to apply to any specific request made by plaintiff. There may well be merit in plaintiff's suggestion. *See DL v. Dist. of Columbia,* 251 F.R.D. 38, 43 (D.D.C.2008); *Hanwha Azdel, Inc. v. C & D Zodiac, Inc.,* No. 12–cv–00023, 2013 WL 3660562, at *5 (W.D.Va. July 11, 2013) (relevance objections waived because the party generally objected "to the extent [the request] seeks information that is not relevant"); *Sonnino v. Univ. of Kan. Hosp. Auth., Inc.,* 221 F.R.D. 661, 666–67 (D.Kan.2004) ("This Court has on several occasions 'disapproved [of] the practice of asserting a general objection 'to the extent' it may apply to particular requests for discovery.' ... Thus, this Court has deemed such 'ostensible' objections waived, or declined to consider them as objections.").

[4] Nevertheless, the Court need not determine whether Claimant has waived his relevance objections because the Court finds that the objections fail on the merits. In its prior order of July 20, 2015, the undersigned rejected similar objections by Claimant. *See* July 20, 2015 Order at 25–29. There, Claimant objected to several interrogatories by plaintiff which requested, *inter alia,* that Claimant explain the source of funds from which the *in rem* assets were derived, Claimant's income during fiscal years 1992 to 1999, and the reasons that the sources of funds provided income or assets to Claimant. *Id.* at 25. Claimant objected that the interrogatories were overbroad. *Id.* at 26. The undersigned found otherwise, reasoning that the sources of funds from which the *in rem* assets were derived and the reasons that each source provided those funds to Claimant are issues "at the very heart of the government's case." *Id.* The undersigned therefore found that "[t]he government is clearly entitled to discover" the information it sought. *Id.*

Similarly, the undersigned later observed that "Claimant's income and assets during the relevant time period, and the reasons that each source provided the income or assets to him" were discoverable. *Id.* at 27. The undersigned reasoned that because the government alleged that Claimant amassed huge wealth between 1992 and 1999 while reporting only a miniscule income, the government was entitled to discover the nature and cause of the disparity. *Id.* Indeed, that disparity, "if proven true, itself [would be] evidence of the illegality the government is seeking to prove in this action." *Id.* at 28 (citing *United States v. $185,000,* 455 F.Supp.2d 145, 155 (E.D.N.Y.2006)). Claimant's bare assertion that his income was legitimate was insufficient to resist discovery; instead, the undersigned found that "Claimant's assertion may be tested by the government through discovery." *Id.* Finally, the undersigned found that the government, based on the allegations in its Amended Complaint, was entitled to discover "the corporate entities and bank accounts Claimant was using" during the time period at issue—1992 to 1999. *Id.* at 29. However, the undersigned rejected the government's attempt to discover such information for fiscal years 2000 to present. *Id.*

The undersigned's prior ruling frames the discussion of the instant motion because the issues raised in the prior ruling—*i.e.,* the source and legitimacy of Claimant's income and assets—are also implicated by the requests at issue here. First, as to fiscal years 1992 to 1999, the undersigned, consistent with the Court's prior order, finds that the tax records plaintiff seeks are relevant. As the undersigned has previously held, records relating to the source of Claimant's assets and income during that period lie "at the very heart of the government's case." *Id.* at 25. Such records are relevant to establishing: ***43** (1) whether Claimant's income during the period matches the quantum of assets he claims here, *see United States v. $30,670,* 403 F.3d 448, 466 (7th Cir.2005); *United States v. $174,206,* 320 F.3d 658, 662 (6th Cir.2003); (2) whether Claimant can prove that his income sources were legitimate, *see United States v. $21,055,* 778 F.Supp.2d 1099, 1105 (D.Kan.2011); *United States v. Cunningham,* 520 Fed.Appx. 413, 415 (6th Cir.2013); and (3) whether Claimant failed to file tax returns at all, a fact which may support forfeiture of the defendant assets, *see $174,206,* 320 F.3d at 662; *Cunningham,* 520 Fed.Appx. at 415. At minimum, plaintiff's requests for these records are reasonably calculated to lead to the discovery of admissible evidence on these issues. No more is required under the liberal discovery standard embodied in Rule 26. July 21, 2015 Order at 31 ("[D]iscovery may be obtained of any matter, not privileged, which is relevant to a claim or defense or is reasonably calculated to lead to the discovery of admissible evidence.") (citing Fed.R.Civ.P. 26(b)(1)); *Friedman v. Bache Halsey Stuart Shields, Inc.,* 738 F.2d 1336, 1348–49 (D.C.Cir.1984); *Food Lion v. United Food & Commercial Workers Int'l Union,* 103 F.3d 1007, 1012 (D.C.Cir.1997).

As noted above, Claimant represents that he has no tax records for fiscal years 1992 to 1999. Opp. at 3. Because the Court compels him to respond to the government's discovery requests at issue here, Claimant must produce any such records in conformity with the requirements of Rule 34. That Rule allows the requesting part to obtain documents which are in the responding party's "possession, custody, or control." Fed.R.Civ.P. 34(a)(1). "With regards to the term 'control,' it has been well established that the test for control is not defined as mere possession, but as the legal right to obtain such documents on demand." *Tequila Centinela, S.A. de C.V. v. Bacardi & Co., Ltd.,* 242 F.R.D. 1, 8 (D.D.C.2007) (citing *Alexander v. FBI,* 194 F.R.D. 299, 304 (D.D.C.2000)); *Tavoulareas v. Piro,* 93 F.R.D. 11, 20 (D.D.C.1981); *Kifle v. Parks & History Ass'n,* No. Civ.A. 98–00048(CKK), 1998 WL 1109117, at *1 (D.D.C. Oct. 15, 1998) (rejecting a party's "attempt to evade their discovery obligations by simply claiming that they do not possess the records sought"); *see also* 8A Charles A. Wright, Arthur R. Miller, & Richard L. Marcus, Federal Practice and Procedure § 2210 (2d ed. 1994) ("Inspection can be had if the party to whom the request is made has the legal right to obtain the document, even though in fact it has no copy"). Accordingly, the Court will direct that Claimant supplement his responses to the requests at issue here (and, indeed, his responses to all other requests for production in this case) not only with those documents he has in his immediate possession but also with those documents within his "control" as contemplated in Rule 34, including any tax records Claimant can obtain from the United States and Ukraine filed by or on Claimant's behalf or on behalf of any legal entity in which Claimant has an interest.

[5] Second, the Court finds persuasive plaintiff's argument in the instant motion that Claimant's 2000 to present tax records are relevant to the issue of standing. *United States v. $290,000,* 249 Fed.Appx. 730, 732 (10th Cir.2007); *United States v. $38,000,* 816 F.2d 1538, 1543–44 n. 12 (11th Cir.1987) (holding that because a forfeiture action is brought against the rem and not the claimant, the claimant bears the burden of proving that "he has a legally cognizable interest in the property that will be injured if the property is forfeited to the government. It is this claim of injury that confers upon the claimant the requisite 'case or controversy' standing to contest the forfeiture"); ***44** *U.S. v. All Assets Held at Bank Julius Baer & Co., Ltd.,* 959 F.Supp.2d 81, 95 (D.D.C.2013) ("Establishing standing requires ... that the claimant demonstrate 'a colorable interest in the property, for example, by showing actual possession, control, title, or financial stake.' "). Claimant argues that there is already ample evidence in the record that he has standing. Opp. at 6. Yet, under the broad scope of discovery embodied in Rule 26, the government is permitted to take further discovery on this issue to contest Claimant's evidence. Likewise, although Claimant argues that he was not required to file tax returns during this period in relation to the *in rem* assets or that he has a good-faith defense to his failure to file, *id.* at 15–16, such arguments are better addressed on the merits of Claimant's standing, not the scope of discovery.

Nevertheless, the 2000 to present records are relevant only for the limited purpose of adjudicating Claimant's standing, *i.e.,* only to the extent they bear on the question of Claimant's interest in defendant assets. As such, the undersigned will not authorize the government *carte blanche* to obtain all tax records from 2000 to present responsive to government's Request for Production No. 28. Rather, the undersigned finds relevant only those tax records, filed by or on Claimant's behalf or on behalf of any legal entity in which Claimant has an interest, which evidence an interest in, reflect income from, reflect income traceable to, or mention the defendant *in rem* assets. [3]

B. Privilege

Claimant's second argument to avoid disclosure of his tax records involves claims of privilege, both statutory and common-law. Neither provides Claimant a sound basis to refuse to respond to plaintiff's requests. Because the scope of each type of privilege is different, they will be treated separately below.

1. *Section 6103*

Claimant argues that section 6103 prohibits disclosure of his tax records to the government in this case. In his objections to Requests No. 28 and 29, Claimant did not identify any particular subsection of section 6103 which operates to prohibit the disclosure of his tax records. In the government's motion, it argues that subsection (a) does not apply because it controls only disclosure of tax returns by government employees, which of course Claimant is not. Mot. at 15. In his opposition, Claimant relies on a different subsection—subsection (i)—which limits the ability of government attorneys to access tax returns and tax return information. Opp. at 16. Subsection (i) provides, in relevant part:

> (i)(1)(A) Disclosure to Federal officers or employees for administration of Federal laws not relating to tax administration.—Disclosure of returns and return information for use in criminal investigations.—In general.—Except as provided in paragraph (6), any return or return information with respect to any specified taxable period or periods shall, pursuant to and upon the grant of an ex parte order by a Federal district court judge or magistrate under subparagraph (B), be open (but only to the extent necessary as provided in such order) to inspection by, or disclosure to, officers and employees of any Federal agency who are personally and directly engaged in—
>
> (i) preparation for any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United ***45** States or such agency is or may be a party,
>
> (ii) any investigation which may result in such a proceeding, or
>
> (iii) any Federal grand jury proceeding pertaining to enforcement of such a criminal statute to which the United States or such agency is or may be a party,
>
> solely for the use of such officers and employees in such preparation, investigation, or grand jury proceeding.
>
> ...
>
> (4)(A) Returns and taxpayer return information.—Except as provided in subparagraph (C), any return or taxpayer return information obtained under paragraph (1) or (7)(C) may be disclosed in any judicial or administrative proceeding pertaining to enforcement of a specifically designated Federal criminal statute or related civil forfeiture (not involving tax administration) to which the United States or a Federal agency is a party—
>
> (i) if the court finds that such return or taxpayer return information is probative of a matter in issue relevant in establishing the commission of a crime or the guilt or liability of a party, or
>
> (ii) to the extent required by order of the court pursuant to section 3500 of title 18, United States Code, or rule 16 of the Federal Rules of Criminal Procedure.

Id. 26 U.S.C. §§ 6103(i)(1)(A), (4)(A).

[6] This Court finds that section 6103 provides no basis for Claimant to avoid discovery requests in this civil case because that section only regulates disclosure of tax returns by the IRS, not private litigants. First, as a matter of text, the statute only purports to prohibit disclosure of tax returns by government employees. *See id.* § 6103(a). Subsection (i) opens a narrow exception to that rule by permitting disclosure to other government agencies when necessary for investigation and litigation. *See id.* § 6103(i)(1)(A). Contrary to Claimant's argument, subsection (i) does not govern attempts by the government to obtain tax returns from private litigants in civil discovery. Instead, it only controls attempts by the government to obtain tax returns directly from the IRS.

Second, the Court finds that the weight of case authority similarly holds that section 6103 did not enact a limitation on civil discovery. *See Commodity Futures Trading Comm'n v. Collins,* 997 F.2d 1230, 1233 (7th Cir.1993) ("[Section 6103] does not block access, through pretrial discovery or otherwise, to copies of tax returns in the possession of litigants; all it prevents is the IRS's sharing tax returns with other government agencies."); *United States v. $644,860,* No. 05–cv–4055, 2007 WL 1164361, at *1 (C.D.Ill. April 19, 2007) ("[Section 6103] does not apply to the discovery at issue [because] Plaintiff sought the tax returns from the claimants, not from a federal agency, employee, or other person designated by the statute."); *United States ex rel. Carthan v. Sheriff, City of New York,* 330 F.2d 100, 101 (2d Cir.1964) ("Disclosure by the taxpayer himself of his copies of returns is not an unauthorized disclosure, even though it be made by reason of legal compulsion."); *United States v. Art Metal–U.S.A., Inc.,* 484 F.Supp. 884, 887 (D.N.J.1980) ("Nothing in [section 6103] or in its legislative history can be reasonably regarded as barring any agency of the United States from gaining [tax returns] where relevant to an administrative investigation or to civil discovery."); *Stokwitz v. United States,* 831 F.2d 893, 896 (9th Cir.1987) ("[T]here is no indication in either the language of section 6103 or its legislative history that Congress intended to enact a general prohibition against public disclosure of tax information."); *Heathman v. District Court,* 503 F.2d 1032, 1035 (9th Cir.1974) ("[Section 6103] only restricts the dissemination of ***46** tax returns by the government and ... does not otherwise make copies of tax returns privileged."); *Gutescu v. Carey Intern, Inc.,* No. 01–4026–CIV, 2003 WL 25589038, at *1 (S.D.Fla. Aug. 29, 2003) ("The argument that sections 6103 and 7213 preclude the Court's power to order tax returns produced pursuant to Fed.R.Civ.P. 26 borders on the frivolous."). Indeed, even the *Gattegno* decision, which includes a lengthy discussion of the common-law privilege for tax returns, discussed further below, found that section 6103 is "not a valid basis for protection" of tax returns. *Gattegno v. Pricewaterhousecoopers, LLP,* 205 F.R.D. 70, 71 (D.Conn.2001) (emphasis omitted); *see also Zuniga v. Western Apartments,* No. CV 13–4637 JFW(JCx), 2014 WL 2599919, at *11 (C.D.Cal. Mar. 25, 2014). Likewise, the court in *Art Metal* observed that if courts applied section 6103 as broadly as Claimant asks this Court to do here, it "would effectively change the rules of civil discovery." *Art Metal,* 484 F.Supp. at 887. Claimant cites to no cases holding otherwise, and the undersigned has found no case applying subsection (i) to bar discovery in an ongoing civil case.

One additional issue arose during the briefing of this motion. In its motion, the government requested that this Court order Claimant to sign a release allowing it to obtain his tax records directly from the IRS. Mot. at 24. Claimant opposes signing a release, relying on section 6103. Opp. 16–18. Regardless of the application of that statute, the Court will deny the government's request. The government cites only two cases in which a court ordered a party to sign a release permitting the opposing party to seek tax information directly from the IRS. *Kelley v. Billings Clinic,* Cv. No. 12–14, 2013 WL 1414442, at *7 (D.Mont. Apr. 8, 2013); *Powell v. Merrimack Mut. Fire Ins. Co.,* 80 F.R.D. 431, 433 (N.D.Ga.1978). In both cases, the party seeking the release had actually requested it in discovery. Here, the government has requested Claimant's tax records, not a release. *See supra* at 39. As such, the propriety of compelling Claimant to sign such a release is not properly before the Court at this time.[4] Therefore, Claimant must respond to the government's requests but the Court will not, at this time, order him to sign any release enabling the government to obtain his tax records on its own.

2. *Common–Law Privilege*

[7] In response to plaintiff's motion, Claimant argues that there exists a common-law qualified privilege against the disclosure of his tax returns. Opp. at 8–10. Claimant did not raise this privilege in his actual responses to plaintiff's requests. Claimant identified only section 6103, not any other privilege, common-law or otherwise, in his responses to Requests No. 28 and 29. Neither do his general objections contain any reference to this privilege. As a result, the undersigned finds Claimant's common-law privilege objection waived. ***47** *Peskoff v. Faber,* 244 F.R.D. 54, 64 (D.D.C.2007) (objection to discovery request not raised in response can be considered waived); *see also In re Veiga,* 746 F.Supp.2d 27, 33–34 (D.D.C.2010) (proponent of a privilege "must adduce competent evidence in support of its claims" and "must offer more than just conclusory statements, generalized assertions, and unsworn averments of its counsel").

In any event, even if the objection was not waived, it is meritless. This Court has recently addressed the same "qualified privilege":

> With respect to income tax returns, courts, including this Court, acknowledge that they are "[']confidential communications between a taxpayer and the government.' " *Am. Air Filter Co., Inc., v. Kannapell,* No. 85–CV–3566, 1990 WL 137385, at *3 (D.D.C. Sept. 10, 1990) (quoting *Fed. Sav. & Loan Ins. Co. v. Krueger,* 55 F.R.D. 512, 514 (N.D.Ill.1972)). *Accord Nat'l Gas Pipeline Co. of Am. v. Energy Gathering, Inc.,* 2 F.3d 1397, 1411 (5th Cir.1993), *cert. denied,* 510 U.S. 1073, 114 S.Ct. 882, 127 L.Ed.2d 77 (1994). In the context of a discovery dispute, however,

> the key issue remains one of relevance. In other words, "[w]hile the courts vary in their interpretations of the breadth of the statutory protection [afforded by the tax laws] ... most courts do not recognize the existence of a 'privilege' against disclosure ... rather [the courts] recognize a general federal policy limiting disclosure to appropriate circumstances." *Eglin Fed. Credit Union v. Cantor,* 91 F.R.D. 414, 416 (N.D.Ga.1981). In order to determine whether disclosure is appropriate, the court must conclude "(1) that the returns are relevant to the subject matter of the action; and (2) that there is a compelling need for the returns because the information contained therein is not readily otherwise obtainable." *S.E.C. v. Cymaticolor Corp.,* 106 F.R.D. 545, 547 (S.D.N.Y.1985).

Robinson v. Duncan, 255 F.R.D. 300, 302 (D.D.C.2009). [5] As discussed in *Robinson*, although tax returns are not "privileged" in a formal sense, many courts recognize the important privacy and confidentiality concerns raised by their disclosure. Here, however, plaintiff has met its burden to demonstrate the relevance of certain of Claimant's tax records. *See supra* at 42–43.

Further, those tax records are not readily obtainable from other sources, creating a compelling need for plaintiff to seek them through discovery in this case. Indeed, it is section 6103 which creates this difficulty for the government because it prevents the IRS from disclosing any records to the government directly. 26 U.S.C. § 6103. Claimant's argument that "other evidence of [his] standing exists" misses the mark. Opp. at 10. The relevant question is not whether there is other evidence of Claimant's standing but whether there is other evidence of the information contained within his tax records.

The evidence Claimant points to falls well short of the sort of thorough, detailed information likely presented in his tax records regarding the nature, source, and amount of any income Claimant received from the defendant *in rem* assets. Although Claimant cites to testimony from various persons that certain assets belonged ***48** to Claimant, this evidence does not give a complete picture of all the assets or all of Claimant's income. Moreover, Claimant does not provide this evidence in the form of exhibits to his brief, so the Court is left unable to verify his statements. In short, Claimant has not demonstrated that the information contained in his tax records is readily obtainable from other sources. Accordingly, no common-law privilege grants Claimant the ability to refuse to answer plaintiff's requests.

The undersigned also notes that any confidentiality concerns Claimant has relating to his tax records and tax information are largely assuaged by the existence of a protective order in this case. *See Am. Air Filter Co., Inc. v. Kannapell,* CIV. A. No. 85–3566, 1990 WL 137385, at *4 (D.D.C. Sept. 10, 1990) ("[T]he traditional privacy concerns are not present in this action [because] the plaintiff has offered to sign a confidentiality stipulation prohibiting disclosure of the returns...."). That protective order gives Claimant discretion to designate as confidential certain documents he produces in discovery. Without determining whether designating his tax returns as confidential is in fact appropriate, the undersigned observes that the protective order is arguably broad enough to permit such a designation.

C. Claimant's Pretrial Services Records and Presentence Investigation Report

[8] Although Claimant's tax records are properly discoverable in this case, Claimant's Pretrial Services records and Presentence Investigation Report, prepared in connection with his criminal prosecution in the Northern District of California, present additional concerns that militate against their disclosure. [6] In his opposition to the instant motion, Claimant argues that 18 U.S.C. § 3153 and California Criminal Local Rule 32–7 protect his Pretrial Services records and Presentence Investigation Report. Opp. at 3. The statute Claimant cites provides that "information obtained in the course of performing pretrial services functions in relation to a particular accused shall be used only for the purposes of a bail determination and shall otherwise be confidential." 18 U.S.C. § 3153(c)(1). Criminal Local Rule 32–7 in the Northern District of California states that "[a] presentence report, probation, supervised release report, violation report and related documents to be offered in a sentencing or violation hearing are confidential records of the Court. Except as otherwise required by Fed.R.Crim.P. 26.2, authorized by statute, federal rule or regulation or unless expressly authorized by order of the Court, such records shall be disclosed only to the Court, court personnel, the defendant, defense counsel and the attorney for the government in connection with sentencing, violation hearings, appeal or collateral review." N.D. Cal.Crim. L.R. 32–7(a).

The undersigned finds that section 3153 protects Claimant's confidential Pretrial Services records from the Northern District of California. Confidential treatment of pretrial services information is intended ***49** to "protect [ ] the relationship between the pretrial services officer and the particular defendant. Defendants may be reluctant to cooperate with pretrial services officers unless assured of the confidentiality of the information they reveal to the officers. The courts, in turn, would receive only incomplete information." H.R. Conf. Rep. 97–792, at 8 (1982), reprinted in 1982 U.S.C.C.A.N. 2393, 2394. In the criminal context, the Second Circuit has observed that "a request by a third party for the pretrial services report of a government witness creates a tension between this confidentiality and the government's discovery obligations." *United States v. Pena,* 227 F.3d 23, 26 (2d Cir.2000). The Second Circuit held that courts should conduct *in camera* review of such records to determine if any information contained therein should be disclosed pursuant to the government's obligations under *Brady, Giglio,* and other cases. *Id.* In perhaps the only civil case applying section 3153, the Ninth Circuit—where the documents at issue here were created—found that even the First Amendment right of access to criminal trials is circumscribed by section 3153. *Seattle Times Co. v. U.S. Dist. Court for W. Dist. of Washington,* 845 F.2d 1513, 1522 (9th Cir.1988). Although the Ninth Circuit's rulings are not binding on this Court, its application of section 3153 to the records of one of its own district courts is persuasive. Because courts closely guard the confidentiality of such records, even in the civil context, the undersigned will not compel Claimant to disclose his Pretrial Services records to plaintiff.

Similarly, although the undersigned doubts that this Court is bound by the local rules of another district court, this Court will not order the production of the presentence investigation report which the Northern District of California's rules seek to keep confidential. It is well-settled that presentence reports are usually highly confidential documents. *See Beller v. United States,* 221 F.R.D. 674, 679 (D.N.M.2003); *United States v. Krause,* 78 F.R.D. 203, 204 (E.D.Wis.1978). Presentence reports are therefore normally discoverable only on a showing of special need. *U.S. Dep't of Justice v. Julian,* 486 U.S. 1, 12, 108 S.Ct. 1606, 100 L.Ed.2d 1 (1988). Plaintiff has not attempted to make such a showing here. Moreover, to the extent plaintiff desires to discover the Presentence Investigation Report, the local rule cited by Claimant permits a request for disclosure to be made to the sentencing judge. *See* N.D. Cal.Crim. L.R. 32–7(b). If plaintiff truly desires a copy of the report, it should make that request in the Northern District of California.

CONCLUSION

Wherefore, for the foregoing reasons, plaintiff's Motion to Compel Production of Records [Dkt. 429] is **GRANTED IN PART** and **DENIED IN PART**. An Order consistent with this Memorandum Opinion will be filed contemporaneously herewith.

All Citations

142 F.Supp.3d 37, 116 A.F.T.R.2d 2015-6650, 93 Fed.R.Serv.3d 387

Footnotes

[1] The relevant docket entries for purposes of this Memorandum Opinion are: (1) Plaintiff's Motion to Compel Production of Records ("Mot.") [Dkt. 429]; (2) Claimant Pavel Lazarenko's Opposition to Plaintiff's Motion to Compel ("Opp.") [Dkt. 447]; (3) Plaintiff's Reply in Support of Its Motion to Compel ("Reply") [Dkt. 454]; (4) July 20, 2015 Memorandum Opinion [Dkt. 417].

[2] *See also United States v. All Assets Held at Bank Julius Baer & Co, Ltd.,* 772 F.Supp.2d 205 (D.D.C.2011); *United States v. All Assets Held at Bank Julius Baer & Co. Ltd.,* 664 F.Supp.2d 97 (D.D.C.2009); *United States v. All Assets Held at Bank Julius Baer & Co., Ltd.,* 571 F.Supp.2d 1 (D.D.C.2008).

[3] As with the 1992 to 1999 records, Claimant should be mindful of his obligations under Rule 34 when producing these records.

[4] Moreover, crafting an appropriate release in this case would likely be very difficult. *Kelley* and *Powell* are far simpler than the instant case. They each involve the tax records of one person with finances exponentially less complex than Claimant's. *Kelley,* 2013 WL 1414442, at *7; *Powell,* 80 F.R.D. at 433. Further, each involves requests tailored to a specific, easily identifiable timeframe. *Kelley,* 2013 WL 1414442, at *7; *Powell,* 80 F.R.D. at 433. Here, by contrast, a

release requiring the IRS to produce records “consistent with this Order” would place a great interpretive burden on the IRS to determine which records should or should not be released. It is a burden which the IRS might well decline to undertake. The better approach is what the Court orders here: that Claimant must obtain his own tax records and produce those relevant portions required by the instant Order. Nevertheless, if the government can craft a release with manageable temporal and topical criteria, the Court can then consider whether to order Claimant to sign it.

[5] Some courts reject this heightened showing required for discovery of tax returns. *See, e.g., Jackson v. N'Genuity Enter. Co.,* No. 09 C 6010, 2010 WL 4928912, at *2 (N.D.Ill. Nov. 29, 2010). Because the undersigned finds that plaintiff has met the higher standard endorsed in *Robinson,* the undersigned need not decide whether the lower standard is more in line with the text and purpose of Rule 26.

[6] Both plaintiff and Claimant make passing reference to records of the United States Probation Office for the Northern District of California. Mot. at 5; Opp. at 4. Neither party clearly defines what these records are. Claimant argues that he already produced these records, whatever their nature, in discovery during his prosecution. Opp. at 4. In its reply, the government does not challenge this assertion or press any other arguments related to the Probation Office records. Instead, the government only addresses the Pretrial Services records and Presentence Investigation Report. Reply at 19. Because neither party develops the facts or arguments related to Claimant's Probation Office records, the Court declines to rule on their discoverability at this time.

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741 F.3d 339
United States Court of Appeals,
Second Circuit.

In re GRAND JURY SUBPOENA
DATED FEBRUARY 2, 2012.
United States of America, Movant–Appellee,
v.
John Doe, Respondent–Appellant.

Docket No. 13–403–cv.
|
Argued: Aug. 22, 2013.
|
Decided: Dec. 19, 2013.

Synopsis
Background: United States sought order compelling John Doe respondent to comply with grand jury subpoena for foreign banking records for accounts in which respondent had a financial interest. The United States District Court for the Eastern District of New York, Joseph F. Bianco, J., 908 F.Supp.2d 348, granted government's motion to compel and held respondent in contempt but suspended the monetary sanction pending appeal. Respondent appealed.

[Holding:] The Court of Appeals, Wesley, Circuit Judge, held that required records exception to act of production doctrine was applicable.

Affirmed.

Attorneys and Law Firms

***341** Robert S. Fink (Caroline Rule, Brian P. Ketcham, on the brief), Kostelanetz & Fink, LLP, New York, NY, for Appellant John Doe.

Alexander P. Robbins (Kathryn Keneally, Assistant Attorney General, Frank P. Cihlar, Chief, Criminal Appeals & Tax Enforcement Policy Section, Gregory Victor Davis, Attorney, Tax Division, United States Department of Justice, on the brief), for Loretta E. Lynch, United States Attorney for the Eastern District of New ***342** York, Brooklyn, NY, for Appellee United States America.

Marc L. Greenwald, Cleland B. Welton II, Quinn Emanuel Urquhart & Sullivan, LLP, New York, NY, for Amicus Curiae New York Council of Defense Lawyers.

Before: WINTER, WESLEY, and CARNEY, Circuit Judges.

Opinion

WESLEY, Circuit Judge:

John Doe appeals from a contempt order and an order compelling him to comply with a grand jury subpoena entered in the United States District Court for the Eastern District of New York (Joseph F. Bianco, *Judge*). With respect to any foreign bank accounts in which Doe has a financial interest, the subpoena seeks records that the Bank Secrecy Act("BSA") requires Doe to maintain. *See* 31 C.F.R. § 1010.420. Doe resists, asserting that the Fifth Amendment privilege against self-incrimination applies to his delivery of the requested documents. The district court held that requiring Doe to produce the subpoenaed documents, over his objections, did not violate Doe's right against self incrimination because the documents were "required records"—records whose creation and preservation serves a legitimate governmental regulatory interest. *In re Grand Jury Subpoena Dated February 2, 2012,* 908 F.Supp.2d 348, 352 (E.D.N.Y.2012). Doe contends both that the "required records" doctrine no longer exists and that, if it does, it does not apply to his case. We are not persuaded and AFFIRM the judgment of the district court.

Background

A federal grand jury in the Eastern District of New York issued a subpoena to Doe calling for him to produce records of his foreign bank accounts, including the names of the account holders, the banks, the account numbers, the type of the account, and the maximum value of the account [1] —all information that must by law be reported to the Commissioner of Internal Revenue. 31 C.F.R. §§ 1010.350, 1010.420. Doe did not comply. The government moved to compel Doe to produce the documents and Doe continued to resist. The district court granted the government's motion. *Subpoena Dated February 2, 2012,* 908 F.Supp.2d 348. Doe still refused to comply, and thereafter the district court entered an order holding Doe in contempt for failure to produce the records. The court imposed a sanction (suspended pending his appeal) of $1,000 per day until he complies.

Discussion

Doe contends that the Fifth Amendment insulates him from a contempt order based on his refusal to comply. He claims that the grand jury's subpoena requires him either to produce documents that might incriminate him or to confirm that he failed to register his foreign bank accounts, ***343** which itself could be incriminating. The government counters that while Doe might otherwise have legitimate Fifth Amendment concerns, the subject documents are records required by federal law, and that the government has a legitimate regulatory interest in requiring Doe, and others like him, to maintain records of offshore accounts. Accordingly, the government contends, it is entitled to demand that Doe produce the records. Thus, we are presented with the question of whether the subpoenaed records fall within the aptly named "required records" exception to the Fifth Amendment act of production privilege. We hold that it does.

I. The Act of Production Privilege under the Fifth Amendment

[1] The Fifth Amendment act of production privilege was first articulated in *Fisher v. United States,* 425 U.S. 391, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976). *Fisher* recognizes that the Fifth Amendment privilege might protect an individual from being required to produce documents, even if the documents' contents are not protected by the privilege, when the witness's simple act of producing the documents could be used against the witness—for example, in those cases when the simple fact that the witness possessed the documents would be incriminating.

In *Fisher* the Court addressed a consolidated challenge by two clients whose lawyers were compelled to produce their tax records. Accountants had prepared each client's tax records and given them to their respective clients, who in turn gave them to their attorneys for legal advice. 425 U.S. at 394, 96 S.Ct. 1569. The Court held:

> The act of producing evidence in response to a subpoena ... has communicative aspects of its own, wholly aside from the contents of the papers produced. Compliance with the subpoena tacitly concedes the existence of the papers demanded and their possession or control by the taxpayer. It also would indicate the taxpayer's belief that the papers are those described in the subpoena.

Id. at 410, 96 S.Ct. 1569. In *Fisher,* the only incriminating aspect of the documents was their content, not their existence. *Id.* at 412, 96 S.Ct. 1569. As a result, the privilege did not apply.

The *Fisher* Court noted that previously the "proposition that the Fifth Amendment prevents compelled production of documents over objection that such production might incriminate stem[med] from *Boyd v. United States,* 116 U.S. 616, 6 S.Ct. 524, 29 L.Ed. 746 [(1886)]." 425 U.S. at 405, 96 S.Ct. 1569. However, the Court described *Boyd's* protections of private papers—heavily dependent on the theory that the privacy interests protected in the Fourth Amendment also figure in Fifth Amendment inquiries—as "a rule searching for a rationale consistent with the proscriptions of the Fifth Amendment against compelling a person to give 'testimony' that incriminates him." *Id.* at 409 96 S.Ct. 1569. Instead of reaffirming *Boyd* 's private/public distinction, *Fisher* articulated a new way of thinking about the Fifth Amendment privilege. [2]

***344** Over 24 years after *Fisher,* the Court articulated a robust act of production privilege in *United States v. Hubbell,* a wire fraud prosecution stemming from the Whitewater investigation. 530 U.S. 27, 120 S.Ct. 2037, 147 L.Ed.2d 24 (2000). Hubbell resisted initial subpoenas by asserting his Fifth Amendment rights; the government granted him use immunity for the act of production and then indicted him based on the content—rather than the production—of the 13,120 pages of documents that he produced. *Id.* at 45, 120 S.Ct. 2037. The Court held that the content of the documents could not be used against Hubbell, in light of the testimonial nature of Hubbell's extensive efforts in identifying and producing them. *Id.* at 43–46, 120 S.Ct. 2037.

> The documents did not magically appear in the prosecutor's office like 'manna from heaven.' They arrived there only after respondent asserted his constitutional privilege, received a grant of immunity, and-under the compulsion of the District Court's order-took the mental and physical steps necessary to provide the prosecutor with an accurate inventory of the many sources of potentially incriminating evidence sought by the subpoena.

Id. at 42, 120 S.Ct. 2037. The Court differentiated Fisher, where "the IRS knew [that the subpoenaed documents] were in the possession of the taxpayers' attorneys." *Id.* at 44, 120 S.Ct. 2037. In *Hubbell,* the government had "not shown that it had any prior knowledge of either the existence or the whereabouts of the 13,120 pages of documents ultimately produced by respondent." *Id.* at 45, 120 S.Ct. 2037. "It was unquestionably necessary for respondent to make extensive use of 'the contents of his own mind' in identifying the hundreds of documents responsive to the requests in the subpoena." *Id.* at 43, 120 S.Ct. 2037 (quoting *Curcio v. United States,* 354 U.S. 118, 128, 77 S.Ct. 1145, 1 L.Ed.2d 1225 (1957)). The government was therefore forbidden to use even the contents of the records and the court affirmed the dismissal of the indictment. *Id.* at 46, 120 S.Ct. 2037.

[2] The privilege has thus evolved since its inception to a broader prophylactic regime that, in certain circumstances, protects individuals from producing documents where they are incriminated by the *contents* of the documents. *See id.* As applied, the privilege is practical; it inoculates people from being forced to contribute to their own prosecution while not unduly restricting grand juries' ability to seek the truth. Doe argues—and the government does not meaningfully contest—that absent an exception, the act of production privilege shields Doe from complying with the grand jury's subpoena.

II. The Required Records Doctrine

A. Background

1. Origins and Interpretations

The act of production privilege contains exceptions, and among them is the required records doctrine, first articulated in *Shapiro v. United States,* 335 U.S. 1, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948). The required records exception applies only when the Fifth Amendment privilege would otherwise allow a witness to avoid producing incriminating documents. It abrogates the protection of the privilege for a subset of those documents that must be maintained by law.

Shapiro was a prosecution of a fruit purveyor for illegal pricing under the Emergency Price Control Act during the Second World War. *Id.* at 3, 335 U.S. 1. ***345** Shapiro, the wholesaler, was served with a subpoena in September 1944 for invoices and other business information "required to be kept pursuant to [Section 14 of Maximum Price Regulation 426, 8 Fed.Reg. 9546 (1943)] 271 and 426." *Id.* at 4–5, 68 S.Ct. 1375. Although the Court acknowledged "that there are limits which the government cannot constitutionally exceed in requiring the keeping of records which may be ... used in prosecuting statutory violations committed by the record-keeper himself," the Court nonetheless compelled un-immunized disclosure of these documents. *Id.* at 32, 68 S.Ct. 1375.

[3] Subsequently, the Court set forth a three-factor test to determine whether documents are "required records." "[F]irst, the purposes of the United States' inquiry must be essentially regulatory; second, information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept; and third, the records themselves must have assumed 'public aspects' which render them at least analogous to public documents." *Grosso v. United States,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968).

In *Grosso* 's sister case, the Court applied the three-factor test to find the required records exception inapplicable. *Marchetti v. United States,* 390 U.S. 39, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968). Marchetti asserted his Fifth Amendment privilege in response to a prosecution under a statutory scheme that required illegal gamblers to register and pay an occupational tax. *Id.* at 41, 88 S.Ct. 697 (1968); *see also Grosso,* 390 U.S. at 64, 88 S.Ct. 709. Marchetti was not inclined to disclose his illegal gambling for good reason. By maintaining receipts of his illegal gambling successes (or failures) he admitted to a crime. Those who break the law understandably are unlikely to register their misdeeds with the government.

Even assuming that the "United States' principal interest [was] the collection of revenue, and not the punishment of gamblers," the Court found that *Shapiro* was distinguishable. *Marchetti,* 390 U.S. at 57, 88 S.Ct. 697. The records were not "of the same kind as he has customarily kept;"[3] there were no "public aspects ... to the records at issue;" and the records were collected about a group largely or entirely defined by their illegal activities. *Id.* (internal quotation marks omitted); *see also Grosso,* 390 U.S. at 68, 88 S.Ct. 709 (deciding the same thing in the context of a gambler's refusal to pay excise taxes and the occupation tax because "[h]ere, as in *Marchetti,* the statutory obligations are directed almost exclusively to individuals inherently suspect of criminal activities"). Marchetti's refusal to comply with the statute was protected by the Fifth Amendment and not subject to the required records exception. *Id.* at 60, 88 S.Ct. 697. His conviction was overturned.

2. Interaction with the act of production privilege

Doe and *amicus* contend that the required records doctrine is no longer valid or that it applies only in exigent circumstances. To support this argument, they point out that *Shapiro* was a wartime case that drew heavily on the reasoning of *Boyd v. United States,* 116 U.S. 616, 6 S.Ct. 524, 29 L.Ed. 746 (1886), which has been either reconfigured or abrogated by the *Fisher* ***346** line of cases. Prior precedents of this Court squarely foreclose this argument.

Courts have consistently applied the required records doctrine and its analytical framework as an exception to the Fifth Amendment privilege, long after the expiration of any exigency. *See, e.g., Baltimore City Dep't of Social Servs. v. Bouknight,* 493 U.S. 549, 556–559, 110 S.Ct. 900, 107 L.Ed.2d 992 (1990). This Court has twice explicitly rejected the idea that the required records exception has been abrogated by the act of production cases. *In re Two Grand Jury Subpoenae Duces Tecum Dated Aug. 21, 1985,* 793 F.2d 69, 73 (2d Cir.1986) ("*Two Subpoenae* "); *In re Doe,* 711 F.2d 1187, 1192–93 (2d Cir.1983).

A psychiatrist associated with a clinic that freely distributed quaaludes to patients without medical need was required to turn over subpoenaed W–2 and prescription forms along with patient files. *In re Doe,* 711 F.2d at 1189. Conceding that "even *Shapiro* recognizes constitutional limits on the government's power to compel record keeping which might circumvent the privilege contained in the Fifth Amendment," we held that "there [wa]s a strong correlation between the purpose of the New York law which require[d] that patient files be kept and that for which their production [wa]s sought." *Id.* at 1192. Finally, we rejected the argument that the act of production privilege recognized in *Fisher* shielded the state-required records from disclosure:

> [T]he required records doctrine is an *exception* to the Fifth Amendment privilege. As such, it necessarily overrides the privilege in instances in which the privilege would otherwise apply. *Fisher* was not concerned with required records and nothing in its analysis could be construed as weakening the required records exception.

Id. at 1192–93 (emphasis in original, internal citations omitted).

[4] Three years later, an attorney appealed a contempt order entered because of his failure to comply with subpoenas related to contingency fee arrangements with his clients. *Two Subpoenae,* 793 F.2d at 70. After noting that the fee documents were not covered by the attorney-client privilege, this Court rejected the lawyer's Fifth Amendment argument based in part on the fact "that the subpoenaed retainer agreements and closing statements ... fall within the 'required records' exception to the fifth amendment." *Id.* at 73. Although the lawyer "claim[ed] that the 'required records' exception to the fifth amendment is no longer valid after the Supreme Court's decision in *United States v. Doe,* 465 U.S. 605 [104 S.Ct. 1237, 79 L.Ed.2d 552 (1984)]," we noted that "*Doe* did not involve required records, and [found] nothing in its 'act of production' analysis that c[ould] be construed as weakening the required records exception." *Id.* (internal citation omitted). We further explained the rationale for the required records exception:

> First, if a person conducts an activity in which record-keeping is required by statute or rule, he may be deemed to have waived his privilege with respect to the act of production—at least in cases in which there is a nexus between the government's production request and the purpose of the record-keeping requirement. Second, because the records must be kept by law, the record-holder 'admits' little in the way of control or authentication by producing them.

Two Subpoenae, 793 F.2d at 73.[4]

[5] Based in part on the *Two Subpoenae* reasoning, this Court still recognizes ***347** the required records exception. In 2008, we applied the exception to information obtained from immigrants from specified countries who had responded to a mandatory registration program following the attacks of September 11, 2001. *See Rajah v. Mukasey,* 544 F.3d 427, 433, 442 (2d Cir.2008). Information obtained under this program was ultimately used by the government in the immigrants' deportation proceedings. This Court denied the immigrants' attempts to block the use of the records through the Fifth Amendment because "the Fifth Amendment's act of production privilege does not cover records that are required to be kept pursuant to a civil regulatory regime." *Id.* at 442. The required records exception remains a part of Fifth Amendment jurisprudence.

B. Application of the Required Records Doctrine to the BSA

[6] Applying the *Grosso* test, several circuits have specifically held that the required records exception applies to cases indistinguishable from the present cases. *See United States v. Under Seal,* 737 F.3d 330, No. 13–4267, 2013 WL 6511517 (4th Cir. Dec. 13, 2013); *In re Grand Jury Proceedings, No. 4–10,* 707 F.3d 1262 (11th Cir.2013); *In re Grand Jury Subpoena,* 696 F.3d 428 (5th Cir.2012); *In re Special February 2011–1 Grand Jury Subpoena Dated September 12, 2011,* 691 F.3d 903 (7th Cir.2012); *In re M.H.,* 648 F.3d 1067 (9th Cir.2011). For the reasons stated below, we agree with our sister circuits.

1. The "essentially regulatory" test

[7] **[8]** **[9]** The first *Grosso* prong asks whether the record requirement is "essentially regulatory." This precludes Congress from circumventing the Fifth Amendment privilege by enacting comprehensive legislation "directed at a 'selective group inherently suspect of criminal activities.' " *Marchetti,* 390 U.S. at 57, 88 S.Ct. 697 (quoting *Albertson v. Subversive Activities Control Bd.,* 382 U.S. 70, 79, 86 S.Ct. 194, 15 L.Ed.2d 165 (1965)). When legislation is not "directed at the public at large" and concerns "an area permeated with criminal statutes," courts are more likely to hold that the required records exception does not apply. *Albertson,* 382 U.S. at 79, 86 S.Ct. 194. In addition to illegal gambling, courts have declined to apply the required records exception to records regarding marijuana sales, ownership of dangerous firearms, and other "area[s] permeated with criminal statutes," *Haynes v. United States,* 390 U.S. 85, 99, 88 S.Ct. 722, 19 L.Ed.2d 923 (1968) (internal quotation marks omitted), but have applied the exception in the context of drivers involved in automobile accidents, custodians of state-supervised children, and even various sections of the BSA.

Determining the target population of a statute is frequently difficult. In *California v. Byers,* 402 U.S. 424, 430, 91 S.Ct. 1535, 29 L.Ed.2d 9 (1971), the Supreme Court examined a California statute in the context of "all persons who drive automobiles in California," despite the statute's facial applicability only to people who have been involved in automobile accidents resulting in damage to property. *Id.* "Driving an automobile, unlike gambling, is a lawful activity. Moreover, it is not a criminal offense under California law to be a driver 'involved in an accident.' " *Id.* at 431, 91 S.Ct. 1535.

***348** Similarly, this Court upheld a conviction under the BSA for failure to report carrying over $5,000 in cash when leaving the country. *United States v. Dichne,* 612 F.2d 632, 633 (2d Cir.1979). We noted that the reporting requirement had incriminating potential while also serving legitimate social interests; as a result, "a balance must be struck between the competing interest of the state and the individual when evaluating the constitutionality of a disclosure requirement." *Id.* at 638 (citing *Byers,* 402 U.S. at 427, 91 S.Ct. 1535). Because "the transportation of such amounts of currency is by no means an illegal act" in itself, "as such [the statute] cannot be faulted as being aimed at an inherently suspect group." *Id.* at 639–40. "In each of the Supreme Court cases holding a reporting requirement invalid, the reporting individual was required to reveal to the Government information which would almost necessarily provide the basis for criminal proceedings against him for the very activity that he was required to disclose." *Id.* at 640. Insofar as transporting large amounts of money across international borders is indicative of other illegal activity, this is still short of requiring reporting from users of marijuana or gamblers, who would be reporting the exact activity for which they would be susceptible for prosecution.

Dichne and other cases concluding that the BSA's purpose is "essentially regulatory" are informative but not dispositive with respect to the provisions at issue here. Our inquiry is not whether the BSA as a whole was motivated by civil or criminal concerns, but rather whether the specific section in question is "essentially regulatory" or directed at " 'an area permeated with criminal statutes.' " *Byers,* 402 U.S. at 430, 91 S.Ct. 1535 (quoting *Albertson,* 382 U.S. at 79, 86 S.Ct. 194).

The record keeping regulation at issue here, 31 C.F.R. § 1010.420, targets those engaged in the lawful activity of owning a foreign bank account. "There is nothing inherently illegal about having or being a beneficiary of an offshore foreign bank account." *M.H.,* 648 F.3d at 1074. Doe's protestations notwithstanding, owners of these accounts are not "inherently suspect" and the statute is "essentially regulatory."

Doe's argument that the statute is criminally focused has some force. The BSA declares that its purpose is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." 31 U.S.C. § 5311. It does list "criminal investigations" first, but this multifaceted statute clearly contributes to civil and intelligence efforts wholly unrelated to any criminal purpose. [5]

***349** Although portions of the statute's legislative history support Doe's characterization of the BSA as focused on criminal activity, "[t]he Supreme Court has already considered and rejected these arguments as they relate to the BSA generally." *M.H.,* 648 F.3d at 1074 (citing *Cal. Bankers' Ass'n v. Shultz,* 416 U.S. 21, 76–77, 94 S.Ct. 1494, 39 L.Ed.2d 812 (1974)). Moreover, "the question is not whether Congress was subjectively concerned about crime when enacting the BSA's recordkeeping and reporting provisions, but rather whether these requirements apply exclusively or almost exclusively to people engaged in criminal activity." *Grand Jury Proceedings, No. 4–10,* 707 F.3d at 1271; *accord Grand Jury Subpoena,* 696 F.3d at 434. Looking beyond "Congressional subjective intent"—if there could be such a thing—the BSA has considerable regulatory utility outside of the criminal justice context.

[10] The question becomes whether a statute with mixed criminal and civil purposes can be "essentially regulatory" with respect to the required records exception. We agree with our sister circuits: the fact "[t]hat a statute relates both to criminal law and to civil regulatory matters does not strip the statute of its status as 'essentially regulatory.' " *Grand Jury Proceedings, No. 4–10,* 707 F.3d at 1270. Because people owning foreign bank accounts are not inherently guilty of criminal activity, the BSA's applicable recordkeeping requirement, designed to facilitate "criminal, tax, or regulatory investigations or proceedings, or [ ] the conduct of intelligence or counterintelligence activities," 31 U.S.C. § 5311, is still essentially regulatory.

Doe argues that our reliance on *Dichne* and other cases involving *ex post* challenges to the validity of statutory reporting requirements are distinguishable from individual assertions of the privilege against self-incrimination. These two categories of challenges are indeed distinct. However, Supreme Court precedent asks us to inquire into the purposes of the regulatory scheme pursuant to which records are required—a necessarily generalized inquiry, and a matter discussed in cases like *Dichne,* 612 F.2d at 640. Besides, in this case—as in *Shapiro* itself—the witness asserted the privilege against self-incrimination in response to the subpoena issued. *See Shapiro,* 335 U.S. at 4–5, 68 S.Ct. 1375. "*Shapiro* did more than set the constitutional parameters for record-keeping requirements; it determined that the Fifth Amendment is not a barrier to the enforcement of a valid civil regulatory scheme." *Special February 2011–1 Grand Jury Subpoena Dated September 12, 2011,* 691 F.3d at 907. The fact that the specific records sought would support a criminal prosecution did not defeat the "essentially regulatory" prong in that case; the analysis does not come out differently here. The BSA's recordkeeping requirement at issue, 31 C.F.R. § 1010.420, is "essentially regulatory" for the purposes of the required records analysis.

2. The "customarily kept" requirement

[11] The second *Grosso* prong requires that the regulated "information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept." ***350** *Grosso,* 390 U.S. at 68, 88 S.Ct. 709.[6] Doe points to no cases in which any court has held that records are not required because they are not "customarily kept."

The records required by 31 C.F.R. § 1010.420 are very basic—they "shall contain the name in which each [ ] account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period." In determining that the records at issue are "customarily kept," the district court relied in large part on the fact that another section of the BSA requires foreign account holders to report substantially identical information to the IRS. *See* 31 C.F.R. § 1010.350(a). Doe contends that this reasoning is "tautological" in that it permits Congress to manufacture a "custom" in order to satisfy the required records doctrine by requiring that the records be kept. We need not address whether, in another case, records "customarily kept" *only* because they are required by law satisfy the prerequisites of the required records doctrine.

Here, the grand jury's subpoena seeks information so basic that the "argument that these records are not 'customarily kept' is a non-starter." *Grand Jury Proceedings, No. 4–10,* 707 F.3d at 1273. "A bank account's beneficiary necessarily has access to such essential information as the bank's name, the maximum amount held in the account each year, and the account number." *M.H.,* 648 F.3d at 1076. "[C]ommon sense" dictates that beneficiaries keep these records "in part because they need the information to access their foreign bank accounts." *Id.* The amount of money in the account is relevant to most foreign bank account holders in that many people are regularly forced to assess prospective purchases against the balance of their accounts. Most people check a bank account before making a major purchase; not everyone who holds a foreign bank account could, without a second thought, incur (for example) vast litigation costs in a feckless attempt to avoid paying lawfully-imposed taxes vital to the functioning of the United States without needing to assess whether losing such a challenge would leave them incapable of paying the inevitable hefty sanctions. And even if the account holder is a person of great wealth surely they want to know where that wealth is located.

Doe believes that, despite the basic presumption that bank account owners know the location of their money, some individuals engaged in wrongdoing are advised not to keep even this basic information.[7] But even if those who possess foreign bank accounts for the purposes of avoiding some specific U.S. tax or criminal laws may be less likely to maintain these records, the BSA covers the entire group of foreign bank account holders. We decline to look at the custom of only the miscreants ***351** among the larger group of foreign bank account holders.

3. The "public aspects" prong

[12] The third *Grosso* prong asks whether the required records " 'have assumed 'public aspects' which render them at least analogous to public documents.' " *Grand Jury Proceedings, No. 4–10,* 707 F.3d at 1273 (quoting *Grosso,* 390 U.S. at 68, 88 S.Ct. 709). The parties dispute the meaning of the "public aspects" test, which—as a vestige of *Boyd*—may not have the same legal significance as it did in 1948, when the public/private distinction was of paramount importance. *Cf. Fisher,* 425 U.S. at 400–01, 96 S.Ct. 1569, Samuel A. Alito, Jr., *Documents and the Privilege against Self–Incrimination,* 48 U. PITT. L.REV.. 27, 36–44 (1986).

Doe urges us to hold that the test requires one of three factors: records have "public aspects" when they "are a direct mainstay of a regulatory scheme that promotes the public welfare," "are vital to a regulatory regime promulgated in response to emergency or other exigent conditions," or "are *routinely* forwarded to a regulatory or licensing body as a means of protecting the public." Doe Brief at 49–50. Although he cites to authority in support of the proposition that each of these is sufficient to establish "public aspects," we see no evidence that one of these three prongs must be met to conclude that the records have a "public aspect."

[13] "The Government's anxiety to obtain information known to a private individual does not without more render that information public. Nor does it stamp information with a public character that the Government has formalized its demands in the attire of a statute." *Marchetti,* 390 U.S. at 57, 88 S.Ct. 697. *Marchetti* restricts Congress's ability to require records for the purpose of securing access to otherwise-private information. However, "records required to be kept pursuant to valid regulatory programs have a 'public aspect' for purposes of constitutional analysis, and thus are not private papers entitled to the protection of the fourth or fifth amendments." *Donovan v. Mehlenbacher,* 652 F.2d 228, 231 (2d Cir.1981). "Where personal information is compelled in furtherance of a valid regulatory scheme, as is the case here, that information assumes a public aspect." *M.H.,* 648 F.3d at 1077.

[14] The rule distilled from *Donovan* and *Marchetti* is that records required to be created under an *otherwise valid* regulatory regime necessarily have "public aspects" for purposes of the required records exception to the Fifth Amendment production privilege. A constitutionally infirm statute cannot recharacterize private information as public. However, information that a statute lawfully requires a person to record is legally distinct from information that no statute lawfully requires anyone to record. This distinction is what the "public aspects" prong of the required records doctrine recognizes. The record need not be 'public' in that anyone can examine or copy it at any time; it need only be lawfully required to be kept.

Doe's argument that the exception applies only in areas in which there are already "substantive restrictions" in place is unpersuasive. "If the witness's argument were correct, then Congress would be prohibited from imposing the least regulatory burden necessary; it would instead be required to supplement a reporting or recordkeeping scheme with additional and unnecessary 'substantive restrictions' for the sole purpose of upholding its record keeping and reporting requirements." *Grand Jury Subpoena,* 696 F.3d at 436. It is enough that Congress *could* prohibit an activity to permit it to validly require records to be kept; it need not actively ***352** prohibit—or otherwise significantly restrict—possession of foreign bank accounts to give force to its recordkeeping requirements.

The BSA is an otherwise-valid regulatory scheme that lawfully requires beneficiaries of foreign bank accounts to retain records containing the basic information about their accounts. 31 C.F.R. § 1010.420. This information, required by lawful statute, has the "public aspects" that make it potentially subject to a grand jury subpoena in a case where a witness could assert the Fifth Amendment privilege to shield more distinctly private information. The "required records" exception to the privilege therefore applies in this case.

* * *

Doe's additional arguments are unpersuasive. Doe asserts that production of records required to be kept may be compelled only when the record keeper sought a related government benefit or license and thus may fairly be said to have deliberately waived her Fifth Amendment privilege with respect to those records by engaging in the regulated activity. He declares that the Fifth Amendment cannot inadvertently be waived, and because (he asserts) beneficiaries of foreign bank accounts are frequently unaware of the BSA's recordkeeping requirements, they cannot be deemed to have waived their Fifth Amendment rights with respect to banking records.

[15] **[16]** Even if the latter assertion (regarding ignorance of the law's recordkeeping requirements) were true—a proposition that we seriously doubt—this argument fails for two reasons. First, the Supreme Court has strongly hinted that, while a waiver must be voluntary, there is no requirement "of any 'knowing' and 'intelligent' waiver" of Fifth Amendment rights. *Schneckloth v. Bustamonte,* 412 U.S. 218, 237 n. 18, 93 S.Ct. 2041, 36 L.Ed.2d 854 (1973). Second, the Fifth Amendment is inapplicable where the testimonial act does not create a related risk of self-incrimination. Because the BSA only criminalizes a knowing and willful failure to engage in the required recordkeeping, an account owner who was truly unaware of the recordkeeping requirement would not incur related criminal sanctions by acknowledging in response to a production order his negligent failure to maintain the required records.[8] 31 U.S.C. § 5322. Thus, for the criminal provisions to apply in the first place, this must be a case where an "individual [ ] enters upon a regulated activity knowing that the maintenance of extensive records available for inspection by the regulatory agency is one of the conditions of engaging in the activity." *Smith v. Richert,* 35 F.3d 300, 303 (7th Cir.1994).

Finally, Doe's assertion that the government could obtain his records only by granting him immunity relies on the inapplicability of the required records exception; here, production of the required records could be compelled without first offering Doe immunity.

Conclusion

The required records exception to the Fifth Amendment privilege against self-incrimination still exists. The BSA's requirements at issue here are "essentially ***353** regulatory," the subpoenaed records are "customarily kept," and the records have "public aspects" sufficient to render the exception applicable. Because Doe cannot lawfully excuse his failure to comply with the subpoena, the district court was within its discretion to impose sanctions for his noncompliance.

For the foregoing reasons, the opinion and order of the district court is **AFFIRMED.**

All Citations

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Footnotes

[1] Specifically, the grand jury's subpoena requested production of:

> Any and all records required to be maintained pursuant to 31 C.F.R. § 1010.420 (formerly 31 C.F.R. § 103.32) for the past 5 years relating to foreign financial bank, securities, or other financial accounts in a foreign country for which [Doe] had/ha[s] a financial interest in, or signature or other authority over and [is] required by law to file a Report of Foreign Bank and Financial Account (FBAR). The records required to be maintained pursuant to 31 C.F.R. § 1010.420 (formerly 31 C.F.R. § 103.32) include records that contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period.

[2] The precise extent to which *Fisher* and subsequent cases constituted a repudiation of *Boyd* and its reasoning is debated, but scholars appear to agree that the Court sought to find similar constitutional protections without relying on *Boyd* 's analysis. *Compare* Samuel A. Alito, Jr., *Documents and the Privilege against Self–Incrimination,* 48 U. PITT. L.REV.. 27, 51 (1986) ("While seeming to reject the entire framework on which *Boyd* rested, *Fisher* stopped short of expressly overruling *Boyd*") *with* RONALD JAY ALLEN ET AL., COMPREHENSIVE CRIMINAL PROCEDURE 308 (2d ed. 2005) ("The Court continued its reconstruction of *Boyd* in *Fisher v. United States*.").

[3] Indeed, it seems plausible that a gambler would not keep any records relating to his gambling activities. The Court needed only to note that the information required was "unrelated to any records which [Marchetti] may have maintained[ ] about his wagering activities." *Marchetti,* 390 U.S. at 57, 88 S.Ct. 697.

[4] Doe argues that the rationale for the survival of the required records doctrine does not apply in his case. However, we view this argument as relating to the applicability of the exception to his current case. Insofar as his attempt to distinguish *Two Subpoenae* challenges the continued existence of the required records exception, this argument has been squarely foreclosed by our prior precedents.

[5] Doe points out that the Treasury Department's Financial Crimes Enforcement Network (FinCEN) lists the BSA as one of the tools that it uses to pursue its goals of criminal investigation. It is neither surprising nor persuasive that a law enforcement organization uses a multi-purposed statute for law enforcement ends. We assume that insofar as the Central Intelligence Agency uses the BSA, it uses it for intelligence and counter-intelligence purposes, while the Internal Revenue Service uses it for revenue collection purposes. Doe asserts that "[t]he government has never pointed to a 'regulatory' act that FinCEN performs with FBAR [Report of Foreign Bank and Financial Account] data." Doe Brief at 35. However, other agencies also use the data obtained through the challenged reports:

> The Treasury Department shares the information it collects pursuant to the Act's requirements with other agencies —including the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of Thrift Supervision—none of which are empowered to bring criminal prosecutions.

Grand Jury Proceedings, No. 4–10, 707 F.3d at 1271 (quoting *Grand Jury Subpoena,* 696 F.3d at 434).

[6] Citing *Bouknight,* the Government urges us to hold that this is no longer a requirement of the required records doctrine. Although *Bouknight* did not discuss the second *Grosso* prong, it was an atypical "required records" case that does not

dictate our analysis here, as the regulated “evidence” was Bouknight's infant. *See* 493 U.S. at 556–62, 110 S.Ct. 900. Perhaps the *Bouknight* Court did not feel it necessary to discuss whether a child is “customarily kept” by his parents. We need not decide this issue for the purposes of this opinion as the “customarily kept” prong is easily met here.

[7] Even if we were to look at only the customs of criminal circles, if a criminal don't have this information, how can he retrieve his ill gotten gains? He must either possess a photographic memory or well-encrypted devices hidden in some offshore location.

[8] Although it is not necessary to our resolution of this case in which Doe has not alleged ignorance of the BSA's recordkeeping requirements, the government's brief acknowledges that “an individual who was unaware that he was engaging in a regulated activity would not be able to establish a risk of self-incrimination in the first place.” Appellee Brief at 38 n. 17.

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2012 WL 4513653
Only the Westlaw citation is currently available.
United States District Court, D. Arizona.

UNITED STATES of America, Plaintiff,
v.
Stephen M. KERR; Michael Quiel;
Christopher M. Rusch, Defendants.

No. CR 11–2385–PHX–JAT.
|
Oct. 2, 2012.

Attorneys and Law Firms

Monica B. Edelstein, Timothy J. Stockwell, U.S. Dept of Justice-Tax Division Criminal Enforcement, Washington, DC, for Plaintiff.

ORDER

JAMES A. TEILBORG, District Judge.

***1** Pending before the Court is Defendants Quiel and Kerr's Joint Motion for Production of Special Agent's Report (Doc. 100). The Court now rules on the Motion. [1]

I. BACKGROUND

On December 8, 2011, Stephen Kerr ("Kerr"), Michael Quiel ("Quiel"), and Christopher M. Rusch ("Rusch") (collectively, "Defendants") were indicted for conspiracy to defraud the United States pursuant to 18 U.S.C. § 371. Both Kerr and Quiel were charged separately with two counts of willful failure to file Reports of Foreign Bank and Financial Accounts ("FBARs") in violation of 31 U.S.C. § 5314 and § 5322(a), as well as two counts of willful filing of false returns for tax years 2007 and 2008 in violation of 26 U.S.C. § 7206(1). *See* Doc. 3.

During the course of the investigation of Defendants, Internal Revenue Service Agent Lisa Giovannelli prepared a Special Agent Report (the "Special Agent Report") relating to the investigation. During discovery, the Government produced all documents in the Government's possession "that had been received pursuant to grand jury subpoena [sic], tax returns and Internal Revenue Service documentation, and memoranda of interviews and grand jury transcripts for prospective witnesses." Doc. 101 at 2. The Government did not include, as part of the discovery, the Special Agent Report "or other internal memoranda or reports authored by the investigating agents or attorneys." Doc. 101 at 2. Defendants Quiel and Kerr now move the Court for an order directing the Government to disclose the Special Agent Report.

II. LEGAL STANDARD

"[A] defendant is not entitled to know all the *evidence* the government intends to produce, but only the *theory* of the government's case." *United States v. Ryland,* 806 F.2d 941, 942 (9th Cir.1986) (emphasis in original) (further holding, "[The defendant] is not entitled to know the content of the testimony of each of the government witnesses before trial."). However, Government disclosure of exculpatory evidence is required by *Brady v. Maryland,* 373 U.S. 83, 83 S.Ct. 1194, 10 L.Ed.2d 215 (1963), and disclosure of other information is required by the *Jencks Act,* 18 U.S.C. § 3500. Federal Rule of Criminal Procedure 16 also provides additional discovery rights.

Federal Rule of Criminal Procedure 16 provides, in relevant part,

> Except as Rule 16(a)(1) provides otherwise, this rule does not authorize the discovery or inspection of reports, memoranda, or other internal government documents made by an attorney for the government or other government agent in connection with investigating or prosecuting the case. Nor does this rule authorize the discovery or inspection of statements made by prospective government witnesses except as provided in 18 U.S.C. § 3500.

Fed.R.Crim.P. 16(a)(2). Pursuant to the *Jenckes Act,* 18 U .S.C. § 3500,

> In any criminal prosecution brought by the United States, no statement or report in the possession of the United States which was made by a Government witness or prospective Government witness (other than the defendant) shall be the subject of subpoena,

> discovery, or inspection until said witness has testified on direct examination in the trial of the case.
>
> ***2** After a witness called by the United States has testified on direct examination, the court shall, on motion of the defendant, order the United States to produce any statement (as hereinafter defined) of the witness in the possession of the United States which relates to the subject matter as to which the witness has testified. If the entire contents of any such statement relate to the subject matter of the testimony of the witness, the court shall order it to be delivered directly to the defendant for his examination and use.

18 U.S.C.A. § 3500(a)(b).

III. ANALYSIS

Defendants argue that the Special Agent's Report should be disclosed because in "nearly every case the Special Agent's Report contains exculpatory information and/or significant *Jencks Act* material." (Doc. 100 at 1). Defendants further argue that they need the Special Agent's Report to determine if the Special Agent is a potential witness and "going to trial without notice of the government's method of proof is a violation of due process." (Doc. 100). In the alternative, Defendants request a Bill of Particulars or that the Court conduct an in camera review of the Special Agent's Report.

In Response, the Government argues that, pursuant to Federal Rule of Criminal Procedure 16 and the *Jencks Act,* 18 U.S.C. § 3500, it is not required to disclose the Special Agent's Report unless and until the Special Agent is called to testify on direct examination. Further, the Government acknowledges its obligation to provide disclosure of internal memoranda and reports if they contain *Brady* material.[2] The Government argues that requiring disclosure of the Special Agent's Report amounts to allowing Defendants to have an unauthorized preview of the Government's theory of the case and the evidence it intends to present in support of that theory. The Government opposes Defendants' alternative request for in camera review because Defendants have not articulated any reasons why the Court should conduct such review or what information the Court would review. Defendants contend that the charges, as outlined in the Indictment, are sufficient to address the Defendants' due process rights.

It is clear that the Government is not required to produce the Special Agent's Report unless the Report contains *Brady* material or material not otherwise disclosed under Federal Rule of Criminal Procedure 16(a)(1), until the Special Agent is called to testify on direct examination in the Government's case. As discussed above, Defendants have failed to make any showing that the Government is withholding *Brady* material from them such that the Court would find an in camera review of the Special Agent's Report necessary.

In their Reply in Support of their Motion to Produce, Defendants argue that statements of Defendants, if any, will be in the Special Agent's Report, and Defendants should not be required to search through the "quagmire of materials" already disclosed to them to determine if any such statements exist. Again, Defendants have failed to show that the Government is withholding any material from them and have failed to cite to any legal authority entitling them to discovery of additional materials that might be more conveniently organized than that already provided to them.

***3** The Government asserts that it does not anticipate that Special Agent Giovannelli will be a witness for the Government. Defendants contend that, to avoid a continuance during trial, the Government should be required to produce the Special Agent's Report before trial if the Special Agent is going to testify at trial. The Court agrees.

Accordingly, each party shall file a witness list of all witnesses expected to be called as witnesses at trial on or before February 13, 2013. If Special Agent Giovannelli is listed as a witness on the Government's Witness list, the Government shall disclose Special Agent Giovannelli's Report on or before February 13, 2013.

IV. CONCLUSION

Accordingly,

IT IS ORDERED that Defendants Quiel and Kerr's Joint Motion for Production of Special Agent's Report (Doc. 100) is granted in part and denied in part as forth herein.

IT IS FURTHER ORDERED that each party shall either (1) file a witness list of all witnesses expected to be called as witnesses at trial on or before February 25, 2013 or (2) submit such witness list to the Chamber's email address[3] with a copy to opposing counsel by February 25, 2013.

IT IS FINALLY ORDERED that, if Special Agent Giovannelli is listed as a witness on the Government's Witness list, the Government shall disclose Special Agent Giovannelli's Report on or before February 25, 2013.

All Citations

Not Reported in F.Supp.2d, 2012 WL 4513653

Footnotes

[1] Because the issues have been fully briefed, the Court denies Defendants' request for oral argument as it would not aid the Court's decisional process. See *Partridge v. Reich,* 141 F.3d 920, 926 (9th Cir.1998); *Lake at Las Vegas Investors Group, Inc. v. Pac. Dev. Malibu Corp.,* 933 F.2d 724, 729 (9th Cir.1991).

[2] In Reply in Support of its Motion to Produce, Defendants appear to argue that the Government disavowed any obligation to produce *Brady* and *Jencks Act* material. The Court disagrees. The Government has acknowledged its disclosure obligations and Defendant has presented no evidence that the Government is failing to comply with those obligations by withholding *Brady* material from Defendants.

[3] teilborg_chambers@azd.uscourts.gov.

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824 F.Supp.2d 1295
United States District Court, D. New Mexico.

UNITED STATES of America, Plaintiff,
v.
Carolynne TILGA and Michael
Chandler, Defendants.

No. CR 09–0865 JB.
|
Nov. 8, 2011.

Synopsis
Background: Defendants who had pleaded guilty to conspiracy to defeat the administration of the tax laws of the United States filed objections to the pre-sentence report.

Holdings: The District Court, James O. Browning, J., held that:

[1] defendant was entitled to claim foreign tax credits against amount of loss from her offense;

[2] offense level enhancement for use of sophisticated means was warranted;

[3] offense level enhancement for use of a special skill was not warranted; and

[4] offense level enhancement for being an organizer, leader, or supervisor was not warranted.

Ordered accordingly.

Attorneys and Law Firms

***1297** Joseph M. Giannullo, United Stated Department of Justice, Washington, D.C., and Kenneth J. Gonzales, United States Attorney, Jonathon M. Gerson, Paula G. Burnett, Assistant United States Attorneys, United States Attorney's Office, Albuquerque, NM, for Plaintiff.

Kimberly A. Middlebrooks, Albuquerque, NM, and Roma W. Theus, II, Wellington, FL, for Defendant, Carolynne Tilga.

Erlinda O. Johnson, Law Office of Erlinda Ocampo Johnson, LLC, Albuquerque, NM, for Defendant, Michael Chandler.

Angela L. Owens, St. Petersburg, FL, and Kenneth Gleria, Albuquerque, NM, for Defendant, Helen Geer.

MEMORANDUM OPINION AND ORDER

JAMES O. BROWNING, District Judge.

THIS MATTER comes before the Court on: (i) Defendant Carolynne Tilga's ***1298** Memorandum in Aid of Sentencing of Defendant Carolyne Tilga and Limited Objections to Presentence Report, filed October 6, 2011 (Doc. 161) ("Tilga's Sentencing Memo."); (ii) Defendant Michael Chandler's Sentencing Memorandum and Request for a Reasonable Sentence, filed August 23, 2011 (Doc. 154) ("Chandler's Sentencing Memo."); [1] and (iii) Government's Sentencing Memorandum, filed October 8, 2011 (Doc. 162) ("Gov't Sentencing Memo."). The Court held an evidentiary hearing on October 13, 2011. The primary issues are: (i) whether the tax loss calculation should be $23,200.00 or $1,937,273.00 (United States Dollars); (ii) whether Defendants Carolynne Tilga and Michael Chandler used sophisticated means to commit the offense of conviction; (iii) whether Tilga and Chandler used special skills to commit the offense of conviction; (iv) whether Tilga should was an organizer, leader, manager, or supervisor of the criminal activity; (v) whether the Presentence Investigation Report on Carolynne Tilga (disclosed July 26, 2011) ("Tilga PSR") should acknowledge the benefits the United States obtained from the Plea Agreement, filed January 6, 2011 (Doc. 126) ("Tilga Plea Agreement"); and (vi) whether the Tilga PSR should contain explicit recognition that the sentencing guidelines are advisory. [2] The Court accepts the parties' stipulated tax loss calculation, $23,300.00 (USD), and finds that the foreign tax credit may apply post-indictment. The Court also agrees with and accepts the parties' stipulations in the Plea Agreements that neither Tilga nor Chandler's offenses involved a special skill, an aggravating role, or obstruction of justice. The Court will sustain Tilga and Chandler's objections to the PSRs to the extent that the PSRs are contrary to these findings. The Court finds, however, that Tilga and Chandler used sophisticated means, as defined in U.S.S.G. § 2T1.1, and will not adopt the parties' stipulation to the contrary. The Court concludes that Tilga's objections to the PSR's failure to acknowledge the benefits that the Plaintiff United States of America obtained from the Plea Agreement and failure to explicitly recognize the sentencing guidelines' advisory status are moot.

FACTUAL BACKGROUND

Tilga was born in Bronxville, New York. *See* Tilga PSR ¶ 51, at 22.[3] She attended Cornell University for her undergraduate ***1299** studies in Hotel Administration and graduated in 1982. *See* Tilga PSR ¶ 67, at 26; Tilga's Sentencing Memo. at 6. Tilga received her Master of Business Administration from the Wharton School of Business at the University of Pennsylvania in 1986. *See* Tilga PSR ¶ 69, at 26; Tilga's Sentencing Memo. at 6. In 1997, Tilga moved to Santa Fe, New Mexico. *See* Tilga PSR ¶ 56, at 23. She has been in a committed relationship with Chandler since 1997, and they have two children. *See* Tilga PSR ¶ 58, at 24.

Chandler was born in Boston, Massachusetts. *See* Presentence Investigation Report on Michael Chandler (disclosed July 26, 2011) ("Chandler PSR"). Chandler attended Boston College and Plymouth State University, but did not graduate from either. *See* Chandler PSR ¶¶ 65–66, at 21. Chandler is a "stay-at-home dad" and works for Taos Ski Academy as ski instructor. *See* Chandler PSR ¶ 68, at 22.

Tilga and Chandler owned and controlled various businesses, including internet service sites, from 1998 to 2006. *See* Tilga PSR ¶ 9, at 7. Between 1999 and 2004, Tilga owned and operated an adults-only internet dating service. *See* Tilga PSR ¶ 17, at 10. Before 2002, Tilga was a partner with two Canadian businessmen, and the internet service sites were located in Canada. *See* Tilga PSR ¶ 17, at 10; Tilga's Sentencing Memo. at 7. Tilga earned income from the Canadian joint venture, in which she owned a 37.5% share, as part of her trade and business between the tax years 1999 and 2004. *See* Tilga's Sentencing Memo. at 7 n. 16. After 2002, Tilga expanded the company on her own, using webcam[4] sites in addition to the standard internet dating sites with which she was working. *See* Tilga PSR ¶ 17, at 10.

Tilga was introduced to the Commonwealth Trust Company ("CTC") in 1998.[5] *See* Tilga PSR ¶ 16, at 9. The CTC was an ***1300** organization[6] that taught individuals how to purchase and manage Pure Trust Organizations ("PTOs").[7] *See* Tilga PSR ¶ 10, at 7. Tilga began purchasing entities from CTC around April 1998. *See* Tilga PSR ¶ 16, at 9; Tilga's Sentencing Memo. at 7. Each of these entities was a "business" that controlled Tilga's internet sites, her homes, and her vehicles. Tilga PSR ¶ 16, at 9. Between 1998 and 2003, Tilga purchased the following entities from CTC: (i) Cabernet Financial, 1998; (ii) Worldwide Communications, 1998; (iii) General Management Services, 1998; (iv) Bressingham Investments, 1998; (v) Astra Management, 1999; (vi) Vantage Global, 2001; (vii) Batavia Guild Group, 2002; (viii) Triad Universal, 2002; (ix) Alsacia Marketing Services, 2002; and (x) Enchantment Property Management, 2003. *See* Tilga PSR ¶ 16, at 9–10.

Tilga requested that the revenue from her Canadian business be generated to Cabernet Financial, which used an offshore trust account. *See* Tilga PSR ¶ 18, at 10. Tilga paid no taxes on her share of the revenues received from her Canadian business. *See* Tilga PSR ¶ 18, at 10; Gov't Sentencing Memo. at 2. Tilga then transferred funds from Cabernet Financial to various other entities purchased from CTC, which were formed to allow Tilga to purchase real estate and vehicles. *See* Tilga PSR ¶ 18, at 10; Gov't Sentencing Memo. at 2.

An IRS investigation revealed that Tilga and Chandler used the CTC trusts and offshore companies to purchase assets and set up new offshore accounts. *See* Tilga PSR ¶ 19, at 10. Between 1999 and 2004, Tilga wired nearly $8.7 million (USD) into the United States from her offshore accounts, but her tax returns usually reported less than $75,000.00 (USD) in income per year. *See* Tilga PSR ¶ 19, at 10. Tilga used those funds to purchase expensive ***1301** real estate in New Mexico, Colorado, and Hawaii. *See* Tilga PSR ¶ 19, at 10–11. Chandler assisted Tilga in wiring money to and from the accounts. *See* Tilga PSR ¶ 22, at 13; Gov't Sentencing Memo. at 2–3.

For the years 1999 to 2004, Tilga failed to report $5,201,064.00 (USD) in taxable income. *See* Tilga PSR ¶ 25, at 14. Additionally, neither Tilga nor the vast number of CTC entities that she owned filed tax returns. *See*

Tilga PSR ¶ 26, at 14. Accordingly, the IRS calculated the additional taxes due and owing for those years was $1,937,272.00 (USD). *See* Tilga PSR ¶ 26, at 15. The United States and Tilga calculated the additional taxes due and owing for those years as a minimum of $1,735,025.00 (USD). *See* Tilga Plea Agreement ¶¶ 6, 13, at 3, 11; Tilga PSR ¶ 5(f), at 5.

In 2005, the IRS began its investigation of Tilga. *See* Tilga's Sentencing Memo. at 8. In August 2009, Tilga filed tax returns in the Dominion of Canada for business income earned in each of the years 1999 to 2004. *See* Gov't Sentencing Memo. at 4. Tilga provided this information to the IRS in April 2010. *See* Gov't Sentencing Memo. at 4. The Canadian Revenue Agency ("CRA") sent Tilga a notice on November 19, 2010, stating that she owed $7,424,514.40 (Canadian Dollars) in taxes on her Canadian income. *See* Tilga PSR ¶¶ 82–83, at 43; Gov't Sentencing Memo. at 4. On April 15, 2010, Tilga attempted to file a notice of claim with the IRS, stating that she was entitled to a credit on her 1999 taxes for taxes owed to the Canadian government for that year. *See* Gov't Sentencing Memo. at 4. The IRS accepted the notice, but did not consider the notice to have been "filed" and did not process it. Gov't Sentencing Memo. at 4.

PROCEDURAL BACKGROUND

A federal grand jury indicted Tilga and Chandler for a *Klien* conspiracy[8] to defeat the administration of the tax laws of the United States during the period 1998 to 2006 in violation of 18 U.S.C. § 371 and with tax evasion for the years 1999 to 2004 in violation of 26 U.S.C. § 7201. *See* Redacted Indictment, filed April 9, 2009 (Doc. 2) ("Indictment"). In post-Indictment negotiations with the United States, Tilga asserted that the Internal Revenue Code permitted her to file amended United States tax returns claiming foreign tax credits for the years 1999 to 2004, because there is a special ten-year statute of limitations for foreign tax credits. *See* Gov't Sentencing Memo. at 3. Tilga argued that, because Canadian taxes are generally higher than United States taxes, the foreign tax credit would wipe out the United States tax deficiency. *See* Gov't Sentencing Memo. at 3.

On January 6, 2011, the United States entered into plea agreements with Tilga and Chandler. *See* Tilga Plea Agreement at 1; Plea Agreement at 1, filed January 6, 2011 (Doc. 128) ("Chandler Plea Agreement"); Gov't Sentencing Memo. at 5. Tilga and Chandler both pled guilty to Count ***1302** One of the Indictment, charging a violation of 18 U.S.C. § 371—the *Klein* conspiracy. *See* Tilga Plea Agreement ¶ 3, at 2; Chandler Plea Agreement ¶ 3, at 2. Tilga admitted the salient facts alleged in the conspiracy count of the Indictment: (i) that she failed to report income from her various businesses on her tax returns; (ii) that she entered into an agreement with CTC to defraud the United States; and (iii) that she intended to conceal her Canadian source of income and defraud the United States. *See* Gov't Sentencing Memo. at 6; Tilga Plea Agreement ¶ 8(a)-(h), at 3–7.

In the Plea Agreement, the parties stipulated to the calculation of the amount of tax loss.

> 10. The United States and the Defendant stipulate as follows:
>
> a. For purposes of the advisory United States Sentencing Guidelines, the tax loss for the tax year ending on December 31, 1998, was $23,200.00.
>
> b. The Defendant believes in good faith, relying on the advice of experienced and skilled tax counsel, that she has a foreign tax credit available to her under Title 26, United States Code, Sections 901 and 6511 and applicable regulations, for taxes accrued or actually paid to a foreign country, and that such foreign tax credit would eliminate her liability for federal income taxes in the United States of America for the remaining years of the conspiracy to which she is pleading guilty, that is, the tax years ending on December 31, 1999, through December 31, 2004, inclusive. The Defendant has elected to forego pursuit of the foreign tax credit and instead pay federal income taxes that may be due and owing in the United States of America. The government does not agree with the Defendant concerning the availability and/or applicability of such foreign tax credit on the facts of the present case, as the Defendant has not actually paid the foreign taxes. The government agrees, however, that the Defendant's decision to pay the United States income taxes should not put her in a worse position for purposes of calculating her relevant conduct under the advisory United States Sentencing Guidelines than had she paid the foreign taxes. The

> parties accordingly stipulate, for relevant conduct purposes, that the tax loss from the conspiracy to which the Defendant is pleading guilty is limited to the $23,200.00 set out in ¶ 10(a), above.

Tilga Plea Agreement ¶ 10(a)-(b). The Chandler Plea Agreement makes the same stipulation, except that the tax loss is calculated as $23,300.00. *See* Chandler Plea Agreement ¶ 9(a), at 5.[9]

***1303** On August 9, 2011, in compliance with rule 32 of the Federal Rules of Criminal Procedure, Tilga submitted her objections to the PSR to the United States Probation Office ("USPO"). Tilga's Sentencing Memo. at 1. Tilga contemporaneously submitted these objections to the United States Attorney's Office for the District of New Mexico ("USAO"). *See* Tilga's Sentencing Memo. at 1 n. 2. Chandler also filed his objections to the PSR on August 9, 2011. *See* Defendant Michael Chandler's Objection to the Pre–Sentence Report, filed August 9, 2011 (Doc. 152) ("Chandler Objection"). Chandler objects to the first sentence of paragraph 22 of the PSR, which states "Chandler was also known to assist [in] wiring money to and from the accounts." Chandler Objection at 1–2. *See* Chandler PSR ¶ 22, at 9. Chandler argues that there is no evidence that he wired money to and from accounts. *See* Chandler Objection at 1–2. The USPO responded to Tilga's objections on August 23, 2011, acquiescing on a few of the objections and rejecting the remainder. *See* Tilga's Sentencing Memo. at 1.

On August 23, 2011, Chandler filed his sentencing memorandum. *See* Chandler's Sentencing Memo. at 1. Chandler argues that he merits a sentence of probation based on: (i) his history and characteristics; (ii) that his crime constitutes aberrant behavior; (iii) the restitution he and Tilga have paid; and (iv) his family ties and responsibilities. *See* Chandler Sentencing Memo. at 1–9. Additionally, Chandler argues that probation would be a reasonable sentence pursuant to the 18 U.S.C. § 3553(a) factors. *See* Chandler Sentencing Memo. at 9–10.

On September 2, 2011, the United States responded to Chandler's objection. *See* Government's Response to Defendant Michael Chandler's Objection to Pre–Sentence Report, filed September 2, 2011 (Doc. 157) ("Response"). The United States asserts that the PSR does not state that Chandler wired any funds; rather, the PSR states that he assisted in wiring such funds. *See* Response at 1. The United States also argues that, in his Plea Agreement, Chandler conceded that he assisted in using the offshore bank accounts and wiring funds. *See* Response at 2; Chandler Plea Agreement at ¶ 7(a), at 3 ("In 1998 or 1999, Carolynne Tilga requested my assistance in using a number of off-shore trusts through which we would move money she earned in Canada to purchase properties in the United States.").

On October 6, 2011, Tilga filed her sentencing memorandum and objections to the PSR. *See* Tilga's Sentencing Memo. at 1. In her memorandum she raised six objections to: (i) the calculation of tax loss based on any figure other than the $23,200.00 (USD) figure set out in the Plea Agreement; (ii) the suggestion in the PSR that the conspiracy involved "sophisticated means"; (iii) the PSR's failure to acknowledge the advantages the United States obtained from the Plea Agreement; (iv) the PSR's failure to explicitly recognize that the guidelines are advisory; (v) the PSR's failure to recognize that there are ***1304** valid bases for a downward variance or downward departure from the guidelines sentencing range; and (vi) the PSR's failure to accord sufficient weight to Tilga's civil liability, liability to the Canadian government, and liability for Foreign Bank and Financial Account Report penalties ("FBAR")[10] when calculating Tilga's ability to pay a fine. *See* Tilga's Sentencing Memo. at 4. Tilga maintains that she could have "eviscerated the federal income tax evasion charges lodged against her by amending her federal income tax returns *before* trial, taking the Foreign Tax Credit, and eliminating any tax deficiency." Tilga's Sentencing Memo. at 9 (citing 26 U.S.C. §§ 901, 6511; *United States v. Cruz,* 698 F.2d 1148, 1150–51 (11th Cir.1983)). Tilga argues that, because she could have avoided most of the tax loss through the foreign tax credit, the Plea Agreement's tax loss calculation is correct and that the Court should reject "the alternative and speculative tax loss calculations set out in the PSR predicated on a purportedly larger tax loss amount." Tilga's Sentencing Memo. at 10. Tilga asserts that her conduct did not involve any special complexity or intricacy, and that the sophisticated means were not of her creation. *See* Tilga's Sentencing Memo. at 11. Tilga further asserts that under 18 U.S.C. § 3553(a), the Court should downwardly depart or vary from the guidelines range to impose a non-custodial sentence. *See* Tilga's Sentencing Memo. at 12–19. Finally, Tilga argues that whether the Court should impose a fine on

Tilga is committed to the Court's discretion. *See* Tilga's Sentencing Memo. at 20.

On October 8, 2011, the United States filed its sentencing memorandum. *See* Gov't Sentencing Memo. at 1. The United States argues that the Court should accept the non-binding stipulated loss amount in this case, because it was the product of lengthy, intensive negotiations between the parties, and the United States' decision to compromise was predicated on a review of its ability to prove a tax deficiency were Tilga to raise her foreign tax credit defense. *See* Gov't Sentencing Memo. at 10. The United States asserts that "[i]t is the position of the United States that a taxpayer cannot defeat a tax prosecution by amending her returns post-Indictment," but goes on to state that it calculated the amount of loss in the Plea Agreement only for the losses in 1998 because of "the risk that the tax evasion counts for 1999 to 2004 may have fallen" to the post-Indictment foreign tax credit defense Tilga planned to assert. Gov't Sentencing Memo. at 11, 15. The United States specifically notes that the Plea Agreement avoids "the risk of generating adverse legal precedent with respect to the defendants' proposed use of the foreign tax credit." Gov't Sentencing Memo. at 16. The United States argues that the Court should impose a sentence at the top of the guidelines range on Tilga, because her conduct is "the most egregious conceivable for similarly situated offenders, motivated ... by sheer greed in the face of conspicuous wealth." Gov't Sentencing Memo. at 18. The United States asserts that a departure or variance would be inappropriate, because the facts Tilga presents—that she is a mother and a first-time offender—do not ***1305** distinguish her from any other defendant. *See* Gov't Sentencing Memo. at 18. Finally, the United States contends that the Court should impose a substantial fine on Tilga. *See* Gov't Sentencing Memo. at 19.

The Court held an evidentiary hearing on Thursday, October 13, 2011. Tilga pointed the Court to a recent case from the United States Court of Appeals for the Tenth Circuit, *United States v. Hoskins,* 654 F.3d 1086 (10th Cir.2011), which held that a sentencing court may consider unclaimed tax deductions when calculating tax loss. *See* Transcript of Hearing at 4:14–20 (October 13, 2011) (Theus) ("Tr.").[11] Tilga stated that her argument is based on the United States Court of Appeals for the Eleventh Circuit's decision in *United States v. Cruz. See* Tr. at 5:17–19 (Theus). The Eleventh Circuit, Tilga asserted, held that, when a defendant has firm tax assessments from a foreign government and attempts to take advantage of the foreign tax credit before trial, there is "a viable basis for dismissal or defeat of the tax evasion charges." Tr. at 6:1–5 (Theus). Tilga further asserted that the foreign tax credit is unique, because a taxpayer has up to ten years to take advantage of the credit. *See* Tr. at 6:5–7 (Theus).

The United States asserted that the distinction between the defendant in *United States v. Cruz* and in this case is that the defendant in *United States v. Cruz* did not address his tax liability under the foreign tax credit before trial while Tilga did. *See* Tr. at 7:1–12 (Gerson). Under *United States v. Cruz,* the United States concedes that there is "a colorable argument to be made." Tr. at 7:23–25 (Gerson). The United States clarified, however, that it is not conceding as a matter of law that Tilga may defeat her tax deficiency post-Indictment through the foreign tax credit. *See* Tr. at 8:1–2 (Gerson). Taking Tilga's argument at face value, the United States contended that Tilga would still be liable for the first year of the conspiracy, 1998, and, therefore, the United States used the tax losses for that year for the purposes of the guideline offense level calculation. *See* Tr. at 8:3–12 (Gerson).

The Court expressed concern whether it has authority to avoid the legal issue and accept the party's stipulation as to the law. *See* Tr. at 10:12–17 (Court). The United States responded that it is not stipulating that the law allows Tilga to make a post-Indictment adjustment to her tax liability through the use of the foreign tax credit. *See* Tr. at 10:18–22 (Gerson). Instead, the United States asserted that it recognizes that Tilga raises a colorable question and that "[w]e were trying to avoid the situation in which a court of the United States held that a defendant could make use of the foreign tax credit in the way that Tilga wished to use it in this case." Tr. at 11:1–4 (Gerson). The United States agreed that the stipulation turned on the parties' reading of *United States v. Cruz* being correct. *See* Tr. at 11:7–14 (Court, Gerson).

The Court also observed that, if it either sustains or overrules the objection, the Court will be implicitly deciding whether it agrees with the holding of *United States v. Cruz* or the parties' construction of that case. *See* Tr. 12:1–6 (Court). The United States responded that the calculation of the tax deficiency is a mixed question of ***1306** law and fact. *See* Tr. 12:10–12 (Gerson). The United States also repeated that it is not the United States' position that a defendant may make such use of the foreign tax credit. *See* Tr. 12:24–13:1 (Gerson). It stated that well-developed case law exists supporting the proposition that a taxpayer may not address her tax deficiency post-Indictment. *See* Tr. at 13:19–14:2 (Gerson). The United States indicated that its concern was that the cases do not address the specific question of "ex-post facto correction of tax returns ... through the use of the foreign tax credit." Tr. at 14:3–5 (Gerson). The United States argued that the USPO and the PSR adopted the stipulated tax loss. *See* Tr. at 15:21–16:3 (Gerson). The Court pointed out, however, that the USPO used the stipulated tax loss, but recognized its disagreement with that calculation, and the United States agreed that the Court had correctly described the USPO's position. *See* Tr. at 16:8–22 (Court, Gerson).

The Court also offered Chandler the opportunity to speak on the issue of tax loss. *See* Tr. at 17:9–11 (Court). Chandler proposed presenting an expert witness that Chandler and Tilga subpoenaed should the Court have concerns about the foreign tax credit. *See* Tr. at 17:12–18:3–5 (Court, Johnson, Theus). The witness, Jeffrey Rubinger, was proposed as a specialist in international tax law who currently works as an accountant at KPMG and, before his current employment, was a partner at Holland & Knight LLP in its Fort Lauderdale, Florida office. *See* Tr. at 18:8–11 (Theus). Mr. Rubinger is also an adjunct professor at the University of Miami School of Law and has written on the subject of international tax law. *See* Tr. at 18:11–15 (Theus). Tilga stated that it would be productive to hear Mr. Rubinger's testimony on the foreign tax credit. *See* Tr. 20:14–15 (Theus). The United States asked whether the nature of Mr. Rubinger's testimony would be factual or legal, and stated that it would object if his testimony concerned the application of the law. *See* Tr. at 20:18–23 (Gerson). The Court stated that it would hear Mr. Rubinger's testimony and that if the United States had specific objections, the Court would hear them as they arose. *See* Tr. at 20:24–21:2 (Court).

Mr. Rubinger testified that, as a partner at Holland & Knight, he provided representational services to Tilga, including analyzing the foreign tax credit issue. *See* Tr. at 22:11–23 (Theus, Rubinger). Mr. Rubinger stated that, when he looked at the facts of Tilga's case, he understood that the income was from foreign sources, and that he discussed the special rules that apply to the foreign tax credit under the Internal Revenue Code. *See* Tr. at 23:3–7 (Rubinger). Mr. Rubinger explained that there is a ten-year statute of limitations to claim a foreign tax credit and that, if the credit is claimed within the ten-year period, it "relates back" to when the tax accrued. Tr. at 23:7–11 (Rubinger). Relating his testimony to Tilga, Mr. Rubinger stated that, if Tilga claimed the foreign tax credit within the statute of limitations for the years 1999 to 2004, she could "eliminate any deficiency for civil and criminal purposes." Tr. at 23:19–24:3 (Rubinger). Mr. Rubinger asserted that the Canadian government assessed tax liability of $7 million (CAD) in 2010 and that the amount has not been released, discharged, or abated in any way. *See* Tr. at 24:11–25 (Rubinger, Theus). Mr. Rubinger further asserted that, Title 26 of the Internal Revenue Code requires that foreign tax credits relate back retroactively such that for civil purposes Tilga would have no deficiency. *See* Tr. at 25:8–14 ***1307** (Rubinger). He commented that, if there is no civil tax deficiency, then there cannot be a criminal tax deficiency. *See* Tr. at 25:8–14 (Rubinger). Mr. Rubinger also referred the Court to *Boulware v. United States,* 552 U.S. 421, 128 S.Ct. 1168, 170 L.Ed.2d 34 (2008), as support for his position. *See* Tr. at 25:16–18 (Rubinger).

Chandler's counsel, Erlinda O. Johnson, also questioned Mr. Rubinger concerning the foreign tax credit. *See* Tr. at 25:24 (Johnson). Mr. Rubinger clarified that there are cases which address a net-operating loss, where taxpayers have a "three year carry back," and that courts have not allowed such losses to eliminate tax deficiencies post-Indictment because the net operating loss does not relate back. Tr. at 26:20–27:6 (Rubinger). Mr. Rubinger stated that relation back under the foreign tax credit is mandatory and that its purpose is to alleviate double taxation. *See* Tr. 27:7–19 (Johnson, Rubinger). "When a United States taxpayer is earning income [in] a foreign country [and] the foreign countr[y] taxes the income ... the whole point [of the foreign tax credit] is to not allow the United States to tax the same income." Tr. at 27:13–19 (Rubinger). Mr. Rubinger went on to explain that "the rules work even though a United States individual taxpayer is typically on a cash method, which means that [their] income is taxable when it's received ... [and] allow[s] individual taxpayers to apply the foreign tax credits on an accrual basis." Tr. at 28:1–9 (Rubinger). "So the Canadian tax credits accrued each [year] when they were owed; despite the fact that they may not have been paid, they were owed to Canada on the accrual method." Tr. at 28:10–12 (Rubinger). Mr. Rubinger stated that, "whether she paid them or not, under the accrual method of claiming the foreign tax credit she would get a retroactive tax credit." Tr. at 28:16–18 (Rubinger).

The United States then cross-examined Mr. Rubinger. Responding to a question whether any federal court had dismissed an indictment on the grounds that a taxpayer, post-indictment, had paid taxes to a foreign sovereign, Mr. Rubinger agreed that no such federal decision existed. *See* Tr. 29:8–14 (Gerson, Rubinger). Expanding on his answer, Mr. Rubinger explained that the decision in *United States v. Cruz* comes very close to this holding, but in that case, the facts were different because the defendant had not filed returns before trial. *See* Tr. 29:14–23 (Rubinger). Mr. Rubinger agreed that it would be fair to say that Tilga's defense is predicated on the reasoning of *United States v. Cruz,* and not on the holding of that case. *See* Tr. at 29:24–30:2 (Gerson, Rubinger). He asserted that Tilga's defense is based on the Internal Revenue Code, which establishes that the foreign tax credit relates back, and that this retroactivity is what the Eleventh Circuit, in *United States v. Cruz,* held could preclude criminal liability pre-trial. *See* Tr. at 30:2–8 (Rubinger). Mr. Rubinger characterized the holding in *United States v. Cruz* as accelerating the expiration of the statute of limitations for claiming the foreign tax credit to the period before trial and added that the "case was highly criticized for that analysis." Tr. at 30:13–15 (Rubinger). Mr. Rubinger agreed that, although the Internal Revenue Code says up to ten years, the judicial authority puts the expiration of the statute of limitations earlier if a criminal tax prosecution is implemented. *See* Tr. at 30:22–31:1 (Gerson, Rubinger).

In Tilga's re-direct, Mr. Rubinger stated that all the returns were prepared and the money was in the trust account ready to be paid before trial such that she was poised to exercise the foreign tax credit before it would expire under *United States* ***1308** *v. Cruz. See* Tr. at 31:8–11 (Theus, Rubinger). The Court asked the United States to clarify the point of its questions regarding the statute of limitations for the foreign tax credit. *See* Tr. at 32:2–3 (Court). The United States responded that it was attempting to show that, although the Internal Revenue Code says the period is ten years, courts have not always applied that time period. *See* Tr. at 32:4–33:15 (Gerson, Rubinger). The United States reiterated that its position has always been that "a taxpayer may not fix the commission of a crime after the crime [has] been completed." Tr. at 33:19–25 (Gerson). The United States admitted that, had it not entered into this stipulation, it would be arguing on the other side of this issue—that the total tax loss should be $1,735,025.00 (USD)—and agreeing with the USPO. *See* Tr. at 34:7–21 (Court, Gerson). The United States stated that is the United States' legal position in this case that "this is an open question of law which we recognize we would have stood some risk of losing had we gone to trial." Tr. at 34:22–25 (Gerson).

The Court also asked the United States to explain what the criticism of the holding in *United States v. Cruz* has been. *See* Tr. at 35:12–15 (Court). The United States responded that it understood that Mr. Rubinger was referencing the position that the Internal Revenue Code is absolute in its position and "when the code says ten years it's ten years," when he referenced criticism. Tr. at 35:17–20 (Gerson). Expanding on this remark, the United States explained that the criticism on the part of tax professionals is that the *United States v. Cruz* decision violates the Internal Revenue Code. *See* Tr. at 35:20–21 (Gerson). The United States asserted that "what the court itself said in Cruz [was] that they need to make decisions that are practical and attempt to fit the best interests of the United States over all and [not just] follow[ ] lockstep with the words of the statute." Tr. at 35:21–25 (Gerson). Mr. Rubinger stated that there is no provision in the Internal Revenue Code that allows for the acceleration of the ten-year period for the foreign credit. *See* Tr. at 38:5–9 (Johnson, Rubinger).

Responding to Tilga's second objection, to the PSR's reference to sophisticated means, the United States asserted that the Plea Agreement stipulated that the sophisticated-means enhancement would not apply to Tilga. *See* Tr. at 39:3–5 (Gerson). The United States explained that it believed that the sophisticated-means enhancement would apply to CTC, and its officers or employees, but not to a customer of CTC like Tilga. *See* Tr. at 39:7–13 (Gerson). The Court asked whether Tilga used business entities, wired offshore accounts, and used shell companies to hide her income, and the United States admitted that she had. *See* Tr. at 40:1–5 (Court, Gerson). The United States said that it agreed to the stipulation, because Tilga was buying a product from another corporation. *See* Tr. at 40:5–11 (Court, Gerson). In response to the Court's questioning, the United States admitted that PTOs are sophisticated means, and that it was unaware of any reported opinion which drew a distinction between the seller and a customer in terms of sophisticated means. *See* Tr. at 40:14–41:4 (Court, Gerson).

Tilga also argued that she did not employ sophisticated means to commit tax evasion. Tilga referred the Court to the argument in her sentencing memorandum and stated that the analysis looks not just to the means a defendant employs, but to "the context of the particular offense or ***1309** offense[s] being examined." Tr. at 41:8–17 (Theus). Tilga argues that her conduct is "par for the course" for the offense she committed, and asserted that several cases cited in her sentencing memorandum involve foreign entities, foreign bank accounts, and substantial sums of money. Tr. at 41:17–42:2 (Theus). Tilga argued that, to qualify for the sophisticated-means enhancement, the conduct has to be "something beyond what happens in the garden variety type of offense" and that there is "nothing especially sophisticate[d] or complex about this matter." Tr. at 42:13–25 (Theus). Tilga agreed that CTC, in marketing and managing different product for their customers, engaged in sophisticated means, but asserted that there is a difference between those activities and the consumer who buys a product relying on CTC's representation about that product. *See* Tr. at 43:13–20 (Theus). Tilga also conceded that she had not found any cases supporting the distinction between a customer and a seller using sophisticated means. *See* Tr. at 43:21–44:6 (Court, Theus). Tilga contended that CTC had lawyers and accountants on staff who made representations to her about the acceptability of their products to the IRS. *See* Tr. at 44:23–25 (Theus). She asserted that sophisticated means requires "some deliberate or volitional activity on the part of the accused in terms of creation or management of these types of products." Tr. at 45:1–6 (Theus). Tilga maintained that, if the sophisticated-means enhancement applies every time some sophisticated means was used in connection to the offense, then a court could apply the enhancement to virtually any offense that might come before the court. *See* Tr. at 45:6–9 (Theus).

Chandler also spoke, and supported the United States' position that Tilga did not employ sophisticated means, because she was no more than a customer who bought a product. *See* Tr. at 45:16–19 (Johnson). Chandler argued that it is the managers and directors of CTC who should have the sophisticated-means enhancement. *See* Tr. at 45:19–23 (Johnson). Chandler asserted that Tilga was a customer and that CTC sold her a bill of goods with the promise that they were completely legitimate. *See* Tr. at 45:24–46:1 (Johnson). Because CTC held Tilga's hand throughout the time period that she held the trusts and prided itself on the fact that its employees would serve as trustees, Chandler argued that Tilga's actions do not qualify for the sophisticated-means enhancement. *See* Tr. at 46:1–6 (Johnson). Chandler further asserted that the customer is not involved in knowing the intricacies of the PTOs that were sold and, therefore, the sophisticated-means enhancement would apply to the individuals who managed the trusts or came up with the idea for the trust. *See* Tr. at 46:6–11 (Johnson). Conceding that at some point Tilga should have realized that her conduct was criminal, Chandler nonetheless argued that Tilga, when she bought the PTOs, was "basically [given] a handbook and ... led by the hand [to] understand 'this is how you do this and you do this and you do that.' " Tr. at 46:12–24 (Johnson).

Additionally, the Court heard arguments on the stipulation in the Plea Agreement that Tilga was not the organizer, leader, or supervisor of the criminal activity. *See* Tr. at 48:12–19 (Court). The United States stated that Tilga is substantially less culpable than the people at CTC. *See* Tr. 48:22–24 (Court, Gerson). Chandler again pointed out, that both he and Tilga were sold a product, and did not start the PTOs. *See* Tr. at 49:11–14 (Johnson). The Court accepted the stipulation on the role adjustment, ***1310** because "when we consider the entire criminal organization, I agree that she's substantially less culpable than the people at Commonwealth." Tr. at 49:16–20 (Court).

The United States also stated that it was the parties' position that neither Tilga nor Chandler "possessed any special skill with respect to tax law or with respect to taxes." Tr. at 50:1–4 (Gerson). It clarified that the United States' argument was not that Tilga does not have skills, because Tilga is highly educated, but that, she did not "victimize[ ] some other person by making use of these special skills." Tr. at 50:5–15 (Court, Gerson). The United States asserted that Tilga has special skills with respect to marketing and collecting fees for services providers, but that she does not have any special skills that relate to taxes or tax liability. *See* Tr. at 51:2–6 (Gerson). The Court agreed that the enhancement for use of a special skill is inappropriate and accepted the parties' stipulation to that effect. *See* Tr. at 52:5–13 (Court).

The Court expressed concern whether an obstruction enhancement was appropriate. *See* Tr. at 52:14–21 (Court). The United States asserted that, had it gone to trial, the United States would have called Grant Simmons, Tilga's former employee, and had him testify that Tilga came to his house and told him that she "was not going to take the fall for this." Tilga PSR ¶ 40, at 21; Tr. at 52:22–25 (Gerson). The United States argued that these actions show consciousness of guilt and "was being uttered to prevent the United States from carrying out an investigation in this case." Tr. at 53:1–8 (Gerson). Tilga stated that no admissible evidence would establish that she intended to obstruct or impede the administration of justice. *See* Tr. at 53:10–13 (Theus). Additionally, Tilga argued that Simmons would have been aggressively cross-examined and impeached. *See* Tr. at 53:13–20 (Theus). The United States admitted that, while it would have been able to establish that Tilga said those things to Simmons, it would not have been "able to establish by a preponderance of the evidence that that was reasonably likely to interfere with the investigation." Tr. at 54:22–55:5 (Gerson).

Tilga stated that her objection to the PSR's failure to acknowledge the advantages that the United States received from the Plea Agreement had been addressed and was more appropriate for argument rather than inclusion in the PSR. *See* Tr. at 57:21–58:3 (Theus). Tilga admitted that her objection is moot to the extent that the information is presently before the Court through her sentencing memorandum. *See* Tr. at 58:4–7 (Court, Theus). Additionally, Tilga stated that her objection to the PSR's failure to acknowledge the advisory status of the guidelines had been satisfactorily addressed and included in the sentencing memorandum. *See* Tr. at 58:12–59:2 (Court, Theus).

On October 31, 2011, Chandler's attorney wrote the Court regarding the standard of proof and Sixth Amendment requirements for applying a sentencing enhancement. *See* Letter from Erlinda Johnson to the Court (dated October 31, 2011), filed October 31, 2011 (Doc. 164) ("Letter"). Chandler requested that the Court accept the stipulations included in paragraph 9(b) of Chandler's Plea Agreement that Chandler's offense did not involve a breach of trust, a special skill, sophisticated means, an aggravating role, or obstruction of justice. *See* Letter at 1. Chandler focuses his discussion on U.S.S.G. § 2T1.1(b)(2)'s sophisticated-means ***1311** enhancement. *See* Letter at 1–2. Chandler points the Court to *United States v. Lewis,* 93 F.3d 1075 (2d Cir.1996), which applied the sophisticated-means enhancement but acknowledged that the enhancement "targets conduct that is more complex, demonstrates greater intricacy, or demonstrates greater planning than a routine tax-evasion case." Letter at 1–2. Chandler also cites *United States v. Rice,* 52 F.3d 843 (10th Cir.1995), which reversed the application of the sophisticated-means enhancement where, "[b]y using [several] corporations, Mr. Rice claimed to have paid withholding taxes he did not indeed pay." Letter at 1–2. Chandler argues that the "*conduct* of the defendants [in this case] was more similar to Mr. Rice's conduct because the defendants herein merely requested, of others, the movement of moneys from one account to a different account." Letter at 2. Chandler also submits that, pursuant to *Blakely v. Washington,* 542 U.S. 296, 124 S.Ct. 2531, 159 L.Ed.2d 403 (2004) and *United States v. Booker,* 543 U.S. 220, 125 S.Ct. 738, 160 L.Ed.2d 621 (2005), a sentence must be determined solely "by reference to 'facts reflected in the jury verdict or admitted by the defendant,' " and that any other sentencing fact must be proved to a jury beyond a reasonable doubt to a jury. Letter at 2.

LAW REGARDING CALCULATION OF TAX LOSS

[1] The guidelines define "tax loss" for the purpose of sentencing defendants in U.S.S.G. § 2T1.1: "If the offense involved tax evasion or a fraudulent or a false return, statement, or other document, the tax loss is the total amount of loss that was the object of the offense (i.e., the loss that would have resulted had the offense been successfully completed)." U.S.S.G. § 2T1.1(c)(1). Under this provision, tax loss "shall be treated as equal to 28% of the unreported gross income ..., unless a more accurate determination of the tax loss can be made." U.S.S.G. § 2T1.1(c)(1), Note A. The United States bears the burden of proving the amount of tax loss arising from the defendant's illegal acts, but under the guidelines, "neither the government nor the court has an obligation to calculate the tax loss with certainty or precision." *United States v. Sullivan,* 255 F.3d 1256, 1263 (10th Cir.2001) (quotation omitted).

1. *Tenth Circuit Jurisprudence on Availability of Unclaimed Deductions.*

In *United States v. Spencer,* 178 F.3d 1365 (10th Cir.1999), the Tenth Circuit stated that U.S.S.G. § 2T1.1 Note A's "more accurate determination" provision does not allow taxpayers "a second opportunity to claim deductions after having been convicted of tax fraud." 178 F.3d at 1368. The Tenth Circuit explained that, in calculating tax loss for the purpose of sentencing, "we are not computing an individual's tax liability as is done in a traditional audit[, but r]ather we are merely assessing the tax loss resulting from the manner in which the defendant chose to complete his income tax returns." *United States v. Spencer,* 178 F.3d at 1368. Although the Tenth Circuit in *United States v. Spencer* discussed the availability of unclaimed deductions when calculating tax loss, the Tenth Circuit ultimately rejected the defendant's tax-loss estimate because it was not supported by a "scintilla of competent evidence." 178 F.3d at 1369.

In *United States v. Hoskins,* 654 F.3d 1086 (10th Cir.2011), the Tenth Circuit ***1312** again refused to "squarely hold that unclaimed deductions can never be considered by a district court." 654 F.3d at 1094. The Tenth Circuit found that "the plain language of § 2T1.1 does not categorically prevent a court from considering unclaimed deductions in its sentencing analysis." *United States v. Hoskins,* 654 F.3d at 1094. Instead, "§ 2T1.1 directs courts to calculate the tax loss that would have resulted had the offense been successfully completed." *United States v. Hoskins,* 654 F.3d at 1094. Thus, "the 'object of the offense' refers to the 'amount by which [a defendant] underreported and fraudulently stated his tax liability on his return.' " *United States v. Hoskins,* 654 F.3d at 1094 (quoting *United States v. Chavin,* 316 F.3d 666, 677 (7th Cir.2002)). Addressing *United States v. Spencer,* the Tenth Circuit explained that the holding of that case still holds true where "a defendant offers weak support for a tax-loss estimate," because "nothing in the Guidelines *requires* a sentencing court to engage in the 'nebulous and potentially complex exercise of speculating about unclaimed deductions." *United States v. Hoskins,* 654 F.3d at 1094 (emphasis original) (quoting *United States v. Yip,* 592 F.3d 1035, 1041 (9th Cir.2010)). The Tenth Circuit held, however, that "nothing in the Guidelines *prohibits* a sentencing court from considering evidence of unclaimed deductions in analyzing a defendant's estimate of the tax loss suffered by the government." *United States v. Hoskins,* 654 F.3d at 1094–95 (emphasis original). "[A] court may exercise its discretion to consider additional evidence that could guide its findings on the losses to the government relevant to sentencing." *United States v. Hoskins,* 654 F.3d at 1095. The United States is not supposed to reap windfall gains as a result of tax evasion and cannot assert to have lost revenue it never would have collected had the defendant not evaded his taxes. *See United States v. Hoskins,* 654 F.3d at 1095 (citing *United States v. Gordon,* 291 F.3d 181, 187 (2d Cir.2002)).

In a footnote, however, the Tenth Circuit emphasized that § 2T1.1 "does not permit a defendant to benefit from deductions unrelated to the offense at issue." *United States v. Hoskins,* 654 F.3d at 1095 n. 9. Thus, "unclaimed deductions for student loan interest or solar energy credits, for example, are not considered because they do not relate to the 'object of the offense' and are not relevant to restitution or guideline calculations for sentencing purposes." *United States v. Hoskins,* 654 F.3d at 1095 n. 9.

Chief Judge Briscoe wrote an opinion concurring in part and dissenting in part in *United States v. Hoskins.* Chief Judge Briscoe concurred with "the portions of the majority's opinion affirming Hoskins' conviction, the district court's ultimate finding regarding the amount of the tax loss, and the district court's application of the U.S.S.G. § 2T1.1(b)(1) enhancement." *United States v. Hoskins,* 654 F.3d at 1100 (Briscoe, C.J., concurring in part and dissenting in part). She dissented with respect to the portions of the majority opinion "in which the majority takes the unnecessary step in announcing a rule permitting defendants in future cases to offer deductions they did not actually claim in order to establish a 'more accurate determination of the tax loss' under U.S.S.G. § 2T1.1(a)." *United States v. Hoskins,* 654 F.3d at 1100. Chief Judge Briscoe explained that, in her view, the majority opinion's rule on tax loss improperly complicates sentencing in tax cases, improperly characterizes the Tenth Circuit's ***1313** holding in *United States v. Spencer,* and "essentially allows the defendant a 'do over.' " *United States v. Hoskins,* 654 F.3d at 1101–02.

2. *The Foreign Tax Credit.*

26 U.S.C. § 901 provides that a United States taxpayer may claim a tax credit for the amount of any income taxes paid or accrued to any foreign country. *See* 26 U.S.C. § 901(a)-(b). Subsection (a) specifically notes that "[s]uch choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed." 26 U.S.C. § 901(a). Section 904 of Title 26 of the United States Code limits the total amount of credit that a United States taxpayer may take under § 901(a) and provides that

"[t]he total amount of the credit taken under section 901(a) shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States ... bears to his entire taxable income for the same taxable year." 26 U.S.C. § 904(a). Furthermore, 26 U.S.C. § 905 states:

> (B) Taxes subsequently paid.—Any such taxes if subsequently paid—
>
> > (i) shall be taken into account—(I) in the case of taxes deemed paid under section 902 or section 960, for the taxable year in which paid (and no redetermination shall be made under this section by reason of such payment), and (II) in any other case, for the taxable year to which such taxes relate....

26 U.S.C. § 905(c)(2)(B).

In another section of Title 26, Congress provides special rules relating to foreign tax credits. *See* 26 U.S.C. § 6511(d). 26 U.S.C. § 6511(d)(3)(A) establishes a special statute of limitations with respect to foreign taxes paid or accrued. Subsection (d)(3)(A) provides:

> If the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country or to any possession of the United States for which credit is allowed against the tax imposed by subtitle A in accordance with the provisions of section 901 or the provisions of any treaty to which the United States is a party, in lieu of the 3–year period of limitation prescribed in subsection (a), the period shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued.

26 U.S.C. § 6511(d)(3)(A).

The Tenth Circuit appears to have addressed the foreign tax credit only in a civil case, *Tipton & Kalmbach v. United States,* 480 F.2d 1118 (10th Cir.1973). *Tipton & Kalmbach v. United States* addressed a claim for refunds of federal income taxes paid in 1964 through 1966, and answered questions relating to the determination of where services were performed. *See* 480 F.2d at 1119, 1121.

The Eleventh Circuit, in *United States v. Cruz,* 698 F.2d 1148, held that a defendant in a tax evasion case could not contend that the foreign tax credit wiped out the United States deficiency, because the foreign tax liability had not been determined before trial. *See* 698 F.2d at 1152. The Eleventh Circuit explained that, "[i]n the case of the foreign tax credit, the final event which fixes the amount of the credit is the levy of the tax." *United States v. Cruz,* 698 F.2d at 1151 (citing *United* ***1314** *States v. Campbell,* 351 F.2d 336, 338 (2d Cir.1965)). The Eleventh Circuit noted that, once the liability becomes fixed, it "relates back" to the year in which it was levied. *United States v. Cruz,* 698 F.2d at 1151. In reaching its holding and interpreting 26 U.S.C. § 905, the Eleventh Circuit emphasized that, "we will not be constrained by intricate technicalities which would create a haven for federal tax evasion." *United States v. Cruz,* 698 F.2d at 1152. The Eleventh Circuit stated: "When interpreting statutes, we are required to give a practical interpretation which will not produce an absurd result." *United States v. Cruz,* 698 F.2d at 1152.

The defendant in *United States v. Cruz* defended himself at trial on the theory that no tax deficiency existed, because as a citizen of the Dominican Republic, a country which taxes income earned worldwide, his tax liability to it had accrued. *See* 698 F.2d at 1150. In rejecting this argument on appeal, the Eleventh Circuit commented:

> [U]nder Cruz's interpretation, a taxpayer in his position could wait and pay no tax, either to the United States or the Dominican Republic until the United States authorities became aware of an irregularity in his tax return. Once discovered, he could either pay or immediately admit the foreign tax and claim the retroactive United States tax credit under section 6511(d)(3), as an absolute defense.

United States v. Cruz, 698 F.2d at 1152. Concerns with fraud and the six-year statute of limitations on 26 U.S.C. § 7201 prosecutions were evident in the Eleventh Circuit's approach to its analysis. *See United States v. Cruz,* 698 F.2d at 1152. The defendant did not offer any proof that he had fixed his foreign tax liability before trial. *See United States v. Cruz,* 698 F.2d at 1152. The Eleventh Circuit upheld a jury instruction which required that the jury find that "all events have occurred which fix the amount of the tax and determine the liability of the taxpayer to pay it." *United States v. Cruz,* 698 F.2d at 1150.

> The practical effect of this decision means the tax evader can no longer play one government against the other to defeat an evasion prosecution.... It now means that when the government begins a section 7201 prosecution of a taxpayer who claims a foreign tax credit under section 905, the government accelerates that time within which the taxpayer may exercise the right to fix the amount of the foreign tax liability and claim the foreign tax credit.

United States v. Cruz 698 F.2d at 1152.

PROOF OF ENHANCEMENTS UNDER THE GUIDELINES

In *Apprendi v. New Jersey,* 530 U.S. 466, 120 S.Ct. 2348, 147 L.Ed.2d 435 (2000), the Supreme Court of the United States reaffirmed the principle that it is permissible for sentencing judges "to exercise discretion—taking into consideration various factors relating both to offense and offender—in imposing judgment within the range prescribed by statute." 530 U.S. at 481, 120 S.Ct. 2348. The Supreme Court cautioned, however, that the Constitution limits this discretion and that the Sixth Amendment requires that, "[o]ther than the fact of a prior conviction, any fact that increases the penalty for a crime beyond the prescribed statutory maximum must be submitted to a jury, and proved beyond a reasonable doubt." *Apprendi v. New Jersey,* 530 U.S. at 490, 120 S.Ct. 2348. In *Blakely v. Washington,* the Supreme ***1315** Court elaborated on its holding in *Apprendi v. New Jersey,* stating that the "statutory maximum for *Apprendi* purposes is the maximum sentence a judge may impose solely on the basis of the facts reflected in the jury verdict or admitted by the defendant." *Blakely v. Washington,* 542 U.S. 296, 303, 124 S.Ct. 2531, 159 L.Ed.2d 403 (2004) (emphasis omitted) (internal quotations and citations omitted). In *United States v. Booker,* the Supreme Court expanded its earlier holdings to apply to sentencing enhancements that exceeded maximum sentences under the sentencing guidelines. *See* 543 U.S. 220, 239, 125 S.Ct. 738, 160 L.Ed.2d 621 (2005) ("Regardless of whether the legal basis of the accusation is in a statute or in guidelines promulgated by an independent commission, the principles behind the jury trial right are equally applicable.").

The Supreme Court in *United States v. Booker* found those provisions of the Federal Sentencing Reform Act of 1984 that made the guidelines mandatory, *see* 18 U.S.C. § 3553(b)(1), or which relied upon the guidelines' mandatory nature, *see* 18 U.S.C. § 3742(e), incompatible with the Sixth Amendment, *see United States v. Booker,* 543 U.S. at 245, 125 S.Ct. 738. Accordingly, the Supreme Court in *United States v. Booker* severed and excised 18 U.S.C. § 3553(b)(1)—the portion of the federal sentencing statute that made it mandatory for courts to sentence within a particular sentencing guideline range—from the remainder of the Act, thus "mak[ing] the Guidelines effectively advisory." *United States v. Booker,* 543 U.S. at 245, 125 S.Ct. 738. The Supreme Court's holding in *United States v. Booker* "requires a sentencing court to consider Guideline ranges, but it permits the court to tailor the sentence in light of other statutory concerns as well." *United States v. Booker,* 543 U.S. at 245–46, 125 S.Ct. 738.

[2] The Supreme Court confirmed that an advisory guidelines system comports with the Sixth Amendment. In *Cunningham v. California,* 549 U.S. 270, 127 S.Ct. 856, 166 L.Ed.2d 856 (2007), Justice Ginsburg, joined by the other four justices who had been part of the constitutional majority in *United States v. Booker* and Chief Justice Roberts, noted that, despite disagreement over the most appropriate method to remedy the mandatory Guidelines' constitutional infirmity, all nine justices that took part in the *United States v. Booker* decision agreed that "the Federal Guidelines would not implicate the Sixth Amendment were they advisory." *Cunningham v. California,* 549 U.S. at 285, 127 S.Ct. 856. Not only did making the guidelines advisory remedy the Supreme Court's Sixth Amendment concerns, it seems to have alleviated the constitutional concerns regarding the appropriate burden of proof that existed under the mandatory system. A person who is found guilty of a crime beyond a reasonable doubt is exposed to the maximum punishment the statute of conviction allows, rather than the maximum allowed under the Guidelines, and it is therefore constitutional to sentence the guilty defendant any where within the range based on facts proved only by a preponderance of the evidence. *See, e.g., Harris v. United States,* 536 U.S. 545, 558, 122 S.Ct. 2406, 153 L.Ed.2d 524 (2002) ("Judicial factfinding in the course of selecting a sentence within the authorized range does not implicate the indictment, jury-trial, and reasonable-doubt components of the Fifth and Sixth Amendments.").

In *United States v. Magallanez,* 408 F.3d 672 (10th Cir.2005), the Tenth Circuit ***1316** held that *Blakely v. Washington* and *United States v. Booker* had not changed the district court's enhancement-findings analysis. *See United States v. Magallanez,* 408 F.3d at 684–85. *United States v. Magallanez* involved plain-error review of a drug sentence in which a jury found the defendant, Magallanez, guilty of conspiracy to possess with intent to distribute and to distribute methamphetamine. *See* 408 F.3d at 676. As part of its verdict, the jury, through special interrogatory, attributed to the defendant 50–500 grams of methamphetamine; at sentencing, however, the judge—based on testimony of the various amounts that government witnesses indicated they had sold to the defendant—attributed 1200 grams of methamphetamine to the defendant and used that amount to increase his sentence under the guidelines. *See United States v. Magallanez,* 408 F.3d at 682. The district court's findings increased the defendant's guideline sentencing range from 63 to 78 months to 121 to 151 months. *See United States v. Magallanez,* 408 F.3d at 682–83. The Tenth Circuit stated that, both before and after Congress' passage of the Sentencing Reform Act, "sentencing courts maintained the power to consider the broad context of a defendant's conduct, even when a court's view of the conduct conflicted with the jury's verdict." *United States v. Magallanez,* 408 F.3d at 684. Although *United States v. Booker* made the guidelines "effectively advisory," the Tenth Circuit in *United States v. Magallanez* reaffirmed that "district courts are still required to consider Guideline ranges, which are determined through application of the preponderance standard, just as they were before." 408 F.3d at 685 (internal citation omitted). In the Tenth Circuit's estimation, "the only difference is that the court has latitude, subject to reasonableness review, to depart from the resulting Guideline ranges." *United States v. Magallanez,* 408 F.3d at 685. Two years later, in *United States v. Hall,* 473 F.3d 1295 (10th Cir.2007), the Tenth Circuit confirmed its position in *United States v. Magallanez* and held that, in the context of sentencing enhancements, "*Booker* makes clear that judicial fact-finding by a preponderance of the evidence standard is unconstitutional only when it operates to increase a defendant's sentence mandatorily." 473 F.3d at 1312.

LAW REGARDING U.S.S.G. § 3B1.3

U.S.S.G. § 3B1.3, entitled "Abuse of Position of Trust or Use of Special Skill," provides:

> If the defendant abused a position of public or private trust, or used a special skill, in a manner that significantly facilitated the commission or concealment of the offense, increase by 2 levels. This adjustment may not be employed if an abuse of trust or skill is included in the base offense level or specific offense characteristic. If this adjustment is based upon an abuse of a position of trust, it may be employed in addition to an adjustment under § 3B1.1 (Aggravating Role); if this adjustment is based solely on the use of a special skill, it may not be employed in addition to an adjustment under § 3B1.1 (Aggravating Role).

U.S.S.G. § 3B1.3. Application Note 4 defines "Special skill" as "a skill not possessed by members of the general public and usually requiring substantial education, training or licensing. Examples would include pilots, lawyers, doctors, accountants, chemists, and demolition experts." U.S.S.G. § 3B1.3 cmt. n. 4. The United States must satisfy two elements to ***1317** meet § 3B1.3: (i) the defendant possessed a special skill or a position of trust; and (ii) the defendant used that skill or abused that position to significantly facilitate the commission or concealment of the offense. *See United States v. Burt,* 134 F.3d 997, 998–99 (10th Cir.1998).

[3] The Tenth Circuit recognizes that a defendant need "not complete formal educational or licensing requirements in order to possess a special skill." *United States v. Hinshaw,* 166 F.3d 1222, 1999 WL 9762, at *3 (10th Cir. Jan. 12, 1999) (table) (unpublished opinion). A special skill may also come from experience or from self-teaching. *See United States v. Gandy,* 36

F.3d 912, 914 (10th Cir.1994). To apply a U.S.S.G. § 3B1.3 enhancement, the skill " 'must be more than the mere ability to commit the offense.' " *United States v. Burt,* 134 F.3d 997, 999 (10th Cir.1998) (quoting *United States v. Young,* 932 F.2d 1510, 1513 (D.C.Cir.1991)). Additionally, there must be a "connection between the crime and the Defendant's special knowledge." *United States v. Burt,* 134 F.3d at 1000.

LAW REGARDING U.S.S.G. § 2T1.1(b)(2)

U.S.S.G. § 2T1.1 addresses tax evasion specifically and subsection (b)(2) provides that, "[i]f the offense involves sophisticated means, increase by 2 levels. If the resulting offense is less than level 12, increase to level 12." U.S.S.G. § 2T1.1(b)(2). Application Note 4 provides that

> For the purposes of subsection (b)(2), "sophisticated means" means especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense. Conduct such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore financial accounts ordinarily indicates sophisticated means.

U.S.S.G. § 2T1.1 cmt. n. 4.

The Tenth Circuit first addressed the tax evasion enhancement for sophisticated means in *United States v. Rice,* 52 F.3d 843 (10th Cir.1995). In *United States v. Rice,* the defendant received a "tax refund based on excessive withholding that was never in fact withheld." 52 F.3d at 845. The district court applied the sophisticated-means enhancement, "in part because [the defendant] contested the IRS' ability to require him to produce documents during the civil phase of his case." *United States v. Rice,* 52 F.3d at 849. The Tenth Circuit held that the defendant's tax evasion scheme was not sophisticated, because it was "the functional equivalent of claiming more in itemized deductions than actually paid." *United States v. Rice,* 52 F.3d at 849. In so holding, the Tenth Circuit noted that, if the defendant's scheme was sophisticated, then "every fraudulent tax return will fall within that enhancement's rubric." *United States v. Rice,* 52 F.3d at 849. In *United States v. Guidry,* 199 F.3d 1150 (10th Cir.1999), the Tenth Circuit found that the district court's application of the sophisticated-means enhancement was appropriate, even though the defendant did not use a sham corporation or offshore bank accounts. *See* 199 F.3d at 1158. The Tenth Circuit held that using multiple storage units to hold items purchased with embezzled funds had a similar effect and that her case was not simply one of claiming to have paid withholding taxes not paid or not disclosing one's income. *See United States v. Guidry,* 199 F.3d at 1158 (citing *United States v. Rice,* 52 F.3d at 849; *United States v. Stokes,* 998 F.2d 279, 282 (5th Cir.1993)).

***1318** The Tenth Circuit has upheld the application of a sophisticated-means enhancement to a defendant who conducted seminars on avoiding tax liability, and "assisted in the preparation of tax returns that were false and fraudulent as to a material matter." *United States v. Ambort,* 405 F.3d 1109, 1113 (10th Cir.2005). In *United States v. Ambort,* the Tenth Circuit found that there was ample evidence in the record to support a sophisticated-means enhancement, because the defendant's program was designed to provide a basis that someone could later articulate as to why they were entitled to the tax status they advanced and included discussions about what information should not be included in tax forms to avoid traceability. *See* 405 F.3d at 1120. Additionally, the United States Court of Appeals for the Sixth Circuit has upheld the imposition of a sophisticated—means enhancement where the defendant created and used fictitious trusts to hide assets from the IRS, even though the defendant was not a sophisticated businessman and no offshore trusts were involved. *See United States v. Schwartz,* 408 Fed.Appx. 868, 870 (6th Cir.2010) (unpublished). The United States Court of Appeals for the Seventh Circuit, in *United States v. Minneman,* 143 F.3d 274 (7th Cir.1998), held that the use of multiple corporate names and the placement of funds in a trust account both constitute complex efforts to hide income. *See* 143 F.3d at 283.

LAW REGARDING U.S.S.G. § 3B1.1(a) AGGRAVATING ROLE ENHANCEMENTS

Section 3B1.1 of the Sentencing Guidelines provides for enhancements to a defendant's offense level based on a defendant having played an aggravating role in the offense. Under § 3B1.1(a), "[i]f the defendant was an organizer or leader of a criminal activity that involved five or more participants or was otherwise extensive, increase by 4 levels." Lesser enhancements are specified for defendants who are "managers or supervisors" rather than organizers or leaders, and for defendants involved in smaller-scale criminal conduct. U.S.S.G. § 3B1.1(b)-(c). "A 'participant' is a person who is criminally responsible for the commission of the offense, but need not have been convicted." U.S.S.G. § 3B1.1 cmt. n. 1. "In assessing whether an organization is 'otherwise extensive,' all persons involved during the course of the entire offense are to be considered." U.S.S.G. § 3B1.1 cmt. n. 3. "The [Sentencing] Commission's intent is that this adjustment should increase with both the size of the organization and the degree of the defendant's responsibility." U.S.S.G. § 3B1.1, backg'd.

Among the factors a sentencing court should consider when weighing an aggravating role enhancement are:

> [T]he exercise of decision making authority, the nature of participation in the commission of the offense, the recruitment of accomplices, the claimed right to a larger share of the fruits of the crime, the degree of participation in planning or organizing the offense, the nature and scope of the illegal activity, and the degree of control and authority exercised over others. There can, of course, be more than one person who qualifies as a leader or organizer of a criminal association or conspiracy.

U.S.S.G. § 3B1.1, cmt. n. 4. The Tenth Circuit has "elaborated that '[i]n considering these factors, the sentencing court should remain conscious of the fact that the gravamen of this enhancement is control, organization, and responsibility for ***1319** the actions of other individuals because § 3B1.1(a) is an enhancement for organizers or leaders, not for important or essential figures.' " *United States v. Sallis,* 533 F.3d 1218, 1223 (10th Cir.2008) (quoting *United States v. Torres,* 53 F.3d 1129, 1142 (10th Cir.1995)). The Tenth Circuit, in the context of conspiracies to distribute illegal drugs, has also

> identified several factors which might indicate that a defendant exercised the requisite control over others, including that: other sellers worked for him, were recruited by him, or had their activities controlled by him; "he paid others for their efforts on behalf of the conspiracy;" "he restricted the people to whom other coconspirators could sell their drugs;" and "he controlled the manner of sales, set prices, or claimed the right to a larger share of proceeds." *United States v. Anderson,* 189 F.3d 1201, 1212 (10th Cir.1999); *see also United States v. Massey,* 48 F.3d 1560, 1572 (10th Cir.1995) (listing similar factors).

United States v. Sallis, 533 F.3d at 1223. "[A] role as a supplier of drugs to others, standing alone, is not enough," however, to justify a 4–level enhancement under § 3B1.1(a). *United States v. Sallis,* 533 F.3d at 1223–24 (quotation omitted).

[4] While there is overlap between the activities that would make a defendant a leader and those that would make a defendant an organizer, the two are distinct. "Nothing in the Guidelines requires that an organizer must exercise some direction or control over underlings." *United States v. Valdez–Arieta* 127 F.3d 1267, 1271 (10th Cir.1997). "As a result, a defendant may be punished as an organizer under § 3B1.1(c)[12] for devising a criminal scheme, providing the wherewithal to accomplish the criminal objective, and coordinating and overseeing the implementation of the conspiracy even though the defendant may not have any hierarchical control over the other participants." *United States v. Valdez–Arieta,* 127 F.3d at 1272.

LAW REGARDING U.S.S.G. § 3C1.1

U.S.S.G. § 3C1.1 states:

> If (A) the defendant willfully obstructed or impeded, or attempted to obstruct or impede, the administration of justice with respect to the investigation, prosecution, or sentencing of the instant offense of conviction, and (B) the obstructive conduct related to (i) the defendant's offense of conviction and any relevant conduct; or (ii) a closely related

> offense, increase the offense level by 2 levels.

The application notes state: "Obstructive conduct that occurred prior to the start of the investigation of the instant offense of conviction may be covered by this guideline if the conduct was purposefully calculated, and likely, to thwart the investigation or prosecution of the offense of conviction." U.S.S.G. § 3C1.1 cmt. n.1.

The application notes to U.S.S.G. § 3C1.1 further state that the conduct that the Sentencing Committee believes warrant the upward adjustment include the following:

> (a) threatening, intimidating, or otherwise unlawfully influencing a co-defendant, ***1320** witness, or juror, directly or indirectly, or attempting to do so ... (d) destroying or concealing or directing or procuring another person to destroy or conceal evidence that is material to an official investigation or judicial proceeding (e.g., shredding a document or destroying ledgers upon learning that an official investigation has commenced or is about to commence), or attempting to do so.

U.S.S.G. § 3C1.1, cmt. n. 4(a) & (c). In *United States v. Farnsworth,* 92 F.3d 1001, 1011 (10th Cir.1996), the Tenth Circuit recognized that an attempt to influence a witness by instructing the witness to lie warrants an enhancement under U.S.S.G. § 3C1.1. *See* 92 F.3d at 1011. The Tenth Circuit remanded the case to the district court, however, because the district court did not make a specific finding as to the issue, instead doing no more than adopting "the analysis of the Probation Department as accurate and correct." *United States v. Farnsworth,* 92 F.3d at 1011. In *United States v. Yuselew,* No. 09–1035, 2010 WL 3834418 (D.N.M. Aug. 5, 2010) (Browning, J.), the Court held that, "to warrant application of the § 3C1.1 enhancement, the defendant must have deliberately—not accidentally, incidentally, or mistakenly—done some act with the specific purpose of thwarting the investigation and prosecution." 2010 WL 3834418, at *12. The Court also held that attempts to obstruct justice may be sufficient if the acts were of a kind that were likely to thwart the investigation and eventual prosecution. *See United States v. Yuselew,* 2010 WL 3834418, at *13.

ANALYSIS

The Court accepts the parties' stipulated calculation of tax loss, $23,300.00, and finds that the foreign tax credit may apply post-indictment. The Court also agrees with and accepts the parties stipulations in the Plea Agreements that neither Tilga nor Chandler's offenses involved a special skill, an aggravating role, or obstruction of justice. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5. The Court will sustain Tilga and Chandler's objections to the PSRs to the extent that the PSRs are contrary to these findings. The Court finds, however, that Tilga and Chandler used sophisticated means, as defined under U.S.S.G. § 2T1.1, and will reject the parties' stipulation to the contrary. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5.

I. *THE COURT WILL SUSTAIN THE OBJECTION TO THE PSR'S TAX LOSS CALCULATION.*

The PSRs state:

> [T]he corresponding tax loss is $1,937,273. Based on the tax table, more than $1,000,000 but less than $2,500,000, in loss warrants a base offense level of 22. However, pursuant to information contained in the co-defendant's plea agreement, the parties stipulate that the total tax loss was $1,735,025.00, and, for relevant conduct purposes, the tax loss amount from the conspiracy to which the defendant is pleading guilty was $23,300.00. Pursuant to U.S.S.G. § 2T4.1(D) tax loss greater than $12,500 but less than $30,000 results in a base offense level of 12.

Tilga PSR ¶ 38, at 18–19; Chandler PSR ¶ 36, at 15. The Plea Agreements stipulate that "the tax loss from the conspiracy to which the Defendant is pleading guilty was $23,300.00." Chandler Plea Agreement ***1321** ¶ 9(a), at 5. *See also* Tilga Plea Agreement ¶ 10(a), at 7.

Tilga argues that the principle that a court may consider a defendant's unclaimed deductions in its calculation of tax loss, established under *United States v. Hoskins,* applies with equal force to her case and the foreign tax credit. *See* Tilga's Sentencing Memo. at 9. Tilga asserts that, under *United States v. Cruz,* she could have eliminated an essential element of the federal income tax evasion charges because the ten-year statute of limitations for the foreign tax credit had not yet expired at the time she fixed her Canadian tax liability. *See* Tilga's Sentencing Memo. at 9–10. Tilga contends that the $23,200.00 (USD) tax loss stipulated in the Plea Agreement is the product of a compromise on the foreign tax credit issue and allowed the parties to avoid a lengthy trial as well as secure prompt payment to the United States. *See* Tilga's Sentencing Memo. at 10.

The United States also asks the Court to use the $23,200.00 (USD) [13] figure as the amount of tax loss and states that the Plea Agreement was specifically designed to avoid a court determination of the applicability of the foreign tax credit. *See* Gov't Sentencing Memo. at 10, 16. The United States maintains that its position is that a taxpayer cannot, through post-indictment amendment of her tax returns, defeat a tax prosecution. *See* Gov't Sentencing Memo. at 11. It cites *United States v. Helmsley,* 941 F.2d 71 (2d Cir.1991), which establishes this principle in the context of a taxpayer's election of a depreciation method. *See* Gov't Sentencing Memo. at 11 (citing *United States v. Helmsley,* 941 F.2d at 91). The United States supports, however, Tilga's position and the stipulation in the Plea Agreement, which is contrary to the Department of Justice's official position. *See* Gov't Sentencing Memo. at 12–16. The United States maintains that, under *United States v. Cruz,* there is a colorable argument that a "prosecution for tax evasion accelerates the time for fixing the amount of the foreign tax credit up until the time of trial" and that Tilga positioned herself to take advantage of the foreign tax credit. Gov't Sentencing Memo. at 14–15 (citing *United States v. Cruz,* 698 F.2d at 1152). Furthermore, the United States' sentencing memorandum suggests that "in considering the non-binding stipulated tax loss, the Court should consider a recent Tenth Circuit decision holding that a sentencing court does not abuse its discretion in considering well-supported but unclaimed tax deductions when calculating tax loss for the purposes of U.S.S.G. § 2T1.1." Gov't Sentencing Memo. at 16 (citing *United States v. Hoskins,* 654 F.3d at 1094–95).

At the hearing, Chandler agreed with Tilga and the United States that the tax loss should be $23,300.00 (USD) and offered to present Mr. Rubinger to help educate the Court on the foreign tax credit issue. *See* Tr. at 17:12–25 (Johnson).

*1322 A. THE COURT WILL DECIDE WHETHER THE FOREIGN TAX CREDIT APPLIED POST–INDICTMENT.

At the hearing, the United States asserted that "[w]e were trying to avoid the situation in which a Court of the United States held that a defendant could make use of the foreign tax credit in the way that Tilga wished to use it in this case." Tr. at 11:2–4 (Gerson). Whether the foreign tax credit applies to effect the calculation of tax loss post-indictment, however, is a legal question. *See United States v. Wick,* 34 Fed.Appx. 273, 278 (9th Cir.2002) (holding that the application of a carry back to reduce the total tax loss to the government is a question of law). The United States asks the Court to do nothing more than accept the non-binding stipulation as to the calculation of tax loss. *See* Tr. at 10:23–11:6 (Gerson) ("I'm certainly not asking the Court to make a legal finding that that is the law.").

"It is emphatically the province and duty of the judicial department to say what the law is." *Marbury v. Madison,* 5 U.S. (1 Cranch) 137, 177, 2 L.Ed. 60 (1803); *Prost v. Anderson,* 636 F.3d 578, 596 n. 13 (10th Cir.2011) ("This opinion answers the question of law as it must and explains the basis for its result."). In line with *Marbury v. Madison,* the Tenth Circuit has held that "[i]t is long settled that 'a party's position in a case (even when that party is the United States) does not dictate the meaning of a federal statute.' " *Prost v. Anderson,* 636 F.3d at 596 n. 13 (citing *United States v. Charles,* 576 F.3d 1060, 1066 (10th Cir.2009)). Furthermore, "[i]t is one thing to allow parties to forfeit claims, defenses, or lines of argument; it would be quite another to allow parties to stipulate or bind us to application of an incorrect legal standard, contrary to the congressional purpose." *Gardner v. Galetka,* 568 F.3d 862, 879 (10th Cir.2009). "The meaning of a statute, for example, cannot vary from case to case depending on concessions a party may have made." *Snider v. Melindez,* 199 F.3d 108, 114 (2d Cir.1999). As the Supreme Court of the United States stated in *Swift & Co. v. Hocking Valley Ry. Co.,* 243 U.S. 281, 37 S.Ct. 287, 61 L.Ed. 722 (1917):

> The duty of this court, as of every judicial tribunal, is limited to determining rights of persons or of property.... No stipulation of parties or counsel, whether in the case before the court or in any other case, can enlarge the power, or affect the duty, of the court in this regard.

243 U.S. at 290, 37 S.Ct. 287.

Even if the Court were to accept, without comment, the parties' stipulation as to tax loss, it would imply approval of *United States v. Cruz,* and in the next foreign tax credit case the Court would be confronted with its decision in this case. *See* Tr. at 14:20–15:20 (Court, Gerson). While the United States may vary its position from case to case, or stipulate to an interpretation contrary to its official position, the Court must try to be as consistent and principled as possible. *See Snider v. Melindez,* 199 F.3d at 114. The United States admitted that the amount of tax loss depends on an interpretation of the foreign tax credit and *United States v. Cruz. See* Tr. at 11:7–11:14 (Court, Gerson). Accordingly, rather than simply accept the parties' stipulated tax loss calculation, the Court will decide whether federal law permits defendants to claim the foreign tax credit post-indictment.

B. TILGA MAY CLAIM THE FOREIGN TAX CREDIT POST–INDICTMENT.

[5] On their face, the statutory provisions that establish the foreign tax credit ***1323** contain no limitation, other than the ten-year statute of limitation, which would prevent the foreign tax credit's application post-indictment. *See* 26 U.S.C. §§ 901–909, 6511(d)(3). Section 901(a) specifically provides that the credit "may be made or changed *any time* before the expiration of the period prescribed for making a claim for credit." 26 U.S.C. § 901(a) (emphasis added). Section 905 states that, if taxes are paid to a foreign government, then they relate back to the taxable year in which they accrued. *See* 26 U.S.C. § 905(c)(2)(B)(i)(II). Section 6511(d)(3) establishes a ten-year statute of limitations for "filing the return for the year in which such taxes were actually paid or accrued." 26 U.S.C. § 6511(d)(3).

The parties, both in their sentencing memoranda and at the hearing, relied almost exclusively on *United States v. Cruz,* 698 F.2d at 1152. Both parties, however, briefly mention *United States v. Hoskins,* a recent Tenth Circuit decision, which held that a sentencing court may take unclaimed tax deductions into account when calculating the amount of tax loss. *See* 654 F.3d at 1094–95. In *United States v. Hoskins,* the Tenth Circuit announced its standard for determining what deductions and credits a sentencing court may use when calculating the United States' tax loss.

United States v. Hoskins establishes that "nothing in the Guidelines prohibits a sentencing court from considering evidence of unclaimed deductions in analyzing a defendant's estimate of the tax loss suffered by the government." 654 F.3d at 1094. Although other United States Courts of Appeals have expressed concerns about allowing defendants to avoid tax evasion prosecution, *see United States v. Helmsley,* 941 F.2d at 86–87 (through tax depreciation method); *United States v. Cruz,* 698 F.2d at 1152 (through the foreign tax credit), the Tenth Circuit expressed no such concerns where a defendant offers "convincing proof" of entitlement to unclaimed deductions, *United States v. Hoskins,* 654 F.3d at 1094. The Tenth Circuit did not expressly address whether a sentencing court may consider tax credits when calculating the government's tax loss in the body of the opinion. In footnote 9, however, the Tenth Circuit suggests that the same analysis applies to the various credits that a defendant may claim. *See United States v. Hoskins,* 654 F.3d at 1094 n. 9. Emphasizing that U.S.S.G. § 2T1.1 does not permit a defendant to benefit from deductions unrelated to the offense at issue, the Tenth Circuit stated: "Thus, unclaimed deductions for student loan interest or solar energy *credits,* for example, are not considered because they do not relate to the 'object of the offense.' " *United States v. Hoskins,* 654 F.3d at 1094 n. 9 (emphasis added). That the Tenth Circuit commented on unrelated deductions and credits being prohibited suggests that related credits would be permissible.[14] Thus, under this analysis, the Court must determine whether ***1324** the foreign tax credits that Tilga claims are related to the "object of the offense"—the "loss that would have resulted had the offense been successfully completed." *United States v. Hoskins,* 654 F.3d at 1094 & n. 9 (citing U.S.S.G. § 2T1.1).

Beyond the commentary in footnote 9, the Tenth Circuit does not elaborate on what it is required for a deduction or credit to relate to the "object of the offense." *United*

States v. Hoskins, 654 F.3d at 1094 & n. 9. Chief Judge Briscoe expressed concern "why it should matter whether the unclaimed deductions are related to the offense or not." *United States v. Hoskins,* 654 F.3d at 1103 (Briscoe, C.J., concurring in part and dissenting in part). She dissented with respect to the portions of the majority opinion "in which the majority takes the unnecessary step in announcing a rule permitting defendants in future cases to offer deductions they did not actually claim in order to establish a 'more accurate determination of the tax loss' under U.S.S.G. § 2T1.1(a)." *United States v. Hoskins,* 654 F.3d at 1100. Chief Judge Briscoe explained that, in her view, the majority opinion's rule on tax loss improperly complicates sentencing in tax cases, improperly characterizes the Tenth Circuit's holding in *United States v. Spencer,* and "essentially allows the defendant a 'do over.' " *United States v. Hoskins,* 654 F.3d at 1101–02. Additionally, her opinion noted: "I fail to see how some unclaimed deductions would be related to the offense and some deductions would not be. All the deductions relate to the return." *United States v. Hoskins,* 654 F.3d at 1103.

The Court finds that the foreign tax credits that Tilga claims in this case are related to the object of this offense. In *United States v. Hoskins,* the Tenth Circuit appears to require a direct link between the defendant's illegal actions, and the deduction or credit that they are claiming. *See* 654 F.3d at 1094 n. 9 (majority opinion). Thus, it noted that the district court could have considered evidence of commission payments to escorts, where the defendant was charged with wilfully evading income taxes on income earned from an escort service, but not peripheral expenses unrelated to the escort service. *See* 654 F.3d at 1094 n. 9. Tilga pled guilty to a *Klein* conspiracy—a conspiracy to victimize the IRS. *See* Tilga PSR ¶¶ 1, 3, at 3. The object of her offense was to conceal her Canadian source of income and defraud the United States. *See* Tilga Plea Agreement ¶ 8(h), at 6–7. Tilga attempted to avoid paying taxes either to the United States or Canada on her Canadian income. *See* Tilga Plea Agreement ¶ 8(h), at 6–7. In this case, the foreign tax credit would relate to the object of the offense, because it concerns the very funds, the income from Tilga's Canadian business, that Tilga sought to conceal through her conspiracy. The foreign tax credits that Tilga claims, for the years 1999 to 2004, are intimately connected to her Canadian funds, because all of the funds that she concealed from the United States government were also concealed from the Canadian government. When Tilga's Canadian tax liability became fixed at $7,424,514.40 (CAD), she was entitled to a foreign tax credit on those funds, because, for the years 1999 to 2004, the statute of limitations had not yet expired and the tax liability relates back to the year in which the liability was accrued. *See* 26 U.S.C. §§ 905(c)(2)(B), 6511(d)(3). This credit is more similar to the claimed deduction for commission payments to escorts in *United States v. Hoskins* than claims for peripheral expenditures or solar panels, because there is a direct connection ***1325** between the United States taxes Tilga sought to avoid and her Canadian tax liability for which she seeks the tax credit. *See* 654 F.3d at 1094 n. 9. Following the analysis that the Tenth Circuit established in *United States v. Hoskins* and looking at the statutory provisions related to the foreign tax credit, the Court finds that Tilga is entitled to claim foreign tax credits for the years 1999 to 2004 and a tax loss calculation of $23,300.00 (USD), for the year in which the foreign tax credit is unavailable, is accurate.

Furthermore, allowing Tilga to claim the foreign tax credits and finding a tax loss of $23,300.00 would avoid the windfall gains about which the Tenth Circuit expressed concerns in *United States v. Hoskins. See* 654 F.3d at 1095. Although Tilga agreed to pay the United States taxes rather than the Canadian taxes, the United States would not be entitled to those funds under the foreign tax credit. *See* Gov't Sentencing Memo. at 7; Tilga Plea Agreement ¶ 10(b), at 7–8. If Tilga had filed accurate tax returns from 1999 to 2004, then the foreign tax credit would most likely eliminate any tax liability owing to the United States, because the United States and Tilga agree that Canadian taxes are higher. *See* 26 U.S.C. §§ 901, 905; Gov't Sentencing Memo. at 3; Tilga's Sentencing Memo. at 9. Thus, the application of the foreign tax credit in the calculation of tax loss is appropriate, because the United States would never have collected the remaining revenue for the years 1999 to 2004 had Tilga not evaded her taxes. *See United States v. Hoskins,* 654 F.3d at 1095 ("Indeed, the government cannot claim to have lost revenue it never would have collected had the defendant not evaded his taxes."). Thus, the loss that would have resulted had the tax evasion been successfully completed would have been only $23,300.00 (USD) for the year 1998, the only year of the conspiracy for which the foreign tax credit is unavailable. *See* U.S.S.G. § 2T1.1; *United States v. Hoskins,* 654 F.3d at 1095.

Although this result appears incongruent with ordinary criminal law practices—a robber does not eliminate his criminal liability when he returns stolen items—the Court recognizes that the foreign tax credit's ten-year statute of limitations and U.S.S.G. § 2T1.1 creates a unique set of circumstances in which a defendant may reduce her liability. In *United States v. Hoskins,* the Tenth Circuit focused on U.S.S.G. § 2T1.1's plain language, which "directs courts to calculate the tax loss that was the 'object of the offense'—'the loss that would have resulted had the offense been completed.' " 654 F.3d at 1094. The Tenth Circuit also examined the language in Note A, which states that the default tax loss is 28% of the unreported gross income, "unless a more accurate determination of the tax loss can be made." *United States v. Hoskins,* 654 F.3d at 1092. The Tenth Circuit held that this language does not categorically prohibit a court from considering unclaimed deductions or credits, and that such information may be useful to ascertain the actual or intended tax loss suffered. *See United States v. Hoskins,* 654 F.3d at 1094–95.

The Court, in determining the applicability of the foreign tax credit, follows the Tenth Circuit's analysis as established in *United States v. Hoskins* rather than the Eleventh Circuit's holding in *United States v. Cruz.* The Court's holding is, however, consistent with the holding in *United States v. Cruz.* The Eleventh Circuit recognized that a defendant may claim a foreign tax credit post-indictment. *See United* ***1326** *States v. Cruz,* 698 F.2d at 1152 ("[T]he jury instruction given by the district court was correct. The instruction required that there be a firmly established taxable amount owed the foreign government and determined by it before the taxpayer would be entitled to a foreign tax credit."). The reasoning in that case, however, started from the premise that a defendant could claim a foreign tax credit at any time within the ten-year statute of limitations, without discussion, and then the Eleventh Circuit created a limitation to that principle when it held that a tax prosecution accelerates the time within which the taxpayer can exercise the right to the credit. *See United States v. Cruz,* 698 F.2d at 1150–52.[15] The Eleventh Circuit drew a line at trial, requiring defendants to claim the foreign tax credit before trial, and used concerns about tax loopholes or fraud to justify such a limitation. *See United States v. Cruz,* 698 F.2d at 1152, 1152 n. 2. The Eleventh Circuit also justified accelerating the foreign tax credit's statute of limitations, because there is a six-year statute of limitations on prosecution under § 7201. *See United States v. Cruz,* 698 F.2d at 1152; 26 U.S.C. § 6531 (establishing general six-year statute of limitations for tax evasion). "[I]f the United States waits for the ten years allowed by statute for the taxpayer to fix the amount of foreign tax liability, then the six-year statute of limitations on the section 7201 prosecution lapses." *United States v. Cruz,* 698 F.2d at 1152. The Court agrees that there is a tension between the two limitations periods and that the foreign tax credit's ten-year statute of limitations allows tax evaders to fix their criminal liability post-indictment, in a way that is unique in the criminal system. The Tenth Circuit has held, however, that the § 7201 "statute of limitations begins to run on the date of the last affirmative act of evasion." *United* ***1327** *States v. Anderson,* 319 F.3d 1218, 1219 (10th Cir.2003). This rule may alleviate some of the Eleventh Circuit's concerns in *United States v. Cruz,* because the United States will still be able to prosecute lengthy tax evasion schemes and ensures that, in at least some cases, the difference between the § 7201 statute of limitations and the foreign tax credit statute of limitations will be less than four years. Tilga's case offers a good example, because her tax evasion scheme began in 1998, the last alleged affirmative act of tax evasion was in 2004, and the grand jury indicted her in 2009. *See* Tilga Plea Agreement ¶ 10(a)-(b). In 2009, the foreign tax credit's statute of limitations for the first year of the conspiracy, 1998, had expired. Thus, difference in length of the statutes of limitations for prosecution and for the foreign tax credit will not always bar prosecution for the evasive conduct. Additionally, not every foreign tax liability will be sufficient to eliminate a taxpayer's liability to the United States. *See* 26 U.S.C. § 901; Gov't Sentencing Memo. at 3 (stating that, because Canadian taxes are higher than taxes in the United States, the foreign tax credit eliminates tax liability to the United States for the years 1999–2004).

The Eleventh Circuit opinion offers no principled rationale for drawing the line at trial, rather than at sentencing or some other point in the litigation post-indictment. *See United States v. Cruz,* 698 F.2d at 1152. The Tenth Circuit in *United States v. Hoskins* did not discuss whether a defendant must claim a deduction or credit before any point in the tax prosecution. *See* 654 F.3d at 1092–97. Moreover, it is not a proper task for the Court to rewrite the foreign tax credit's statute of limitations to address the inherent tension between that time frame and § 7201's statute of limitations. *See* 1–12 Rhoades and Langer, *United States Int'l Taxation* *and Tax Treaties* (Matthew Bender & Co.), § 12.03, n. 43 (criticizing the Eleventh Circuit for accelerating the foreign tax credit's statute of limitations period in *United States v. Cruz*). Although the Internal Revenue Code may not provide all of the safeguards desirable to protect the public interest, the Court is not the body best situated to address this issue—that is a problem for Congress. *See United Student Aid Funds, Inc. v. Espinosa,* ––U.S. ––, 130 S.Ct. 1367, 1382, 176 L.Ed.2d 158 (2010) ("And to the extent existing sanctions prove inadequate to this task, Congress may enact additional provisions to address the difficulties the United States predicts will follow our decision."); *Bd. of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp.,* 474 U.S. 361, 374, 106 S.Ct. 681, 88 L.Ed.2d 691 (1986) ("If the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the courts, to address."). Even if the Court were to adopt the Eleventh Circuit's requirement that a foreign tax credit be fixed before trial and attempt to address the criticisms of that opinion, the Court need not decide whether those limitations apply here because Tilga satisfied the Eleventh Circuit test when she fixed her foreign tax liability before trial. *See* Gov't Sentencing Memo. at 14.

Although asking the Court to accept the stipulated tax loss amount, the United States refers the Court to the Department of Justice's position that a "taxpayer cannot defeat a prosecution by amending her returns post-Indictment" and refers the Court to several cases. Gov't Sentencing Memo. at 11 (citing *United States v. Helmsley,* 941 F.2d 71 (2d Cir.1991); ***1328** *United States v. Kleifgen,* 557 F.2d 1293 (9th Cir.1977); *Witte v. Commissioner,* 513 F.2d 391 (D.C.Cir.1975); *Fowler v. United States,* 352 F.2d 100 (8th Cir.1965)). The United States Court of Appeals for the Second Circuit in *United States v. Helmsley* agreed with the United States Court of Appeals for the Eighth Circuit's decision in *Fowler v. United States* and held that a taxpayer who has used a particular depreciation method may not defend against an evasion charge on the ground that, under an alternative method, the taxpayer could have claimed additional depreciation. *See United States v. Helmsley,* 941 F.2d at 86. The United States asserts that its position mirrors the general rule established in the Second Circuit's *United States v. Helmsley* decision—that a taxpayer may not amend her returns or suggest an alternative means of calculating the taxes owed. The Second Circuit expressed concerns about tax evaders using the tax system to avoid paying the full amount due after authorities discover their scheme, if the Second Circuit did not find post-indictment alterations impermissible. *See United States v. Helmsley,* 941 F.2d at 86–87. It stated

> The law could hardly be otherwise. If it were, evaders with complicated returns would be allowed to evade taxes on one portion of their return while using a depreciation period that would be the most profitable in the long run if the evasion went undetected. If the evasion were uncovered, then they would need only to recalculate under a shorter depreciation period that would increase deductions for the years in which evasion is charged.

United States v. Helmsley, 941 F.2d at 86–87. The United States cites cases from other circuits for the same proposition. *See United States v. Kleifgen,* 557 F.2d at 1298 n. 9 ("The Commissioner's consent to a change in accounting methods is required regardless of whether the change is from one proper method to another proper method or from an improper method to a proper one."); *Witte v. Commissioner,* 513 F.2d at 393–94 (same). None of the cases cited in favor of the Department of Justice's position are from the Tenth Circuit.

While the decisions the United States cites raise important issues about the ability of defendants to avoid tax evasion charges post-indictment, the Tenth Circuit's *United States v. Hoskins* opinion does not appear to share such concerns. Rather, the Tenth Circuit's concerns focus on whether the government will reap a windfall as a result of tax evasion. *See United States v. Hoskins,* 654 F.3d at 1095. The Tenth Circuit's decision in *United States v. Hoskins* also does not reference the *United States v. Helmsley* line of cases. The divergence between the two opinions can perhaps be explained by the evolution of U.S.S.G. § 2T1.1's language. Earlier versions of § 2T1.1 "required courts to calculate tax loss based on *gross* income and prohibited consideration of legitimate but unclaimed deductions." *United States v. Hoskins,* 654 F.3d at 1096 (emphasis original). The 1991 version, for example, made "irrelevant the issue of whether the taxpayer was entitled to offsetting adjustments that he failed to claim." U.S.S.G. § 2T1.1 cmt. n. 4 (1991). Later versions of the guidelines eliminated such language and instructs courts that tax loss "shall be treated as equal to 28% of the unreported income ..., *unless a more accurate determination of the tax loss can be made.*" U.S.S.G. § 2T1.1 Note A (emphasis added). The Second Circuit also recognized that later versions of the guidelines "permit[ ] consideration of legitimate but unclaimed deductions." ***1329** *United States v. Martinez–Rios,* 143 F.3d 662, 671 (2d Cir.1998). In the *United States v. Martinez–Rios* opinion, the Second Circuit does not refer to the *United States v. Helmsley* opinion. *See United States v. Martinez–Rios,* 143 F.3d 662. This later decision undercuts the United States' reliance on *United States v. Helmsley* and provides further support for the Court's decision that defendants may claim the foreign tax credit post-indictment. Thus, the Court applies the reasoning from *United States v. Hoskins* to Tilga and Chandler's foreign tax credit claim, and determines that, under the law of the Tenth Circuit, Tilga and Chandler may claim the foreign tax credit for all years within the statute of limitations.

[6] The Court finds that the foreign tax credit may be claimed post-indictment and that Tilga has successfully established her Canadian tax liability, such that she could eliminate any tax liability owed to the United States for the years 1999 to 2004. Accordingly, the Court will sustain the objection to the calculation of tax loss based on any figure other than the $23,300.00 (USD) figure established in the Plea Agreements and accept the stipulations in the Plea Agreements. *See* Tilga Plea Agreement ¶ 10(b), at 8; Chandler Plea Agreement ¶ 9(a), at 5. The amount of loss for both Tilga and Chandler is thus $23,300.00 (USD).

II. *THE COURT WILL OVERRULE THE OBJECTION TO THE PSR'S REFERENCES TO SOPHISTICATED MEANS.*

[7] The PSRs indicate that "the defendant and co-defendant utilized Pure Trust Organizations as business entities, wiring money to offshore accounts, and back to shell companies in an effort to hide the true amount of money earned." Tilga PSR ¶ 38, at 18–19; Chandler PSR ¶ 36, at 15. Based on this conduct, the PSRs maintain that a 2–level sophisticated-means enhancement should apply. *See* Tilga PSR ¶ 38, at 19; Chandler PSR ¶ 36, at 15. In the Plea Agreements, the parties stipulated that neither defendant used sophisticated-means to commit the offense. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5. Tilga argues that her conduct did not involve especial complexity or intricacy, see Tilga's Sentencing Memo. at 11, and that the enhancement requires that the alleged sophisticated means be "something beyond what happens in the garden variety type of offense," Tr. at 42:13–25 (Theus). Tilga maintains that "tax offenses involving foreign or offshore bank accounts, and conspiracies for the tax offenses involving foreign or offshore bank accounts, inherently involve sophistication." Tilga's Sentencing Memo. at 11. Tilga further asserts that, to the extent that sophisticated means were involved in her case, they were not of her creation. *See* Tilga's Sentencing Memo. at 11. At the hearing, the United States and Chandler argued that Chandler and Tilga's offenses did not use sophisticated means, because Tilga and Chandler only purchased the PTOs—they did not create them. *See* Tr. at 40:5–11 (Court, Gerson); Tr. at 45:16–19 (Johnson). All parties agree that CTC used sophisticated means when it created the PTOs. *See* Tr. at 43:13–20 (Theus); Tr. at 39:3–5 (Gerson); Tr. at 45:19–23 (Johnson). Chandler also argued in a supplementary letter that, under *Blakely v. Washington* and *United States v. Booker,* "any fact (other than a prior conviction) which is necessary to support a sentence exceeding the maximum authorized by the facts established by a plea of guilty or a jury verdict must be admitted by the defendant or proved to a ***1330** jury beyond a reasonable doubt." Letter at 2 (citations omitted).

U.S.S.G. § 2T1.1 provides for a 2–level base offense enhancement where the offense involved sophisticated means. *See* U.S.S.G. § 2T1.1(b)(2) ("If the offense involved sophisticated means, increase by 2 levels."). Application Note 4 provides: "For the purposes of subsection (b)(2), 'sophisticated means' means especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense. *Conduct* such as *hiding* assets or transactions, or both, *through the use of* fictitious entities, corporate shells, or offshore financial accounts ordinarily indicates sophisticated means." U.S.S.G. § 2T1.1 cmt. n. 4 (emphasis added).

Chandler and Tilga must admit the facts providing the basis for the sophisticated-means enhancement or the United States must prove them by a preponderance of the evidence. *See United States v. Magallanez,* 408 F.3d at 685; *United States v. Hall,* 473 F.3d at 1312. Chandler suggests that the standard should be beyond a reasonable doubt; however, the Tenth Circuit has held that "*Booker* makes clear that judicial fact-finding by a preponderance of the evidence standard is unconstitutional only when it operates to increase a defendant's sentence mandatorily."

United States v. Hall, 473 F.3d at 1312. The Court believes that it can apply the sophisticated-means enhancement under U.S.S.G. § 2T1.1 using only those facts that Tilga and Chandler admitted in the Plea Agreements. Nonetheless, the Court notes that Tilga and Chandler both agreed that "the Court may rely on any of the[ ] facts [included in the Plea Agreement], as well as the facts in the presentence report, to determine [their] sentence[s], including, but not limited to, the advisory guideline offense level." Chandler Plea Agreement ¶ 8, at 4. *Accord* Tilga Plea Agreement ¶ 9, at 7.

Tilga originally argued that "tax offenses involving foreign or offshore bank accounts, and conspiracies for the tax offenses involving foreign or offshore bank accounts, inherently involve sophistication," and that Tilga's conduct must be analyzed in context of her class of offense. Tilga's Sentencing Memo. at 11. The United States did not address this aspect of Tilga's argument. *See* Tr. at 39:3–41:6 (Court, Gerson). At the hearing, however, Tilga agreed that CTC's conduct would qualify as sophisticated means. *See* Tr. at 43:13–20 (Theus) ("No I think Commonwealth Trust Company, in its creation of a number of types of [products], marketing those products, managing those products for their customers ... does engage in sophisticated means."). Thus, Tilga appears to have conceded at the hearing that the use of offshore bank accounts and sham entities constitutes sophisticated means despite her argument to the contrary in her sentencing memorandum. The application note specifically instructs sentencing courts that "fictitious entities, corporate shells, or offshore financial accounts ordinarily indicate[ ] sophisticated means." U.S.S.G. § 2T1.1 cmt. n. 4. If the Court followed Tilga's original argument, this portion of Application Note would be devoid of meaning, because Tilga would require the United States to establish that a defendant's conduct was unique for the category of offense. *See* Tilga's Sentencing Memo. at 11. Thus, for defendants using fictitious entities, corporate shells, or offshore accounts to qualify for the sophisticated-means enhancement, Tilga would require that such means be used in an especially complex or novel manner, and ignore the inherent complexity of those ***1331** entities, which is what the Application Note recognizes. *See United States v. Ambort,* 405 F.3d at 1120 (stating that the sophisticated-means enhancement applies to actions that are "more complex or demonstrate[ ] greater intricacy or planning than a routine tax-evasion case"); *United States v. Schwartz,* 408 Fed.Appx. at 870 (affirming the sophisticated-means enhancement where the defendant created and used fictitious trusts to hide assets from the IRS, even though the defendant was not a sophisticated businessman); *United States v. Minneman,* 143 F.3d at 283 (holding that, the use of multiple corporate names and the placement of funds in a trust account both constitute complex efforts to hide income).

Furthermore, the Tenth Circuit defines "garden variety" tax fraud through reference to *United States v. Rice,* "a case of claiming to have paid withholding taxes not paid," and *United States v. Stokes,* a case of "not disclosing income to one's accountant." *United States v. Wardell,* 218 Fed.Appx. 695, 698 (10th Cir.2007) (citing *United States v. Rice,* 52 F.3d at 849; *United States v. Stokes,* 998 F.2d at 281–83). The standard does not look to the specific category of tax evasion that the defendant committed to determine whether the sophisticated means enhancement applies; rather the Tenth Circuit instructs courts to determine whether the tax scheme was "more complex or demonstrates greater intricacy or planning than a routine tax evasion case." *United States v. Ambort,* 405 F.3d at 1113. Other courts have rejected similar arguments. *See United States v. O'Doherty,* 643 F.3d 209, 220 (7th Cir.2011) ("Although [the defendant] protests that corporations are ubiquitous 'in most modern business transactions' ... their use to impede the discovery of personal income, as they were used here, permits the imposition of the enhancement."); *United States v. Maggert,* 428 Fed.Appx. 874, 880 (11th Cir.2011) ("To facilitate his tax evasion scheme, Maggert set up two fictitious entities and used them to try and hide his income. Such conduct falls squarely within § 2T1.1's definition of sophisticated means.").

Tilga, Chandler, and the United States all argue that Tilga's conduct does not qualify for the sophisticated-means enhancement, because she did nothing more than purchase a product and, to the extent that sophisticated means were used, they were not of her creation. *See* Tilga's Sentencing Memo. at 11; Tr. at 40:5–11 (Court, Gerson); Tr. at 45:16–19 (Johnson). The PSRs state that Tilga and Chandler's conduct warrants a 2–level sophisticated means enhancement, because "[i]n this case, the defendant and co-defendant utilized Pure Trust Organizations as business entities, wiring money to offshore accounts, and back to shell companies in an effort to hide the true amount of money earned." Tilga PSR ¶ 38, at 18–19; Chandler PSR ¶ 36, at 15. Neither the United States nor Tilga, either in a sentencing memorandum or at the hearing, directed the Court to any federal court opinion that drew a distinction between a customer who purchases sophisticated means from a corporation and the producers of the sophisticated product. *See* Tr. at 41:1–4 (Court, Gerson); Tr. at 43:23–44:6 (Court, Theus). The Court, however, located three cases that discuss similar factual situations and U.S.S.G. § 2T1.1(b)(2). The United States Court of Appeals for the First Circuit, in *United States v. Anthony,* 545 F.3d 60 (1st Cir.2008)—addressed the same facts as the Court, a customer who purchased trusts and corporations from CTC—and held that there was no error in applying the sophisticated-means ***1332** enhancement. *See* 545 F.3d at 63, 68. In *United States v. Firestien,* No. 04–331, 2007 WL 174108 (W.D.N.Y. Jan. 19, 2007), the United States District Court for the Western District of New York applied the sophisticated-means enhancement where the defendant established shell corporations under Nevada law and used bank accounts in Costa Rica. *See* 2007 WL 174108, at *2. The Western District of New York found the enhancement appropriate, notwithstanding the defendant's argument that the Anderson Ark program informed him of the steps to take, because he took affirmative action to set up the shell corporation and utilize the Costa Rican accounts. *See United States v. Firestien,* 2007 WL 174108, at *2. In *United States v. Baxter,* No. 04–371–1, 2006 WL 1155872 (N.D.Ill. Apr. 27, 2006), the United States District Court for the Northern District of Illinois held that a 2–level sophisticated-means enhancement was inappropriate. *See* 2006 WL 1155872, at *4. In that case, the defendant used that "Aegis system" and "believed in the legality of the advice given by the Aegis instructors and in the legitimacy of the Aegis system." *United States v. Baxter,* 2006 WL 1155872, at *3. The Northern District of Illinois found that, because the defendant "did not admit[ ] to participating in the Aegis system knowing that it was illegal," her conduct was "certainly ... not as sophisticated as 'using offshore bank accounts, or transactions through corporate shells.' " *United States v. Baxter,* 2006 WL 1155872, at *4.

Tilga and Chandler's conduct fits squarely within what Application Note 4 contemplates as sophisticated means. The application note states that ordinarily the "*use* of fictitious entities, corporate shells, or offshore financial accounts" indicate sophisticated means. U.S.S.G. § 2T1.1 cmt. n. 4 (emphasis added). There is nothing in the comments or the case law to suggest that a person must create the sophisticated means to qualify for the enhancement. Taxpayers should not be able to avoid a sophisticated-means enhancement because they pay someone else to think of the scheme or means that they then use to defraud the United States. The application note focuses on whether such means were "used," and this limited factual inquiry is the appropriate one. *See* U.S.S.G. § 2T1.1 cmt. n. 4. Tilga and Chandler *used* "corporate shells" and "offshore accounts." Tilga wired nearly $8.7 million (USD) into the United States from offshore accounts, she transferred funds between nominee entities, and she used the nominee entities to purchase real estate and vehicles. *See* Tilga PSR ¶¶ 18–19, at 10. In her Plea Agreement, Tilga admits that: (i) she purchased several nominee entities from CTC; (ii) she directed her Canadian businesses to distribute her share of the revenue to one such entity; (iii) the entity then transferred funds to other nominee entities at her direction; (iv) she used those entities to purchase real property, renovate those properties, and purchase vehicles; and (v) she did all this with the intent to conceal her Canadian income source and defraud the United States. *See* Tilga Plea Agreement ¶ 8(d)-(h), at 4–7. Chandler assisted Tilga in using the offshore trusts to move money, he rented mailboxes in the names of entities that he and Tilga purchased from CTC, and titled an automobile in the name of one of the CTC purchased entities. *See* Chandler Plea Agreement ¶ 7(a)-(e). At the hearing, Tilga asserted that, to qualify for the sophisticated-means enhancement, there must be "some deliberate or volitional activity on the part of the accused in terms of creation or *management* of these types of products." Tr. at ***1333** 45:1–6 (Theus) (emphasis added). Tilga and Chandler were more than a passive participants in this scheme. Rather, their conduct indicates that they took affirmative actions to manage the PTOs, shell corporations, and accounts to keep the United States from taxing Tilga's Canadian income. *See United States v. Firestien,* 2007 WL 174108, at *2. Furthermore, Tilga and Chandler's actions went beyond those of the defendant in *United States v. Baxter,* because Tilga and Chandler used offshore bank accounts and shell corporations and because Tilga and Chandler admitted that they "entered into an agreement with certain employees of CTC ... with the intent to conceal her Canadian source of income and the intent to defraud the United States." Tilga Plea Agreement ¶ 8(h), at 6–7. *See also* Chandler Plea Agreement ¶ 7(b)-(c), at 4; *United States v. Baxter,* 2006 WL 1155872, at *4. The First Circuit's holding in *United States v. Anthony,* applying the sophisticated-means enhancement to another CTC customer, also bolsters the Court's conclusion here. *See United States v. Anthony,* 545 F.3d at 63, 68.

Chandler, in his letter in support of the parties' stipulations, argued that *United States v. Lewis* and *United States v. Rice* require that the Court not apply the sophisticated-means enhancement. *See* Letter at 2. In *United States v. Rice,* the defendant—Rice—established several S Corporations, which do not have to pay taxes, but must file quarterly statements concerning their employees' withholding. *See* 52 F.3d at 844–45. Over the course of three years, Rice claimed more money on his individual tax return than had been withheld. *See United States v. Rice,* 52 F.3d at 845. The Tenth Circuit held that Rice's fraud was "the functional equivalent of claiming more in itemized deductions than actually paid" and reversed the application of the sophisticated-means enhancement, because "[i]f that scheme is sophisticated within the meaning of the guidelines, then every fraudulent tax return will fall within that enhancement's rubric." *United States v. Rice,* 52 F.3d at 849. Chandler suggests that his conduct was similar to Rice's, because Tilga and Chandler "merely requested, of others, the movement of moneys from one account to a different account." Letter at 2. Tilga and Chandler's conduct, however, goes beyond claiming more in deductions than actually paid, or claiming more withholdings than actually withheld. Tilga and Chandler certainly "requested, of others, the movement of moneys," Letter at 2; they requested that funds for Tilga's Canadian businesses be transferred to one nominal entity, then transferred them to other nominal entities, then used the funds to purchase real estate and vehicles that would not be titled in their names, all to ensure that the IRS never discovered their Canadian income, *see* Chandler Plea Agreement ¶ 7(a)-(e), at 3–4; Tilga Plea Agreement ¶ 8(d)-(h), at 4–7. Tilga and Chandler actively attempted to conceal their entire Canadian income; they did not merely falsely report an amount on their tax form. Furthermore, in *United States v. Lewis,* another case Chandler cites, the Second Circuit stated that "the provision targets conduct that is more complex, demonstrates greater intricacy, or demonstrates greater planning than a routine tax-evasion case." 93 F.3d at 1080. *See* also Letter at 1–2. Here, even discounting the creation of the PTOs and offshore accounts, Tilga and Chandler admit to taking affirmative steps to transfer money between accounts to conceal their income, to using the offshore trusts for these purposes, to titling their property in the name of nominal entities to avoid detection, and ***1334** to taking other steps, *i.e.* setting up mailboxes, to conceal the true amount of their income. *See* Tilga Plea Agreement ¶ 8(d)-(h), at 4–7; Chandler Plea Agreement ¶ 7(a)-(e). Under almost any metric, their use of these items was complex, so complex that Tilga and Chandler attended seminars to learn more. *See* Tr. at 45:24–25 (Johnson) ("[Y]ou have Tilga who is a customer. She went to one of their seminars ..."); Tr. at 49:9–11 (Johnson) ("[T]hat would be paragraph 40 that the probation officer indicates that Mr. Chandler attended some of the seminars. That is true ..."). Tilga and Chandler's purchases from CTC, purchases of real estate, and attendance at seminars also indicate that a great deal of planning went into how best to conceal their income. Thus, even under the two cases Chandler cites, Tilga and Chandler both qualify for the sophisticated-enhancement.

Tilga and Chandler's offense was far "more complex or demonstrates greater intricacy or planning than a routine tax-evasion case," *see United States v. Ambort,* 405 F.3d at 1120, and fits well within the range of conduct that the sophisticated-means enhancement targets, *see* U.S.S.G. § 2T1.1 cmt. n. 4. Consequently, the Court will overrule the objection to the PSR's reference to the sophisticated-means enhancement, and will apply the 2–level enhancement to Tilga and Chandler's base offense levels. The Court will also not accept the parties' stipulations in the Plea Agreements that neither defendant was subject to a sophisticated-means enhancement. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5.

III. *THE COURT WILL SUSTAIN THE OBJECTION TO THE PSR'S REFERENCES TO SPECIAL SKILLS.*

Tilga's PSR states that "the defendant attended seminars sponsored by Commonwealth Trust Company and utilized their program to start Pure Trust Organizations.... The knowledge of how to start a PTO and the purpose of a PTO is not a skill commonly possessed by the public." Tilga PSR ¶ 42, at 20. The PSR also references Tilga's Masters of Business Administration degree before concluding that, "[b]ased on this information, a two-level increase should be applied." Tilga PSR ¶ 42, at 20. The PSR on Chandler states that "the defendant attended CTC seminars, became closer than some with founders and managers of the company, and was able to assist his wife and setting up offshore accounts and wiring money to and from the accounts." Chandler PSR ¶ 40, at 16–17. The PSRs maintain that, based on this information, Tilga and Chandler should receive a 2–level special skills enhancement. *See* Tilga PSR ¶ 42, at 20; Chandler PSR ¶ 40, at 16–17. In the Plea Agreements, the parties stipulated that no special skills enhancement should apply either to Tilga or to Chandler. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5. The United States asserted that neither Tilga nor Chandler "possessed any special skill with respect to taxes." Tr. at 50:1–4 (Gerson). The United States recognized that Tilga is highly educated, but argued that Tilga did not "victimize[ ] some other person by making use of these special skills." Tr. at 50:5–15 (Court, Gerson).

U.S.S.G. § 3B1.3 provides that "[i]f the defendant abused a position of public or private trust, or used a special skill in a manner that significantly facilitated the commission or concealment of the offense, increase by 2 levels." U.S.S.G. § 3B1.3. Application Note 4 defines "special skill" as "a skill not possessed by members of the general public and usually requiring substantial education, training or licensing." ***1335** U.S.S.G. § 3B1.3 cmt. n. 4. To apply a § 3B1.3 enhancement: (i) the defendant must possess a special skill or a position of trust; and (ii) the defendant must use that skill or abuse that position to significantly facilitate the commission or concealment of the offense. *See United States v. Burt,* 134 F.3d at 998–99.

[8] The PSR seems to suggest that Tilga possessed two sets of special skills that she brought to bear in the commission of her offense: (i) business skills acquired in the course of her education; and (ii) skills related to PTOs acquired during CTC's seminars. *See* Tilga PSR ¶ 42, at 20. The Court will consider each "special skill" in turn.

Tilga has a bachelor's degree in Hotel Administration from Cornell University and a Masters in Business Administration from the Wharton School of Business. *See* Tilga PSR ¶¶ 68–69, at 26. The skills she acquired over the course of her education, however, were not tax specific, and related to marketing and collecting fees for services provided. *See* Tr. at 51:2–6 (Gerson). There is no evidence that Tilga used the business and marketing skills that she acquired during her education to significantly facilitate the concealment of her crime. *See United States v. Burt,* 134 F.3d at 1000 ("Without the requisite connection between the crime and Defendant's special knowledge, the section 3B1.3 enhancement for use of a special skill cannot be affirmed."). While Tilga has some special education, the Court is not convinced that the special skills that she acquired during that education facilitated the commission of the concealment of the offense.

[9] Tilga attended several CTC seminars and used CTC's program to start PTOs. *See* Tilga PSR ¶ 42, at 20. Chandler also attended some CTC seminars, but argued that "attending some seminars would not rise to the level of a special skill." Tr. at 49:7–14, 51:14–25 (Johnson). Generally, attending a few seminars would not appear to be comparable to a skill requiring "*substantial* education, training or licensing." U.S.S.G. § 3B1.3 cmt. 4 (emphasis added). The Tenth Circuit recognizes, however, that a defendant need "not complete formal educational or licensing requirements in order to possess a special skill." *United States v. Hinshaw,* 1999 WL 9762, at *3. At the hearing, Chandler stated that "CTC held Tilga's hand throughout the time period" and was involved in the administration of Tilga's trusts. Tr. at 46:1–6 (Johnson). Tilga also asserts that she accepted the representations of CTC's sales personnel, lawyers, and accountants, and did no more than purchase CTC products. *See* Tilga's Sentencing Memo. at 7. CTC conducted seminars on a variety of topics, including the "use of trustee documents, privacy issues, offshore banking, certificate holder issues, how to wire transactions to offshore accounts and where to store documents." Tilga PSR ¶ 15, at 9. While these seminar topics conveyed specialized knowledge, there is no evidence that participants were taught specialized skills not possessed by members of the general public, as § 3B1.3 requires. *See* U.S.S.G. § 3B1.3 cmt. 4. More likely is that participants walked away from these seminars with a general understanding of the topic, which may be more than what the public knows, but which still does not rise to the level of a specialized skill. Although Tilga and Chandler used sophisticated programs, offshore accounts, and other entities, as discussed above in reference to the sophisticated-means enhancement, there is no evidence that Tilga or Chandler possessed ***1336** any special skills related to the creation or operation of the PTOs. Furthermore, even if Tilga or Chandler possessed specialized skills, it does not appear that either used them to commit the crime, because CTC exercised its skills to create the means for their offenses, and Tilga and Chandler followed their program. *See* Tilga PSR ¶¶ 18–20, at 10–11; *United States v. Lee,* 296 F.3d 792, 794–95, 799 (9th Cir.2002) (holding that, a defendant did not possess a "special skill" where the defendant copied and pasted "scripts from a legitimate website to create a phony website").

Accordingly, the Court finds that neither Tilga nor Chandler used a special skill to conceal their offense and will accept the parties' stipulations to that effect in the Plea Agreements. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5.

IV. *THE COURT WILL SUSTAIN THE OBJECTION TO THE PSR'S REFERENCES TO AN AGGRAVATING ROLE ADJUSTMENT.*

[10] The PSR states that Tilga can be identified as an organizer, leader, manager, or supervisor in the criminal activity, thus warranting a 2–level enhancement. *See* Tilga PSR ¶ 41, at 20. The PSR asserts that Tilga had her husband, as well as her bookkeeper, open mail accounts for shell companies, so that they would not be associated with her name, and that she used unindicted coconspirators to assist in her attempt to evade paying taxes to the IRS. *See* Tilga PSR ¶ 41, at 20. In the Plea Agreement, the parties stipulated that Tilga's offense did not involve an aggravating role. *See* Tilga Plea Agreement ¶ 10(c), at 8. At the hearing, the United States and Tilga asserted that she was not an organizer, leader, or supervisor of the criminal activity, because the criminal activity extended to CTC, and the CTC executives were the ones who created the product. *See* Tr. at 48:12–21 (Court, Gerson, Theus).

Section 3B1.1 of the Sentencing Guidelines provides for enhancements to a defendant's offense level based on a defendant having played an aggravating role in the offense. Under § 3B1.1(a), "[i]f the defendant was an organizer or leader of a criminal activity that involved five or more participants or was otherwise extensive, increase by 4 levels." U.S.S.G. § 3B1.1(a). Lesser enhancements are specified for defendants who are "managers or supervisors" rather than organizers or leaders, and for defendants involved in smaller-scale criminal conduct. U.S.S.G. § 3B1.1(b)-(c). Among the factors a sentencing court should consider when weighing an aggravating role enhancement are:

> [T]he exercise of decision making authority, the nature of participation in the commission of the offense, the recruitment of accomplices, the claimed right to a larger share of the fruits of the crime, the degree of participation in planning or organizing the offense, the nature and scope of the illegal activity, and the degree of control and authority exercised over others. There can, of course, be more than one person who qualifies as a leader or organizer of a criminal association or conspiracy.

U.S.S.G. § 3B1.1 cmt. n. 4. The Tenth Circuit has "elaborated that '[i]n considering these factors, the sentencing court should remain conscious of the fact that the gravamen of this enhancement is control, organization, and responsibility for the actions of other individuals because § 3B1.1(a) is an enhancement for organizers ***1337** or leaders, not for important or essential figures.' " *United States v. Sallis,* 533 F.3d 1218, 1223 (10th Cir.2008) (quoting *United States v. Torres,* 53 F.3d 1129, 1142 (10th Cir.1995)).

The criminal activity in this case extends beyond Tilga to CTC's executives and employees, who encouraged and created the means for this offense. *See* Tilga PSR ¶¶ 10–15, at 7–9. Considering the entire criminal organization, Tilga is substantially less culpable than those at CTC. The PSR maintains that Tilga directed the activities of her husband and bookkeeper. Tilga's role, however, is much less culpable than the conduct in other cases where the Tenth Circuit has approved the aggravating role enhancement. *See United States v. Cruz Camacho,* 137 F.3d 1220, 1225 (10th Cir.1998) (affirming an aggravating role enhancement where the defendant had a leadership role, recruited other members, directed activities, and paid other members of the organization); *United States v. Bernaugh,* 969 F.2d 858, 863 (10th Cir.1992) (affirming an aggravating role enhancement where the defendant was the moneyman, engaged in negotiations, and took possession of drugs). The nature of Tilga's role was not such that she exercised decision-making authority or control over the criminal enterprise, and the nature of her participation was no more than that of an average participant in the tax evasion scheme that CTC established. Indeed, as a consumer of CTC's products, Tilga appears to be the average participant.

Accordingly, the Court agrees with the parties that an aggravating role enhancement is inappropriate and will sustain the objection to the PSR's references to the applicability of such an enhancement. The Court will also accept the stipulation to that effect in the Plea Agreement. *See* Tilga Plea Agreement ¶ 10(c), at 8.

V. *THE COURT WILL OVERRULE THE OBJECTION TO THE PSR'S REFERENCES TO OBSTRUCTION.*

The PSR asserts that, but for the Plea Agreement, a obstruction enhancement, pursuant to § 3C1.1, would be appropriate, because during the three years that Tilga employed Simmons she told him that if he were ever asked about Tilga's property, to lie, and because, upon learning of the IRS' investigation, Tilga told Simmons that he was going to pay. *See* Tilga PSR ¶ 43, at 20–21. The Plea Agreement stipulates that Tilga's offense did not involve obstruction of justice. *See* Tilga Plea Agreement ¶ 10(c), at 8. At the hearing, the United States asserted that it could prove that Tilga said the things the PSR alleges, through the testimony of Simmons, but stated that it believed that the statements showed Tilga's state of guilty conscious, rather than a motive to obstruct. *See* Tr. at 53:22–54:8 (Gerson). Tilga responded that she could impeach Simmons, and that there is no admissible evidence that Tilga intended to obstruct or impede the administration of justice. *See* Tr. at 53:10–20 (Theus). The United States conceded that it would not be able to prove obstruction of justice by a preponderance of the evidence. *See* Tr. at 54:22–55:14 (Court, Gerson).

U.S.S.G. § 3C1.1 states:

> If (A) the defendant willfully obstructed or impeded, or attempted to obstruct or impede, the administration of justice with respect to the investigation, prosecution, or sentencing of the instant offense of conviction, and (B) the obstructive conduct related to (i) the defendant's offense of conviction ***1338** and any relevant conduct; or (ii) a closely related offense, increase the offense level by 2 levels.

The application notes state: "Obstructive conduct that occurred prior to the start of the investigation of the instant offense of conviction may be covered by this guideline if the conduct was purposefully calculated, and likely, to thwart the investigation or prosecution of the offense of conviction." U.S.S.G. § 3C1.1 cmt. n.1.

Tilga's alleged conduct, asking a witness to lie, generally falls within the ambit of conduct considered obstructive in § 3C1.1. *See United States v. Farnsworth,* 92 F.3d at 1011; *United States v. Hernandez,* 967 F.2d 456, 459 (10th Cir.1992) (finding that the defendant asked another to lie as to his culpability, thereby impeding administration of justice). Tilga's PSR indicates that most of her conduct occurred before the start of the investigation. *See* Tilga PSR ¶ 43, 20–21. The conduct, therefore, must be "purposefully calculated, and likely, to thwart the investigation or prosecution of the offense of conviction." U.S.S.G. § 3C1.1 cmt. n. 1. The United States conceded, at the hearing, that it would not be able to establish by a preponderance of the evidence that Tilga's conduct was "reasonably likely to interfere with the investigation." Tr. at 55:3–5 (Gerson). The Court agrees that it is unlikely that the false statements of an employee that Tilga did not own property would reasonably interfere with the investigation or thwart prosecution. Any reasonable investigation would question both whether an employee would have personal knowledge of the employer's property ownership and the accuracy of such knowledge. Additionally, the United States conceded that Tilga's statements upon learning of the investigation were an "unpremeditated emotional response on Ms. Tilga's part that showed her state of mind with respect to her knowledge that she was committing tax evasion but not that it was being uttered for the purpose of trying to prevent the United States from carrying out an investigation in this case." Tr. at 53:4–8 (Gerson). The Court finds that Tilga's alleged statements, that she "was not going to take the fall" and that Simmons was "going to pay," Tilga PSR ¶ 43, at 21, are not the kind of statements aimed at obstructing justice. Tilga's alleged statements do not threaten Simmons or otherwise indicate that he should do anything to impede the investigation, which the Court would recognize as obstruction. *See United States v. Yuselew,* 2010 WL 3834418, at *12–13 (finding the obstruction enhancement applicable where the defendant threatened the only witness with death and attempted to bury evidence).

Because the United States concedes that it could not prove obstruction of justice by a preponderance of the evidence, and because the Court finds that Tilga's alleged statements were not reasonably likely to thwart the investigation or prosecution, the Court concludes that this conduct cannot form the basis of an obstruction-of-justice enhancement. Furthermore, because the United States concedes, and the Court agrees, that Tilga's later statement was not purposefully directed at obstructing justice, the Court concludes that there is no basis for an obstruction-of-justice enhancement pursuant to § 3C1.1. Accordingly, the Court will sustain the objection and accept the stipulation in the Plea Agreement. *See* Tilga Plea Agreement ¶ 10(c), at 8.

VI. *THE COURT OVERRULES THE OBJECTIONS TO THE TILGA PSR'S FAILURE TO ACKNOWLEDGE THE PLEA AGREEMENT'S ADVANTAGE TO THE UNITED STATES AND TO RECOGNIZE THE ADVISORY NATURE OF THE GUIDELINES.*

Tilga objected to her PSR's failure to explicitly recognize that the guidelines are ***1339** advisory and the PSR's failure to acknowledge the advantages that the United States gained from the Plea Agreement. *See* Tilga's Sentencing Memo. at 4. At the hearing, however, Tilga stated that her objection, to her PSR's failure to acknowledge the advantages that the United States received from the Plea Agreement, had been addressed, because the USPO agreed to reflect that Tilga brought those matters to the Court's attention, and was more appropriate for argument rather than inclusion in the PSR. *See* Tr. at 57:21–58:3 (Theus). Tilga also admitted that her objection is moot to the extent that the information is presently before the Court through her sentencing memorandum. *See* Tr. at 58:4–7 (Court, Theus). Additionally, Tilga stated that her objection to her PSR's failure to acknowledge the advisory status of the guidelines had been satisfactorily addressed and included in the sentencing memorandum. *See* Tr. at 58:12–59:2 (Court, Theus).

Because the USPO satisfactorily addressed these objections, by reflecting that Tilga brought the matter to the Court's attention, and because Tilga concedes that they are not moot, the Court will overrule the objections to her PSR's failure to state that the guidelines are advisory and to her PSR's failure to acknowledge the advantages that the United States' obtained from the Plea Agreement.

IT IS ORDERED that the objections in Defendant Carolynne Tilga's Memorandum in Aid of Sentencing of Defendant Carolyne Tilga and Limited Objection to Presentence Report, filed October 6, 2011 (Doc. 161), are sustained in part and overruled in part. The Court accepts the parties' stipulated tax loss calculation, $23,300.00 (USD), and sustains the objection to the Defendant Carolynne Tilga's Presentence Investigation Report ("Tilga's PSR"), disclosed July 26, 2011, and Defendant Michael Chandler's Presentence Investigation Report ("Chandler's PSR"), disclosed July 26, 2011. The Court also accepts the parties' stipulations in the Defendant Carolynne Tilga's Plea Agreement, filed January 6, 2011 (Doc. 126) and Defendant Michael Chandler's Plea Agreement, filed January 6, 2011 (Doc. 128) ("Chandler Plea Agreement") that neither Tilga nor Chandler's offenses involved a special skill, an aggravating role, or obstruction of justice, and sustains Tilga and Chandler's objections to portions of the PSRs which suggest otherwise. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5. The Court rejects the parties' stipulation that the offense did not involve sophisticated means, and overrules Tilga and Chandler's objections to her PSRs' references to the enhancement. *See* Tilga Plea Agreement ¶ 10(c), at 8; Chandler Plea Agreement ¶ 9(b), at 5. The Court concludes that Tilga's objections to the PSR's failure to acknowledge the benefits that the United States obtained from the Plea Agreement and failure to explicitly recognize that the sentencing guidelines are advisory are moot.

All Citations

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Footnotes

[1] Defendant Michael Chandler also filed Defendant Michael Chandler's Objection to the Pre–Sentence Report on August 9, 2011 (Doc. 152). Because Chandler did not address his objection at the hearing and because the objection is not relevant to the Court's conclusions in this memorandum opinion and order, the Court will not address the objection at this time. If necessary, the Court will address Chandler's objection at the sentencing hearing, and in a subsequent memorandum opinion and order.

2 The Court will not address Tilga's request for a downward variance and/or downward departure, or Tilga's ability to pay a fine. This memorandum and opinion addresses only the objections to the PSR that could impact the calculation of the guideline sentencing range. If necessary, the Court will address Tilga's request for a variance and/or downward departure, and her objection to the PSR's analysis of her ability to a pay a fine, at the sentencing hearing and in a subsequent sentencing memorandum.

3 Tilga did not object to any of the Tilga PSR's factual findings either in her sentencing memorandum or at the hearing. Chandler objected to paragraph 22 of the Chandler PSR in Defendant Michael Chandler's Objection to the Pre–Sentence Report, filed August 31, 2011 (Doc. 156) ("Chandler Objection"). Chandler objects to the Chandler PSR's finding that "Chandler was also known to assist [in] wiring money to and from the account." Chandler Objection at 1–2. Other than this one objection, Chandler did not contest the factual findings of the Chandler PSR either in his Objection, his sentencing memorandum, or at the hearing.

4 A webcam is a video camera that feeds its images in real time to a computer or computer network, often via USB, ethernet, or Wi–Fi. The name, webcam, is derived from their common use as a video camera for the World Wide Web, or internet. Webcams are frequently used to establish video links, permitting personal computers to act as video-phones or video-conference stations. *See* Webcam, WIKIPEDIA.ORG, http://en.wikipedia. org/wiki/Webcam (last visited October 28, 2011).

5 CTC marketed their services and products as a means of providing privacy and asset protection. *See* Tilga PSR ¶ 11, at 8. CTC described privacy as "a means to get assets out of your name" and asset protection as "a method to owe more than the asset is worth." Tilga PSR ¶ 11, at 8. The CTC provided clients with documentation from the Internal Revenue Service ("IRS") that Pure Trust Organizations ("PTOs") were considered legal, even though they did not have to file income tax returns. Tilga PSR ¶ 11, at 8. When a client purchased a CTC product, such as a Pure Trust Organization, the client would receive the original documents, and CTC would inform the client that the documents should be stored away from the client's personal residence. *See* Tilga PSR ¶ 13, at 8. This off-site storage occurred because if the IRS were to locate the documents, it would confirm that the PTOs were an alter ego of the client who purchased the product. *See* Tilga PSR ¶ 13, at 8. The Director of Operations of CTC from 1998 to 2003, Wayne C. Rebuck, knew that the majority of pure trusts sold by CTC were used in an abusive manner, wherein individuals "evaded and defeated taxes." Tilga PSR ¶ 14, at 8–9.

6 Although it is unclear whether the CTC still operates as an organization, the PSR refers to it in the past tense, and it appears that CTC's Director of Operations, Wayne C. Rebuck, has been involved in this and other criminal prosecutions. *See* Tilga PSR ¶ 15, at 9 ("Rebuck was able to identify Carolynne Tilga and Michael Chandler as individuals who met with representatives from CTC to purchase trusts and foreign companies."); *United States v. Anthony,* 545 F.3d 60, 63 n. 4 (1st Cir.2008) ("Pursuant to an agreement with the government [Wayne] Rebuck testified at Anthony's trial.").

7 The PSR notes:

> A Pure Trust Organization (PTO) has been defined as a common law contract in trust form. The Pure Trust is a contract at common-law in equity created in trust form. Unlike the Trust, the PTO receives the assets by exchange, meaning there is a full and adequate exchange for the assets. In other words each party gives something and receives something in return, and the agreement has a stipulated duty to perform that all parties must adhere to. The Exchanger exchanges the assets to the Trust for Trust Certificate Units ("TCU's"). The Creator appoints at least two Trustees to manage the trust. The Trustees can appoint a General Manager to oversee the day-to-day business activities of the Trust. The Exchanger has no control over the Trustees, the business of the Trust or the income stream. The Trustees are in total control and the Exchanger has no reversionary interest in the Trust. This entity has the substance of a contract and the form of a trust.

Tilga PSR ¶ 10, at 7–8. The IRS states that the term "pure trust" does not appear in the Internal Revenue Code and that "[w]hatever the name of the arrangement ... the taxation of the entity must comply with the requirements of the Internal Revenue Code." Abusive Trust Tax Evasion Schemes—Special Types of Trusts, INTERNAL REVENUE SERVICE, http://www.irs. gov/businesses/small/article/0,,id=106553,00.html (last visited October 21, 2011).

8 A conspiracy to defeat the IRS' lawful function and victimize the IRS is known as a *Klein* conspiracy. *See United States v. Adkinson,* 158 F.3d 1147, 1154 (11th Cir.1998) (citing *United States v. Klein,* 247 F.2d 908 (2d Cir.1957)). To show a *Klein* conspiracy the United States must show not only (i) the requisite act of a failure to properly report income, but also (ii) an agreement between at least two conspirators to impede the IRS' functioning and (iii) knowing participation in such a conspiracy. *See United States v. Adkinson,* 158 F.3d at 1153; *United States v. McKee,* 506 F.3d 225, 238 (3d Cir.2007).

9 The parties calculated the tax loss based on the following information: (i) Tilga wired $186,982.50 (USD), income from one of her Canadian businesses, to Tierra del Taos Title Co. for the purchase of a home on September 10, 1998; (ii) Tilga had previously invested $50,000.00 (USD) in Tierra del Taos; and (iii) Tilga had loaned approximately $20,252.00

(USD) to the company. *See* Gov't Sentencing Memo. at 15 n. 13. Thus, after deducting the $70,252.00 that Tilga was entitled to recover before being taxed, the remaining income was $116,730.50 (USD). *See* Gov't Sentencing Memo. at 15 n. 13. That income should have been taxed at the then-prevailing long-term capital gain rate of twenty percent. *See* Gov't Sentencing Memo. at 15 n. 13. Accordingly, the tax losses were approximately $23,346.10 (USD). *See* Gov't Sentencing Memo. at 15 n. 13. The Tilga Plea Agreement, however, stipulates that the tax loss is $23,200.00 (USD). *See* Tilga Plea Agreement ¶ 10(a), at 7. Pursuant to U.S.S.G. § 2T4.1(D), all tax losses greater than $12,500.00 but less than $30,000.00 result in a base offense level of 12. *See* U.S.S.G. § 2T4.1(D); Tilga PSR ¶ 38, at 19. Thus, whether the tax loss is $23,300.00 (USD) or $23,200.00 (USD) does not change the base offense level. The Court will, however, use the more accurate stipulated tax loss, agreed to in the Chandler Plea Agreement—$23,300.00 (USD). *See* Chandler Plea Agreement ¶ 9(a).

[10] Tax Form TD F 90–22.1, the “Report of Foreign Bank and Financial Accounts,” is known as the “FBAR.” *In re M.H.,* 648 F.3d 1067, 1070 (9th Cir.2011). The United States may seek to enforce civil penalties for failure to report an interest in a foreign bank account, as 31 U.S.C. § 5314 requires. *See United States v. Williams,* No. 09–437, 2010 WL 2842931, at *1–2 (E.D.Va. Mar. 19, 2010).

[11] The Court's citations to the transcript of the hearing refer to the court reporter's original, unedited version. Any final transcript may contain slightly different page and/or line numbers.

[12] Section 3B1.1(c) applies to leaders, organizers, managers, or supervisors of organizations with less than five persons. The only relevant difference between an organizer under § 3B1.1(a) and an organizer under § 3B1.1(c), it seems, is the size of the organization.

[13] Although the United States asked the Court to accept the tax loss calculation, stipulated to in the Tilga Plea Agreement, of $23,200.00 (USD), the United States' calculations put the tax loss amount at $23,300.00 (USD) and the Chandler Plea Agreement stipulates to a tax loss of $23,300.00. *See* Gov't Sentencing Memo. at 15 n. 13; Chandler Plea Agreement ¶ 9(a), at 5. Because the United States stressed that Chandler should “be given the benefit of the same stipulated loss amount as to the tax loss,” Chandler Plea Agreement ¶ 9(a), at 5, and because the $23,300.00 (USD) calculation is more accurate, the Court will treat the United States' and Tilga's requests as asking the Court to accept a stipulate tax loss of $23,300.00 (USD).

[14] It is also reasonable to apply *United States v. Hoskins* to the foreign tax credit, because deductions and credits serve similar purposes—reducing the total tax owed. A tax credit reduces the total amount of taxes that a taxpayer owes to the state or federal government, and may be in recognition of taxes already paid, as a subsidy or to encourage certain behaviors. *See* Tax Credit, WIKIPEDIA.ORG, http://en. wikipedia.org/wiki/Tax_credit (last visited November 5, 2011). A tax deduction reduces the amount of income subject to tax for various items, especially expenses incurred to produce income. *See* Tax Deduction, WIKIPEDIA.ORG, http://en.wikipedia.org/wiki/Tax_deduction (last visited November 5, 2011).

[15] At the hearing, Mr. Rubinger testified that *United States v. Cruz* “was highly criticized” for accelerating the expiration of the statute of limitations for claiming the foreign tax credit to the period before trial. Tr. at 30:13–15 (Rubinger). In researching the issue, the Court found only six cases citing *United States v. Cruz,* none of which engaged in a discussion of this issue, criticizing Eleventh Circuit's conclusion or otherwise. *See, e.g., United States v. Williams,* 875 F.2d 846, 850 (11th Cir.1989) (citing *United States v. Cruz* for the elements of a § 7201 conviction and for the principle that the Eleventh Circuit did not condone a taxpayer's “wait and see gamble”). Additionally, the Court has found only two articles that engaged in a substantive discussion about the post-indictment application of the foreign tax credit and whether the Eleventh Circuit decided *United States v. Cruz* correctly. One is Mr. Rubinger's article in the *Journal of Taxation. See* J. Rubinger and A. Weinstein, *Foreign Tax Credits: Can a Deficiency be Retroactively Wiped Out For Criminal Tax Evasion Purposes?,* 112 J. TAX'N 166, 172 (2010) (“While post-indictment actions taken by a taxpayer typically have no effect on the calculation of a deficiency, certain unique aspects of the [foreign tax credits] provisions may yield a different result.”). The other, a leading legal commentator, has gone so far as to say that the Eleventh Circuit “rewrote the law of accrued foreign taxes” when it held that the United States' prosecution of a defendant for tax evasion accelerates the foreign tax credit's statute of limitations. *See* 1–12 Rhoades and Langer, *United States Int'l Taxation and Tax Treaties* (Matthew Bender & Co.), § 12.03, n. 43 (“The taxpayer claimed that his tax obligation was fixed and hence properly accruable even though not assessed in his home country. Had the taxpayer not been accused of garnering his wealth from drug peddling his argument may have fallen on more receptive ears. The majority was so convinced, however, that he was going to escape punishment of any sort ... that it rewrote the law of accrued foreign taxes.”). The Court need not, and does not, decide whether the foreign tax credit's statute of limitations should be accelerated before trial—the aspect of the *United States v. Cruz* decision which these articles criticize.

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T.C. Memo. 2017-108
United States Tax Court.

James AWAD, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 3755–14W
|
Filed June 8, 2017

Synopsis
Background: Applicant petitioned for review of IRS determination to deny his claim for whistleblower award.

[Holding:] The Tax Court, Vasquez, J., held that IRS's collection of proceeds of over $2 million in tax, penalties, and interest was not attributable to the IRS's proceeding with administrative or judicial action on the basis of applicant's information.

Decision for IRS.

Attorneys and Law Firms

Howard W. Gordon, Leticia Vega, and Alyssa L. Razook Wan, for petitioner.

Marianna Lvovsky, Patricia P. Davis, and John T. Arthur, for respondent.

P provided information to the IRS Whistleblower Office (WO) regarding individuals TH and TW's alleged failure to disclose their ownership interests in foreign bank accounts. WO forwarded P's information to the Large Business & International Division (LB & I), which declined to examine TH and TW's returns. TH died while LB & I was considering P's information. Thereafter TW and her adult children filed voluntary disclosures with the Criminal Investigation Division (CID) in which they reported income from a previously undisclosed account at the same foreign bank P had identified.

CID accepted the voluntary disclosures and forwarded them to the Small Business/Self Employed Division (SB/SE) for examination. The SB/SE examination resulted in the assessment of over $2 million in income tax, accuracy-related penalties, and interest against TH and TW, in addition to a title 26 miscellaneous penalty. Although WO forwarded P's information to SB/SE, the revenue agent who conducted the examination denied using it.

[*2] WO also forwarded P's information to SB/SE's Estate and Gift Tax Group (E & G), which had selected TH's estate's estate tax return for examination. The revenue agent who was conducting the examination asserted that P's information was not relevant to his investigation. Thereafter, WO issued a determination denying P's claim for a whistleblower award.

Held: We need not decide the standard of review in this case because we would sustain R's determination under either a de novo or an abuse of discretion standard of review.

Held, further, because the administrative action taken by the IRS against the taxpayers was not based on his information, P is not entitled to a whistleblower award.

MEMORANDUM FINDINGS OF FACT AND OPINION

VASQUEZ, Judge:

***1** Pursuant to section 7623(b)(4), petitioner has appealed the Internal Revenue Service's (IRS) denial of his claim for a nondiscretionary **[*3]** whistleblower award. [1] The issue for decision is whether petitioner is entitled to an award under section 7623(b)(1).

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the attached exhibits are incorporated by this reference. Petitioner resided in New York when he filed his petition.

Petitioner's Whistleblower Claim

On November 18, 2008, petitioner filed Form 211, Application for Award for Original Information, with the IRS Whistleblower Office (Whistleblower Office). In the Form 211 petitioner implicated taxpayer husband, taxpayer wife, and their three adult children (taxpayer children) (collectively, taxpayers) as owners of undisclosed foreign bank accounts. Petitioner alleged that taxpayer husband was likely transferring millions of untaxed dollars to these accounts. While petitioner provided the name of the bank, he did not list any account numbers or give other identifying information about the alleged accounts. The Whistleblower Office confirmed receipt of the Form 211 and informed petitioner that his claim had been assigned to analyst Nancy Burcham.

[*4] Referral of Whistleblower Information to LB & I

In February 2009 Ms. Burcham forwarded petitioner's information to the IRS Large Business and International Division (LB & I). The matter was assigned to LB & I examiner Alan Hymes.

Mr. Hymes reviewed petitioner's information and, in June 2009, decided to accept the taxpayers' returns as filed. In a written statement to the Whistleblower Office Mr. Hymes wrote: “At this point there is not enough information to determine that this is a good case for the field. * * * [Petitioner] did not provide any documentation to show that the * * * account or accounts exist or that any money was transferred”.

Inexplicably, LB & I allowed several months to pass before returning the case to the Whistleblower Office.[2] The administrative record indicates that Ms. Burcham may not have received Mr. Hymes' written statement until July 2010, over a year after LB & I had made its decision.

The Taxpayers' Voluntary Disclosure

Meanwhile, taxpayer husband died in August 2009. In January 2010 the surviving taxpayers filed voluntary disclosures pertaining to a previously **[*5]** undisclosed account at the same foreign bank petitioner had identified to the Whistleblower Office.[3] The taxpayers' voluntary disclosures included account information and amended returns reporting previously undisclosed income for tax years 2003 through 2008. CID accepted the taxpayers' voluntary disclosures and forwarded their case file to the IRS Small Business/Self–Employed Division (SB/SE) for examination. The matter was assigned to SB/SE revenue agent (RA) Thomas George. RA George's examination of the taxpayers' voluntary disclosure submission began in July 2010.

Referral of Whistleblower Information to SB/SE

***2** After learning that LB & I would not be examining the taxpayers' returns, Ms. Burcham contemplated issuing a rejection letter to petitioner. Before doing so, she performed additional research and discovered that SB/SE was examining **[*6]** the taxpayers' returns in connection with their voluntary disclosure. Consequently, in September 2010, Ms. Burcham forwarded petitioner's information to SB/SE “to determine if any of * * * [petitioner's] information was used to assist in the exams being opened on the taxpayers.”

After receiving petitioner's information, SB/SE subject matter expert Frank Stamm contacted petitioner and arranged a telephone interview. During the interview petitioner further explained the basis for his allegations against the taxpayers. In an internal memorandum recounting the interview, Mr. Stamm wrote: “While he could not provide account numbers he did provide lists of shares owned in various * * * [foreign] corporations, and properties owned in the US and abroad by the taxpayers.” Mr. Stamm recommended that petitioner's submission “be sent to the field for association with * * * [the taxpayers'] ongoing * * * audits.”

Petitioner's information was forwarded to RA George. Thereafter RA George provided the Whistleblower Office with a written statement indicating that the sole cause of the examination was the taxpayers' voluntary disclosure. He stated: “There has been no indication in the case files that * * * [petitioner's] information initiated the investigation or assisted to gather any offshore accounts.” **[*7]** In August 2011 taxpayer wife and an SB/SE group manager signed a Form 906, Closing Agreement on Final Determination Covering Specific Matters (closing agreement). The closing agreement, to which taxpayer wife and the estate of taxpayer husband were parties, referenced the 2009 OVDP[4] and stated that the taxpayers' voluntary disclosure was made pursuant to that program. In accordance therewith, taxpayer wife and taxpayer husband's estate agreed to pay a title 26 miscellaneous penalty “in lieu of any other penalties that the * * * [IRS] may impose with respect to the offshore financial arrangements that were the subject of the voluntary disclosure”. Additionally, the IRS adjusted taxpayer husband and taxpayer wife's tax liabilities for 2003 through 2008, assessing taxes, penalties, and interest in excess of $2 million. Having reached an agreement with taxpayer wife and taxpayer husband's estate, RA George did not make any adjustments to the returns of the taxpayer children. The examination of the taxpayers' returns was officially closed in November 2011.

Meanwhile, petitioner's whistleblower claim remained open. In 2012 or 2013 Ms. Burcham left the Whistleblower Office, and petitioner's claim was reassigned to analyst Kenneth Chatham. Mr. Chatham reviewed the claim file and decided to email RA George for clarification regarding whether petitioner's **[*8]** information had been used during the examination. In a subsequent telephone call RA George stated that he had relied exclusively on information provided by the taxpayers and that he had not used petitioner's information.

Referral of Whistleblower Information to SB/SE Estate and Gift Tax

In August 2013 Mr. Chatham learned that SB/SE's Estate and Gift Tax Group (E & G) had selected taxpayer husband's estate's estate tax return for examination. Mr. Chatham forwarded petitioner's information to E & G.

E & G examiner James Truman did not find petitioner's information to be helpful. Mr. Truman provided the Whistleblower Office with a written statement in which he explained: "The whistleblower claim has nothing to do with the estate tax return, only income tax issues. This estate tax return should never have been classified as a whistleblower case."

Award Determination and Appeal

***3** On January 28, 2014, the Whistleblower Office issued a determination letter to petitioner denying his claim for an award. Petitioner timely filed a petition appealing the Whistleblower Office's determination. Petitioner asserts that he is entitled to 15% to 30% of the total amounts collected from: (1) the assessment of additional income tax, accuracy-related penalties, and interest for 2003 through 2008 against taxpayer husband and taxpayer wife; (2) "FBAR penalties" against **[*9]** taxpayer husband and taxpayer wife; and (3) additional estate tax for which taxpayer wife's estate is liable on account of the inclusion of the foreign bank account in her gross estate. [5]

A trial was held in Miami, Florida. Thereafter both parties filed opening and answering briefs.

OPINION

We decide whether petitioner, a whistleblower, is entitled to a section 7623(b) award after a trial on the merits. Because petitioner failed to prove that the IRS proceeded with administrative or judicial action against the taxpayers on the basis of his information, we hold that he is not.

I. Statutory Framework

The IRS has long had authority to pay discretionary awards to persons, now called "whistleblowers", who provide information leading to the recovery of unpaid taxes. See sec. 7623 (1954). In response to concerns about the management of the discretionary award regime, Congress enacted legislation in 2006 to address perceived problems with the whistleblower program. Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, div. A, sec. 406, 120 Stat. at 2958 (effective Dec. 20, 2006). The 2006 legislation added to section 7623 a new **[*10]** subsection (b), which requires the payment of nondiscretionary whistleblower awards in specified circumstances and provides this Court jurisdiction to review IRS determinations regarding such awards. See Cooper v. Commissioner, 135 T.C. 70, 73 (2010).

Section 7623(b)(1) requires payment of an award if the IRS "proceeds with any administrative or judicial action" to collect taxes "based on information brought to the Secretary's attention by an individual". The award amount must be at least 15% and not more than 30% of "the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action" or settlement thereof. Id. The determination of the amount of the award "shall depend upon the extent to which the individual substantially contributed to such action." [6] Id.

[1] Section 7623(b)(5) defines the scope of claims that are subject to the nondiscretionary award program established in subsection (b). The IRS must pay claims on a nondiscretionary basis only with respect to actions against a taxpayer **[*11]** whose "gross income exceeds $200,000 for any taxable year subject to such action" and only "if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." Sec. 7623(b)(5)(A) and (B). The IRS must raise a failure to satisfy these monetary thresholds as an affirmative defense. See Lippolis v. Commissioner, 143 T.C. 393, 400 (2014).

II. Jurisdiction and Standard of Review

[2] **[3]** Section 7623(b)(4), captioned "Appeal of award determination", governs our jurisdiction over whistleblower claims. It provides: "Any determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter)." A "determination regarding an award" means a determination as to the amount of an award or a determination to deny an award. Cooper v. Commissioner, 135 T.C. at 75. Thus, this Court has jurisdiction under section 7623(b)(4) where, as here, (1) the IRS makes a determination denying a claim for award under section 7623(b); and (2) a petition invoking our jurisdiction over that matter is timely filed. See Kasper v. Commissioner, 137 T.C. 37, 41 (2011).

***4** Neither the text nor the legislative history of section 7623(b)(4) specifies the standard of review that the Court is to apply in reviewing IRS determinations. **[*12]** Petitioner contends that de novo review is appropriate, while respondent argues for an abuse of discretion standard. We need not resolve this question today since we would sustain respondent's determination under either standard of review. [7] See Golub v. Commissioner, T.C. Memo. 2013–196, at *7.

III. Analysis

Respondent's determinations are presumptively correct, and petitioner bears the burden of proving that those determinations are erroneous. See Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

Section 7623(b) provides: "If the Secretary proceeds with any administrative or judicial action * * * based on information brought to the Secretary's attention by an individual, such individual shall * * * receive as an award at least 15 percent but not more than 30 percent of the collected proceeds * * * resulting from the action (including any related actions) or from any settlement in response to such action." Section 301.7623–2, Proced. & Admin. **[*13]** Regs., [8] defines terms used in section 7623(b) and the regulations interpreting it. The IRS "proceeds based on information provided by a whistleblower" when, for example, "the IRS initiates a new action, expands the scope of an ongoing action, or continues to pursue an ongoing action, that the IRS would not have initiated, expanded the scope of, or continued to pursue, but for the information provided." Sec. 301.7623–2(b), Proced. & Admin. Regs.

[4] In sum, petitioner's entitlement to an award turns on two issues: first, whether there was a collection of proceeds; and, second, whether that collection was attributable to the IRS' proceeding with administrative or judicial action on the basis of petitioner's information. See Whistleblower One 10683–13W v. Commissioner, 145 T.C. 204, 206 (2015).

A. Collection of Proceeds

Whether there was a collection of proceeds from the taxpayers is not in serious dispute. The parties stipulated that the IRS' adjustment of taxpayer husband and taxpayer wife's tax liabilities for 2003 through 2008 resulted in the **[*14]** assessment of over $2 million in tax, penalties, and interest. Furthermore, in their closing agreement, taxpayer wife and taxpayer husband's estate agreed to pay, and the IRS agreed to accept, a title 26 miscellaneous penalty for the 2007 tax year "in lieu of any other penalties that the * * * [IRS] may impose with respect to the offshore financial arrangements that were the subject of the voluntary disclosure". Respondent has not claimed that the taxpayers failed to pay these sums. We therefore find that there was a collection of proceeds from the taxpayers.

B. Administrative or Judicial Action

***5** **[5]** Next we must decide whether the collection of the above proceeds was attributable to the IRS' proceeding with administrative or judicial action on the basis of petitioner's information. Our inquiry here turns on whether petitioner's information had any effect on the IRS' examination of the taxpayers' returns.

The record shows that, on three separate occasions, the Whistleblower Office forwarded petitioner's information to other operating divisions of the IRS for further investigation: first, to LB & I in February 2009; then, to

SB/SE in September 2010; and finally, to E & G in August 2013. We address each referral in turn.

[*15] 1. LB & I Referral (February 2009)

With respect to the LB & I referral, a representative of that division reviewed petitioner's information and decided not to examine the taxpayers' returns. Nothing in the record indicates that LB & I later changed course. Because LB & I did not proceed with administrative or judicial action against the taxpayers, petitioner is not entitled to an award on the basis of this referral. See Cooper v. Commissioner (Cooper II), 136 T.C. 597, 601 (2011) ("[W]histleblower awards are preconditioned on the Secretary's proceeding with an administrative or judicial action.").

2. SB/SE Referral (September 2010)

Unlike LB & I, SB/SE opted to examine the taxpayers' returns. The parties disagree about whether petitioner's information prompted and/or facilitated the examination. Under respondent's theory of the case, the taxpayers' voluntary disclosure was the sole cause of the examination and resulting adjustments. Respondent contends that there is no evidence that RA George or anyone else at SB/SE used petitioner's information during the examination.

Conversely, petitioner argues that his information prompted the examination of the taxpayers' returns and the adjustments that followed. Under petitioner's theory of the case, the IRS had received his information about the taxpayers' **[*16]** undisclosed bank accounts before it accepted their voluntary disclosure. By admitting the taxpayers into the OVDP when it was already on notice of the their noncompliance, the IRS disregarded its own rules and procedures.[9] Such disregard, petitioner argues, is evidence that the IRS shepherded the taxpayers into the OVDP in order to avoid paying him an award.[10] Petitioner cites respondent's apparent refusal to provide him with documents concerning the taxpayers' acceptance into the OVDP as evidence of this scheme.

On the basis of the record before us, we disagree with petitioner. In a written statement to the Whistleblower Office, RA George stated that there was no evidence in his case file that petitioner's information had prompted the examination. RA George also confirmed to Mr. Chatham that he did not use petitioner's information during his examination of the taxpayers' voluntary disclosure submission. There is nothing in the record that shows or even suggests otherwise. Also absent from the record is any evidence of a causal connection **[*17]** between petitioner's whistleblower submission and the taxpayers' decision to come forward to the IRS.[11]

***6** **[6]** Furthermore, the IRS' purported disregard of its own rules in accepting the taxpayers' voluntary disclosure does not support the inference that the IRS used the OVDP as a cover for denying petitioner an award. For one, the rule petitioner primarily relies on is found in the Internal Revenue Manual (IRM). See supra note 9. It is a well-settled principle that the IRM does not have the force of law and is not binding on the IRS. McGaughy v. Commissioner, T.C. Memo. 2010–183, slip op. at 17; see United States v. Caceres, 440 U.S. 741 (1979); Fargo v. Commissioner, 447 F.3d 706, 713 (9th Cir. 2006), aff'g T.C. Memo. 2004–13. Second, Congress explicitly authorized the IRS to enter into closing agreements like the one it reached with the taxpayers. See sec. 7121 (authorizing the IRS to enter into a written closing agreement "with any person relating to the liability of such person * * * in respect of any internal revenue tax for any taxable period"). Such agreements "may be used for procedural economy, or to prevent a dispute from arising." United States v. Nat'l Steel Corp., 75 F.3d 1146, 1151 (7th Cir. **[*18]** 1996). We cannot conclude that the exercise of this authority, absent proof of any actual wrongdoing, is evidence of a scheme to deprive petitioner of an award.

Nor can we conclude that respondent's apparent refusal to provide petitioner with certain documents evidences such a scheme. If a party is troubled by another party's response to a discovery request, Rule 72(b)(2) permits the requesting party to file an appropriate motion with the Court. See Whistleblower One 10683–13W v. Commissioner, 145 T.C. at 207 (granting a whistleblower's motion to compel the production of documents and responses to interrogatories). Having proceeded to trial without taking this step, petitioner cannot cite the failure to produce documents as grounds for requesting a negative inference against respondent. Accordingly, petitioner is not entitled to an award on the basis of the referral to SB/SE.

3. E & G Referral (August 2013)

In a written submission to the Whistleblower Office, an E & G examiner stated that petitioner's information "has nothing to do with * * * [taxpayer husband's estates's] estate tax return, only income tax issues" and that "[t]his estate tax return should never have been classified as a whistleblower case." There is no evidence that E & G later changed course. Because E & G did not **[*19]** initiate, expand the scope of, or continue to pursue its examination of taxpayer husband's estate's estate tax return on account of petitioner's information, petitioner is not entitled to an award on the basis of this referral.

IV. Conclusion

Because the administrative action taken by the IRS against the taxpayers was not based on his information, petitioner is not entitled to a whistleblower award. Accordingly, we sustain respondent's determination.

The Court has considered all of the arguments made by the parties, and to the extent they are not addressed herein, they are considered irrelevant, moot, or without merit.

To reflect the foregoing,

Decision will be entered for respondent.

All Citations

T.C. Memo. 2017-108, 2017 WL 2492008, 113 T.C.M. (CCH) 1485, T.C.M. (RIA) 2017-108, 2017 RIA TC Memo 2017-108

Footnotes

[1] All section references are to the Internal Revenue Code in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] In an internal memorandum Ms. Burcham stated: "The entire casefile [sic] was received in the * * * [Whistleblower Office] a considerable time after the signing of * * * [Mr. Hymes' written statement]."

[3] The IRS Criminal Investigation Division (CID) maintains a longstanding practice of voluntary disclosure whereby taxpayers can generally avoid criminal prosecution by disclosing their tax noncompliance to CID timely and completely. See Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014, Q & A–3. In March 2009 the IRS launched the offshore voluntary disclosure program (OVDP), a "counterpart" to this practice under which taxpayers who timely disclosed their ownership of unreported foreign bank accounts were eligible for reduced monetary penalties. See id. The extended deadline for participating in the 2009 OVDP was October 15, 2009. Id. A second OVDP (called the "Offshore Voluntary Disclosure Initiative") was initiated on February 8, 2011, and ran until September 9, 2011. Id. A third, open-ended OVDP began in 2012. Id. Q & A–1. There was no OVDP in effect during 2010.

[4] See supra note 3.

[5] Taxpayer wife died in July 2014.

[6] The IRS may determine a lower percentage award if the whistleblower's information is derived from publicly disclosed allegations (unless such information "was originally provided by" the whistleblower) or if the whistleblower planned and initiated the activities leading to the underpayment of tax. Sec. 7623(b)(2) and (3). The IRS is directed to deny an award altogether if the whistleblower is convicted criminally for planning and initiating such activities. See sec. 7623(b)(3).

[7] At trial we heard testimony from petitioner and Mr. Chatham. Neither party argued that we could not consider this testimony because it was outside the administrative record. Nor did the parties attempt to introduce other evidence outside the administrative record. Accordingly, we need not decide whether our scope of review is limited to the administrative record.

[8] Pursuant to sec. 301.7623–2(f), Proced. & Admin. Regs., the section is effective on August 12, 2014, and applies to information submitted on or after that date and to claims for awards that are open on that date. Respondent concedes that the regulations are not controlling here because the petition was filed before the effective date of the regulations. Nevertheless, we find the above-quoted wording instructive. We express no opinion on the validity of other wording in sec. 301.7623–2(b), Proced. & Admin. Regs., or its applicability in other contexts.

[9] Internal Revenue Manual (IRM) pt. 9.5.11.9(3) (Dec. 2, 2009) states that a voluntary disclosure must be timely. A voluntary disclosure is timely if received before the IRS "has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer's noncompliance." Id. pt. 9.5.11.9(4)(b).

[10] Petitioner also argues that the taxpayers were ineligible for the OVDP because they submitted their voluntary disclosure after the extended deadline for the 2009 OVDP and before the start of the 2011 OVDP.

[11] Accordingly, we need not decide whether the IRS “proceeds with administrative or judicial action” based on a whistleblower's information when: (1) the IRS examines a taxpayer's return in connection with a voluntary disclosure and (2) the disclosure was prompted by the taxpayer's discovery that an informant had named him or her in a whistleblower submission.

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234 F.Supp.3d 115
United States District Court,
District of Columbia.

UNITED STATES of America, Plaintiff,
v.
ALL ASSETS HELD AT BANK JULIUS,
Baer & Company, Ltd., Guernsey Branch,
account number 121128, in the Name of
Pavlo Lazarenko et al., Defendants In Rem.

Civil Action No. 04–0798 (PLF)
|
Signed 01/17/2017

Synopsis

Background: Government brought civil forfeiture action against assets in various foreign bank accounts of claimant, who was former prominent Ukranian politician, alleging that the assets were traceable or otherwise related to criminal activity that occurred at least in part in the United States. The District Court, G. Michael Harvey, United States Magistrate Judge, 142 F.Supp.3d 37, granted in part and denied in part government's motion to compel claimant to produce certain financial documents, including tax records. Claimant filed objections.

Holdings: The District Court, Paul L. Friedman, J., held that:

[1] claimant's tax and other financial records from time period after claimant was prominent Ukranian politician were relevant to issue of standing, and thus, were subject to discovery;

[2] claimant's tax and other financial records from 1999 were relevant to issue of forfeitability in addition to issue of standing, and thus, were subject to discovery; and

[3] any public policy concern with respect to disclosure of tax records did not overcome government's compelling need for claimant's tax records, so as to require production of such documents during discovery.

Affirmed.

Attorneys and Law Firms

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Bryant Everett Gardner, Winston & Strawn LLP, Washington, DC, Doron Weinberg, Weinberg & Wilder, San Francisco, CA, for Defendants.

MEMORANDUM OPINION AND ORDER

PAUL L. FRIEDMAN, United States District Judge

On November 3, 2015, Magistrate Judge G. Michael Harvey issued a Memorandum Opinion and Order granting in part and denying in part the United States' motion to compel Claimant Pavel Lazarenko to produce certain financial documents, including tax records, in connection with this in rem proceeding. See United States v. All Assets Held at Bank Julius Baer & Co., Ltd., 142 F.Supp.3d 37 (D.D.C. 2015) ("All Assets VII"). Claimant Lazarenko filed Objections to Magistrate Judge Harvey's Memorandum Opinion and Order on November 24, 2015. See Dkt. 504. Upon consideration of the parties' papers, the relevant legal authorities, and the entire record in this case, the Court concludes that Magistrate Judge Harvey's decision was not clearly erroneous or contrary to law, and accordingly affirms the decision. [1]

I. FACTUAL AND PROCEDURAL BACKGROUND

This is a civil in rem action in which the United States seeks forfeiture of over $250 million dollars scattered throughout bank accounts located in Antigua, Barbuda, Guernsey, Liechtenstein, Lithuania, and Switzerland. See Am. Compl. ¶ 1. This Court's prior opinions summarize the procedural history of this case, starting with the criminal prosecution of Lazarenko, and continuing through this civil forfeiture proceeding. See, e.g., United States v. All Assets Held at Bank Julius Baer & Co., Ltd., 571 F.Supp.2d 1, 3–6 (D.D.C. 2008); United States v. All Assets Held at Bank Julius Baer & Co., Ltd., 959

F.Supp.2d 81, 84–94 (D.D.C. 2013) ("All Assets V"); United States v. All Assets Held at Bank Julius Baer & Co., Ltd., 307 F.R.D. 249, 250–51 (D.D.C. 2014). In brief, Lazarenko is "a prominent Ukrainian politician who, with the aid of various associates, was 'able to acquire hundreds of millions of United States dollars through a variety of acts of fraud, extortion, bribery, misappropriation ***118** and/or embezzlement' committed during the 1990s." All Assets V, 959 F.Supp.2d at 85 (quoting Am. Compl. ¶¶ 1, 10).

As relevant to Lazarenko's present objections, the United States during discovery submitted requests for production of financial and tax records relating to Lazarenko's asserted interest in the in rem assets. Mot. at 7. At issue here are request Nos. 28 and 29, which read as follows:

> 28. Produce all documents and communications relating to personal income tax returns, business tax returns, and Reports of Foreign Bank and Financial Accounts (FBARs) filed with or submitted to the United States Government or any State of the United States of America by or on your behalf or any legal entity in which you claim an interest for the years 1992 to date.
>
> 29. Produce all documents and communications submitted to the Government of the United States of America, any State of the United States of America or any other foreign or domestic government office concerning your income or assets, including but not limited to any financial disclosure documents, tax returns, or other statements of income you have submitted to any government between January 1, 1992 and the present.

Mot. at 7.

Lazarenko responded by generally objecting to "any and all Document Requests to the extent that they are overly broad, seek information that is irrelevant, will be inadmissible at trial, are unduly burdensome, or are not reasonably calculated to lead to the discovery of admissible evidence." Opp. at 2. He also made the specific objections that his tax records were privileged under the confidentiality provisions of 26 U.S.C. § 6103, and that he did not possess any foreign bank account records. Id. The parties could not resolve the discovery dispute and the United States moved to compel. Lazarenko opposed the motion, arguing that the requested tax and financial records are not discoverable because: (1) he does not have tax and other financial records from 1992 to 1999; and (2) such records from 2000 to the present are not relevant. Opp. at 3.

Magistrate Judge Harvey found that Lazarenko's tax and other financial records from 1992 to 1999 records are relevant to both forfeitability and Lazarenko's standing, and thus discoverable. All Assets VII, 142 F.Supp.3d at 42–43. He concluded that those records are relevant to forfeitability because they might establish: "(1) whether Claimant's income during the period matches the quantum of assets he claims here; (2) whether Claimant can prove that his income sources were legitimate; and (3) whether Claimant failed to file tax returns at all, a fact which may support forfeiture of the defendant assets." Id. (internal citations omitted). Magistrate Judge Harvey also found that Lazarenko's records from 2000 to the present day are relevant only to Lazarenko's standing. Id. at 44. While there may already be evidence in the record demonstrating Lazarenko's "interest" in the in rem assets in this case, Magistrate Judge Harvey explained that "the broad scope of discovery embodied in Rule 26" of the Federal Rules of Civil Procedure permits the government "to take further discovery on this issue to contest [Lazarenko's] evidence" concerning his interest. Id.[2] Accordingly, Magistrate ***119** Judge Harvey granted Lazarenko's motion in part and denied it in part. Lazarenko subsequently filed the Objections currently before the Court.

II. STANDARD OF REVIEW

[1] **[2]** **[3]** **[4]** **[5]** A party may seek review of a magistrate judge's decision in a discovery dispute by filing an objection pursuant to Rule 72 of the Federal Rules of Civil Procedure. A magistrate judge's determination in a non-dispositive matter such as a discovery dispute is entitled to "great deference," and the Court will set it aside only if it is "clearly erroneous or contrary to law." FED. R. CIV. P 72(a); see also LOC. CIV. R. 72.2(c); Beale v. District of Columbia, 545 F.Supp.2d 8, 13 (D.D.C. 2008). The district court reviews objections to the magistrate judge's factual findings or discretionary decisions for clear error. American Center for Civil Justice v. Ambush, 794 F.Supp.2d 123, 129 (D.D.C. 2011). Under this standard, the Court will affirm the magistrate judge's factual findings or discretionary decisions unless the court "is left with the definite and firm conviction that a mistake has been committed." Neuder v. Batelle Pacific Northwest Nat. Laboratory, 194 F.R.D. 289, 292 (D.D.C. 2000) (quoting United States v. U.S. Gypsum Co., 333 U.S. 364, 365, 68 S.Ct. 525, 92 L.Ed. 746 (1948)). By contrast, the "contrary to law" standard requires the Court to review the magistrate judge's legal conclusions de novo. American Center for Civil Justice v. Ambush, 794 F.Supp.2d at 129.

III. DISCUSSION

The Court concludes that Magistrate Judge Harvey correctly articulated the applicable legal principles and that his decision was not clearly erroneous. As an initial matter, Lazarenko does not object to Magistrate Judge Harvey's decisions that (1) none of Lazarenko's tax and financial records were privileged, and (2) those records from 1992 to 1999 are relevant to the issues of forfeitability and standing, and thus discoverable. Nor does he object to Magistrate Judge Harvey's decision respecting his Pretrial Services records and Presentence Investigation Report from his criminal case.

Lazarenko's first objection is that Magistrate Judge Harvey erred in compelling production of his tax and other financial records from 2000 to present day because (1) his standing (and, particularly, his "ownership") is not in dispute, Obj. at 9, and (2) "public policy concerns strongly counsel against production" of tax records. Id. at 11–12. He claims that "the government's arguments would necessitate a series of fact-intensive mini-trials on this threshold issue of standing in every civil forfeiture case." Id. at 1–2. In support, Lazarenko cites the complaint, the testimony of government agents, and the testimony of non-government witnesses to show that he has sufficiently established standing based on undisputed facts. Id. at 7–8. Lazarenko's second objection is that Magistrate Judge Harvey erred in grouping Lazarenko's 1999 tax return with tax years 1992 to 1998 instead of with tax years 2000 to the present, because Lazarenko was not a public official in 1999. Id. at 11.

A. Records from 2000 to Present Day

[6] "Civil forfeiture actions are governed by the procedures set forth in 18 U.S.C. § 983 and the Supplemental Rules for Admiralty or Maritime Claims and Asset Forfeiture Actions ('Supplemental Rules'), a subset of the Federal Rules of Civil Procedure." All Assets V, 959 F.Supp.2d at 91. When contesting the forfeiture ***120** of assets in an in rem proceeding, the Supplemental Rules dictate that a claimant must "assert [ ] an interest" in "specific property" that is named as a defendant. SUPP. R. G(5)(a)(i)(A); see 18 U.S.C. § 983(a)(4)(A) ("[A]ny person claiming an interest in the seized property may file a claim asserting such person's interest in the property [.]"). The Supplemental Rules clarify that such an "interest" includes "actual possession, control, title, or financial stake." All Assets V, 959 F.Supp.2d at 95. "The Court has previously explained that in order to assert such an 'interest,' a claimant must demonstrate Article III standing in addition to the separate, though partly overlapping, requirements of statutory standing." United States v. All Assets Held at Bank Julius, Baer & Co., Ltd., 228 F.Supp.3d 118, 122, 2017 WL 65554, at *2 (D.D.C. Jan. 6, 2017) (internal quotation marks omitted).

[7] There is little doubt that Lazarenko's tax or other financial records from 2000 to the present day may contain relevant evidence about Lazarenko's interest, or lack thereof, in the in rem assets. The scope of a discovery request under Rule 26 of the Federal Rules of Civil Procedure is quite broad, requiring only that the party's request be reasonably calculated to lead to the discovery of admissible evidence. See Food Lion v. United Food & Commercial Workers Int'l Union, 103 F.3d 1007, 1012 (D.C. Cir. 1997). Magistrate Judge Harvey therefore did not clearly err when he found Lazarenko's tax or other financial records from 2000 to the present day to be relevant, discoverable evidence on the issue of standing, and granted the United States' motion to compel Lazarenko to produce them.

B. Records from 1999

Lazarenko further objects that his tax and other financial records from 1999 should be included in the group of records from 2000 to the present day and not 1992 to 1998 because Lazarenko's tenure as a public official in Ukraine ended in 1998. Obj. at 11. This is important because Magistrate Judge Harvey found records from 1992 to 1999 relevant to both forfeitability and standing, but found records from 2000 to the present day relevant only to standing. All Assets VII, 142 F.Supp.3d at 42–43.

[8] The Court finds that Magistrate Judge Harvey did not clearly err in determining that Lazarenko's tax and other financial records from 1999 are relevant to forfeitability. The United States in its amended complaint alleges that events related to Lazarenko's criminal activities took place in 1999, such as transporting the proceeds of his criminal activities into United States financial institutions, see Am. Compl. ¶¶ 12–13 [Dkt. 20], and concealing proceeds from illegal activities, id. ¶¶ 55–56. The United States in its amended complaint also identifies several specific financial transactions that took place in 1999. Id. ¶¶ 92, 100, 111–13. These allegations support a finding that Lazarenko's 1999 tax and financial records may include information relevant to forfeitability.

C. Public Policy Concerns

[9] **[10]** "In order to determine whether disclosure" of tax records "is appropriate, the court must conclude (1) that the returns are relevant to the subject matter of the action; and (2) that there is a compelling need for the returns because the information contained therein is not readily [or] otherwise obtainable." Robinson v. Duncan, 255 F.R.D. 300, 302 (D.D.C. 2009) (internal quotation marks omitted). The Court has already determined that Lazarenko's tax records are relevant. See supra at 119–20. Lazarenko does not argue here that his tax and financial records are privileged, ***121** but instead argues that "public policy concerns strongly counsel against the production of Mr. Lazarenko's post–1999 tax records." Obj. at 11. At base, Lazarenko's argument is that "there is no compelling need to produce these [tax] records because standing is not in dispute." Id. at 12.

Magistrate Judge Harvey correctly observed that 26 U.S.C. § 6103 prevents the Internal Revenue Service "from disclosing any records to the government directly." All Assets VII, 142 F.Supp.3d at 47. As such, ordering Lazarenko to disclose his tax records to the United States is the only way for the United States to discover "thorough" and "detailed information ... regarding the nature, source, and amount of any income [Lazarenko] received from the defendant in rem assets." Id. The Court also notes that the protective order in this case, see Dkt. 393, mitigates Lazarenko's confidentiality concerns. See, e.g., Stokwitz v. United States, 831 F.2d 893, 897 (9th Cir. 1987) ("The confidentiality of tax information may also be preserved in civil proceedings through protective orders."); In re Heritage Bond Litigation, 2004 WL 1970058, *5 n.12 (C.D. Cal.) ("Any privacy concerns [the parties] have in their bank records and related financial statements are adequately protected by the protective order, and are not sufficient to prevent production in this matter."); CEH, Inc. v. FV "Seafarer", 153 F.R.D. 491, 499 (D.R.I. 1994) ("While a party does have an interest in nondisclosure and confidentiality of its financial records, this interest can be adequately protected by a protective order."). The Court therefore finds that Magistrate Judge Harvey did not clearly err in finding that the United States has a compelling need for Lazarenko's tax records, and that Lazarenko therefore must produce them.

IV. CONCLUSION

For the foregoing reasons, it is hereby

ORDERED that claimant Pavel Lazarenko's objections [Dkt. 504] are OVERRULED; it is

FURTHER ORDERED that the Court AFFIRMS Magistrate Judge Harvey's Memorandum Opinion [Dkt. 490] and Order [Dkt. 491]; and it is

FURTHER ORDERED that claimant Pavel Lazarenko respond on or before February 20, 2017, to the United States Requests for Production Nos. 28 and 29 with: (1) all relevant records from 1992 to 1999 within his control, including any tax records Lazarenko can obtain from the United States and Ukraine filed by or on Lazarenko's behalf or on behalf of any legal entity in which Lazarenko has an interest; and (2) all records from 2000 to present within his control, including any tax records Lazarenko can obtain from the United States and Ukraine filed by or on Lazarenko's behalf or on behalf of any legal entity in which Lazarenko has an interest, which evidence an interest in, reflect income from, reflect income traceable to, or mention the defendant in rem assets.

SO ORDERED.

All Citations

234 F.Supp.3d 115

Footnotes

[1] The documents reviewed by the Court in resolving the pending motion include the following: United States' motion to compel production of records ("Mot.") [Dkt. 429]; claimant Pavel Lazarenko's opposition to plaintiff's motion to compel ("Opp.") [Dkt. 447]; United States' reply in support of its motion to compel ("Reply") [Dkt. 454]; Lazarenko's objection to the magistrate judge's order on plaintiff's motion to compel production of tax records from 1999 to the present ("Obj.") [Dkt. 504]; United States' response to Lazarenko's objection to the magistrate judge's order on plaintiff's motion to compel Lazarenko's production of records ("Response") [Dkt. 549]; and Lazarenko's reply in further support of his objection ("Reply") [Dkt. 565].

[2] Magistrate Judge Harvey held that none of Lazarenko's tax and financial records were privileged. All Assets VII, 142 F.Supp.3d at 44–48. Nonetheless, he also held that 18 U.S.C. § 3153 and the local rules of the United States District Court for the Northern District of California prevented him from issuing an order compelling Lazarenko to produce his Pretrial Services records and Presentence Investigation Report from his criminal case. Id. at 48–49. Lazarenko does not object to either of these holdings.

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United States of America
v.
Dmitrij Harder

Crim. No. 15-1
|
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ORDER

Paul S. Diamond, District Judge

***1** The grand jury has charged Defendant Dmitrij Harder with conspiracy to violate the Foreign Corrupt Practices and Travel Acts, substantive violations of the FCPA and Travel Act, conspiracy to commit international money laundering, substantive violations of the international money laundering statute, and aiding and abetting. (Doc. No. 1, Cts. 1-14); 18 U.S.C. § 371; 15 U.S.C. § 78dd-2; 18 U.S.C. § 1952; 18 U.S.C. § 1956(h), (a)(2)(A); 18 U.S.C. § 2. On December 15, 2015, the grand jury returned a Superseding Indictment with the same counts and several wording changes. (Doc. No. 62.)

The Government alleges that from 2007 to 2009, Defendant conspired to pay and conceal some $3.5 million in bribes to Tatjana Sanderson, the sister of European Bank of Reconstruction and Development officer Andrej Ryjenko. These payments, which Defendant funneled through Chestnut Consulting Group (his company), were intended to obtain EBRD business and favorable EBRD treatment for two of Defendant's Russian clients: Irkustsk Oil and Gas Company and Vostok Energy.

On October 16, 2015, Defendant filed a Motion to Suppress statements he made to the authorities after he flew into New York's Kennedy Airport from overseas. (Doc. No. 38.) On December 10, 2015, I conducted a suppression hearing. (Doc. No. 74.)

On March 1, 2016, Defendant filed a second Motion to Suppress, this time asking me to exclude from trial emails obtained from Google and 1&1 pursuant to October 15, 2010 search warrants. (Doc. No. 79.) The Government has responded. (Doc. No. 102.) I held a suppression hearing on March 21, 2016. (Doc. No. 116, Suppress. Hr'g Tr.) On March 29, 2016, Defendant submitted a Supplement in Support of his Motion, which included a Declaration from Stephanie C. Chomentowski, an attorney for Defendant. (Doc. No. 118, Ex. A.)

At the conclusion of the March 21 hearing, I announced that I would deny the Defendant's Motion respecting his statements at JFK and issue findings and conclusions. See Fed. R. Crim. P. 12(d). Those issued on April 15, 2016. (Doc No. 123.) At this same hearing, I also announced my tentative decision to deny the instant Email Suppression Motion, subject to reviewing Defendant's supplemental submission. Having reviewed the submission, I will deny Defendant's Motion.

I. Factual Findings

During the March 21 hearing, the Government called FBI Special Agent Vickie Humphreys, whose testimony I credit. I find that the Government has proven the following facts by a preponderance of the evidence. Fed. R. Crim. P. 12(d); United States v. Lowe, 791 F.3d 424, 432 n.4 (3d Cir. 2015).

In October 2010, in connection with its investigation of Defendant, the Government prepared search warrants directed at two internet service providers—Google and 1&1 Internet— pursuant to the Stored Communications Act (enacted as Title II of the Electronic Communications Privacy Act). See 18 U.S.C. § 2703(a)-(c); (Doc. No. 116, Suppress. Hr'g Tr. at 8-9.). FBI Special Agent Stephen R. Gray signed the supporting affidavits, relying on, *inter alia*, witness statements, bank records, emails, and related documents to make out probable cause. Gray also relied on information obtained from the FBI's February

2010 interview of Defendant at JFK Airport (during which it learned Defendant's company email account: dharder@chestnut-consulting.com).

***2** On October 15, 2010, then Magistrate Judge Restrepo approved the two search warrant applications. (Tr. at 8.) Additionally, on the Government's Motion, Judge Restrepo sealed the supporting affidavits. Each warrant also had an "Attachment A," listing "Property to Be Searched." Attachment A to the Google Warrant listed the "Property to Be Searched" as information associated with the email accounts dmitrij.harder@gmail.com (Defendant's email address) and aryjenko@gmail.com (Ryjenko's email address). (Doc. No. 79 at Ex. A, Attach. A.) Attachment A to the 1&1 warrant listed the "Property to Be Searched" as information associated with Defendant's company email account dharder@chestnut-consulting.com. (Id. at Ex. B, Attach. A.)

Each warrant also had an "Attachment B," listing "Items to be Seized." Attachment B provided that any seized item "constitute[ ] fruits, evidence and instrumentalities of violations of 15 U.S.C. § 78dd-1 et seq. (Foreign Corrupt Practices Act), 18 U.S.C. § 1343 (Wire Fraud), 18 U.S.C. § 1957 (Money Laundering), 18 U.S.C. § 371 (Conspiracy), 18 U.S.C. § 1001 (False Statements), and 31 U.S.C. § 5314 (FBAR)," involving Dmitrij Harder, Andrey Ryjenko, Tatjana Sanderson (the Subjects) since February 1, 2007 ...." (Doc. No. 79, Exs. A, B, Attachs. B.) In Attachment B, the Government further limited the seizure to information pertaining to the following seven matters:

1) Communications between the Subjects;

2) Communications between the Subjects and employees of Chestnut Consulting Group, Inc. or Dmitrij Harder;

3) Communications between the Subjects and EBRD employees;

4) Communications between the Subjects and officers, employees, or agents of several enumerated Russian energy companies;

5) Communications between the Subjects and financial institutions at which the Subjects banked during the course of the scheme;

6) Communications relating to payments to or from the Subjects to facilitate the scheme; and

7) Records relating to who created, used, or communicated with the account or identifier, including records about their identities and whereabouts.

(Doc. No. 79, Exs. A, B, Attachs. B.)

Special Agent Humphreys served the Google warrant by fax on October 15, 2010 and served the 1&1 Warrant in person on October 18, 2010. (Tr. at 9.) Within some ten days of receipt, both companies had complied with the warrants and produced the entirety of the requested email accounts. (Id.) Defendant alleges that the Google emails spanned 2006 to 2010, and that 1&1 emails spanned 2007 to 2010. (Doc. No. 79 at 7.) The Google production included thirteen emails or attachments between Defendant and his counsel, Stephen Lacheen. (Id.; Doc. No. 118, Ex. A at 2.) It also included 631 emails between Defendant and his former attorney, Sergei Bespalov, of which Defendant alleges "approximately two dozen" constituted attorney client communications. (Id.) Although the Google production apparently also included four emails between Defendant and another former attorney, Dmitrij Filippov, Defendant does not claim privilege respecting these emails. Finally, the Google production included emails between Ryjenko and his counsel. (Doc. No. 79 at 7.) Taken together, the search warrants yielded some 11,919 records (emails and attachments). (Doc. No. 118-1, Decl. at 1.)

On October 28, 2010, the FBI shared the search warrant returns with the City of London Police, which was also investigating Ryjenko and Sanderson. (Doc. No. 102 at 4; Tr. at 9.) The FBI kept a copy of the search warrant returns but did not review them. (Tr. at 11.) Shortly after, a City of London Police detective informed the FBI that he had seen the header of an email containing potentially privileged information and then stopped reading. (Doc. No. 102 at 4, Tr. at 10.) In response, the Government instituted a segregation and filter process to ensure that its review of the seized documents conformed to the warrant's requirements and did not otherwise violate attorney-client privilege. (Doc. No. 102 at 4; Tr. at 9-10.)

***3** To further this objective, on December 14, 2010, the FBI submitted a request to a computer forensics laboratory to segregate potentially privileged emails. (Id.) The laboratory returned non-privileged emails to the FBI in February 2011. (Id.) Accordingly, the FBI Agents' subsequent (and only) review of the warrant returns was limited to non-privileged documents. (Tr. at 12-13.)

Once the FBI received the screened returns, Agent Humphreys conducted targeted searches for documents "between or among Mr. Harder, Mr. Ryjenko, and Ms. Sanderson and ... certain key points of the investigation where deals were being solidified, [and] payments were anticipated coming to Chestnut Consulting." (Tr. at 13.) The Government's review of the seized communications thus required it to "identify and seize the more limited set of documents that constitute evidence of crimes within the scope of Attachment B." (Doc. No. 102 at 12.) Additionally, Agent Humphreys limited her review to communications occurring after February 1, 2007. (Tr. at 13.) Once she completed her initial targeted review, Agent Humphreys did not again look at the documents. (Id. at 14.)

To date, the Government has produced all the search warrant returns to Defendant. (Id.) On September 14, 2015, Defendant's Counsel contacted both Google and 1&1 requesting information pertaining to their responses to the warrants, including a request for: 1) the physical location of seized data, and 2) an explanation for why they did not notify Defendant of the seizure. (Doc. No. 79, Ex. D.) Neither Google nor 1&1 responded.

Defendant now moves to suppress the documents the Government obtained from Google and 1&1. (Doc. No. 79.)

II. Legal Standard

The Government must show by a preponderance of the evidence the reasonableness of each individual act constituting a Fourth Amendment search and seizure. See United States v. Ritter, 416 F.3d 256, 261 (3d Cir. 2005).

A magistrate judge's initial probable cause determination is entitled to "great deference." Id.; United States v. Conley, 4 F.3d 1200, 1205 (3d Cir. 1993) ("[T]he duty of a reviewing court is simply to ensure that the magistrate had a substantial basis for ... conclud[ing] that probable cause existed.") (citing Illinois v. Gates, 393 U.S. 410, 419 (1969) (internal citations omitted)). Additionally, "the exclusionary rule does not necessarily apply every time a Fourth Amendment violation occurs." United States v. Wright, 625 Fed.Appx. 99, 102 (3d Cir. 2015). Rather, suppression is appropriate only where police behavior is "deliberate, reckless, or grossly negligent." Id.; see also Herring v. United States, 555 U.S. 135, 140 (2009) ("[Suppression] has always been our last resort, not our first impulse.") (further citations omitted).

III. Conclusions of Law

Defendant argues that the search warrants were impermissibly overbroad, and that as a result, the Government seized information outside the warrant's scope, including privileged emails. Defendant also argues that the warrants were deficient because: 1) they lacked probable cause; 2) Judge Restrepo lacked authority to approve them; and 3) the Government failed to comply with notification requirements. I do not agree.

a. Scope and Overbreadth

A valid search warrant "must contain, either on its face or by attachment, a sufficiently particular description of what is to be seized." Bartholomew v. Pennsylvania, 221 F.3d 425, 429 (3d Cir. 2000). As it did here, the Government often shows particularity by attaching to the warrant the list of items to be seized. See United States v. Wright, 493 Fed.Appx. 265, 267 (3d Cir. 2012) ("It is common for applicants to fill in these sections by writing, "See ATTACHMENT A" or "See ATTACHMENT B." Attachment A is normally a description of the property to be searched, and Attachment B is normally a listing of the items to be searched for or seized."). The Third Circuit has acknowledged that during the execution of a sufficiently particular warrant, it is "certain that some innocuous documents will be examined, at least cursorily, in order to determine whether they are, in fact, among those papers authorized to be seized." United States v. Stabile, 633 F.3d 219, 234 (3d Cir. 2011) (citations omitted). As such, a cursory examination of non-responsive documents during the execution of a valid warrant does not violate the Fourth Amendment. Id.

***4** Here, in Attachment B to each warrant, the Government detailed precisely the items to be seized, including only those documents relating to, *inter alia*, the alleged EBRD bribery and money laundering schemes. The warrants further required that any seized emails involve the Subjects and pertain to seven enumerated categories. (Doc. No. 79, Exs. A & B, Attachs. B (identifying relevant communications and records.).) Both warrants also included a temporal limitation on the emails to be seized: from February 1, 2007 forward. These requirements more than suffice to identify the relevant period, constrain the reviewing agents' discretion, and limit the warrants' scope.

Defendant nonetheless argues that the warrants were deficient because they lacked "search protocols." He relies on a suggestion in a concurring Ninth Circuit opinion that warrant applications for electronic seizures include search protocols to prevent investigating agents from "examining or retaining any data other than that for which probable cause is shown." United States v. Comprehensive Drug Testing, Inc., 621 F.3d 1162, 1179 (9th Cir. 2010) (Kozinski, C.J., concurring). The en banc majority in Comprehensive Drug Testing did not impose such a requirement, however. Indeed, courts that have addressed the issue—including the Third Circuit—have not followed Judge Kozinski's suggestion. See, e.g., Stabile, 633 F.3d at 234 (permitting the seizure and subsequent off-site search of six hard drives pursuant to a search warrant lacking an ex ante search protocol); United States v. Brooks, 427 F.3d 1246, 1251 (10th Cir. 2005) (search warrant need not "contain a particularized computer search strategy"); United States v. McNamara-Harvey, No. CRIM.A. 10-219, 2010 WL 3928529, at *4 (E.D. Pa. Oct. 5, 2010) (rejecting Defendant's overbreadth argument based on Comprehensive Drug Testing); United States v. Bowen, 689 F. Supp. 2d 675, 681 (S.D.N.Y. 2010) ("[W]e join ... several other federal courts in holding that the Fourth Amendment does not require a search warrant to specify computer search methodology."), aff'd sub nom., United States v. Ingram, 490 Fed.Appx. 363 (2d Cir. 2012); United States v. Fumo, No. CRIM.A. 06-319, 2007 WL 3232112, at *6 (E.D. Pa. Oct. 30, 2007) ("[S]earch protocols and keywords do not mark the outer bounds of a lawful search; to the contrary, because of the nature of computer files, the government may legally open and briefly examine each file when searching a computer pursuant to a valid warrant."). Defendant's reliance on Comprehensive Drug Testing is thus unpersuasive.

Defendant next argues that the warrants were facially invalid because the Government did not provide the underlying sealed affidavits to Google or 1&1. (Doc. No. 102.) I disagree. The Government was not required to provide the sealed affidavits to Google and 1&1 because neither company was required to conduct a detailed search of the seized accounts. Rather, the Third Circuit and sister circuits have repeatedly upheld the two-step process the Government employed here for executing search warrants for electronically stored information.

In Stabile, for instance, the Third Circuit approved the Government's off-site search of six seized hard drives because the "practical realities of computer investigations preclude on-site searches." 633 F.3d at 234. The Stabile Court recognized that electronic-based searches—which are "time consuming and require trained forensic investigators"—necessarily cannot be "rushed by a cursory on-site search." Id. The Third Circuit thus found reasonable the Government's initial seizure of large amounts of potentially non-responsive data, followed by a subsequent off-site filtering and search of those data. Id. Plainly, the Stabile Court's approval of this two-step process applies not only to the seizure of physical electronics (e.g., computers and hard drives) but also to that of electronic data (e.g., email accounts); see also Fed. R. Crim. P. 41(e)(2)(B) (permitting a "later review of the media or information [including electronically stored information] consistent with the warrant").

***5** Because the seizure of electronic data necessarily requires two steps—the internet service provider produces all potentially responsive data, and an independent technician then segregates and reviews that data to ensure warrant compliance—any failure to provide Google and 1&1 with the underlying affidavits did not violate the Fourth Amendment. In these circumstances, providing the affidavits to the providers would have been pointless. See, e.g., United States v. Bach, 310 F.3d 1063, 1065-66 (8th Cir. 2002) ("According to Yahoo!, when executing warrants, technicians do not selectively choose or review the contents of the named account ... Yahoo!'s execution of the search warrant in this case did not violate [Defendant's] Fourth Amendment rights); United States v. Grimmett, 439 F.3d 1263, 1270 (10th Cir. 2006); United States v. Evers, 669 F.3d 645, 652 (6th Cir. 2012); United States v. Scully, 108 F. Supp. 3d 59, 95 (E.D.N.Y. 2015) ("[E]very case of which we are aware that has entertained a suppression motion relating to the search of an email account has upheld the Government's ability to obtain the entire contents of the email account to determine which particular emails come within the search warrant."); In the Matter of a Warrant for All Content & Other Info. Associated with the Email Account xxxxxxx gmail.com Maintained at Premises Controlled

By Google, Inc., 33 F. Supp. 3d 386, 395 (S.D.N.Y. 2014) ("Google Warrant") ("Not surprisingly, courts have routinely rejected arguments made in the course of suppression motions that a warrant should have required a third party to conduct searches of electronic information."). In sum, the warrants' execution was thus proper and reasonable.

Finally, relying on United States v. Ganias, Defendant argues that the Government's retention of all seized emails (privileged or otherwise) warrants suppression. 755 F.3d 125 (2d Cir. 2014); (Doc. No. 79 at 20-22). In Ganias, the Second Circuit held that the Government's seizure and retention for two and a half years of Defendant's personal records, which were plainly outside the warrant's scope, violated the Fourth Amendment when the Government used the warrant returns to develop probable cause in an unrelated investigation. Id. at 141.

Here, the circumstances are wholly dissimilar. Agent Humphreys testified that she has not re-reviewed the search warrant returns since her initial 2011 review. (Tr. at 14.) Rather, the Government has retained the returns for proper purposes including, *inter alia*, authentication. (Doc. No. 102 at 19); see, e.g., Scully, 108 F. Supp. 3d at 101 ("[T]he Government states that any such emails are being retained for authentication purposes only and will not be used in future criminal investigations. Accordingly, consistent with Ganias, suppression is not an appropriate remedy for the alleged improper retention."); see also Google Warrant, 33 F. Supp. 3d at 398 ("[W]e recognize that the Government has a need to retain materials as an investigation unfolds for the purpose of retrieving material that is authorized by the warrant"). Ganias thus provides no support for the result Defendant urges.

The warrants were thus sufficiently particular and were not overbroad. Accordingly, I will deny suppression on these grounds.

b. Privilege

Defendant argues that the Government's failure to provide the sealed affidavits to Google and 1&1 impermissibly resulted in the production of privileged information. Defendant thus requests a "hearing into who had access to the privileged communications" and the appointment of a special master for document review because "it appears that the FBI and not the DOJ reviewed" the purportedly tainted documents. (Doc. No. 79 at 19-20.) I will deny these requests, which appear intended to delay Defendant's trial needlessly.

Defendant apparently does not understand that the FBI is part of the Department of Justice. His suggestion that there was something improper about the FBI review of this material thus makes no sense. In any event, as I have discussed, the Government has adequately described its extensive efforts—including the establishment of an independent forensics filter team—to segregate potentially privileged information. (Doc. No. 102 at 4, n.1.) Moreover, Agent Humphreys testified credibly that no agent at the DOJ reviewed the search warrant returns before they were screened for potentially privileged communications. (Tr. at 12.) I am thus satisfied that the Government employed proper procedures to exclude emails that were privileged or otherwise outside the warrants' scope, including emails between Defendant and Mr. Lacheen or Mr. Filippov. See, e.g., In re Search of Elec. Commc'ns in the Account of chakafattah gmail.com at Internet Serv. Provider Google, Inc., 802 F.3d 516, 530 (3d Cir. 2015) (approving of a similar privilege review procedure).

***6** Nor has Defendant shown that he entitled to suppression based on the Government's purported review of privileged communications, including approximately "two dozen" emails between Defendant and his former attorney, Sergei Bespalov. (Doc. No. 118 at 2.) Although Defendant perfunctorily suggests that the Government *seized* voluminous privileged information, he has made no showing that the Government actually *reviewed* these communications, much less did so deliberately or in bad faith. (Doc. No. 118 at 2); cf. United States v. Voigt, 89 F.3d 1050, 1066 (3d Cir. 1996) (an intrusion into the attorney-client relationship, standing alone, is not per se prejudicial; a claim of outrageous government conduct premised on intrusion into attorney-client relationship is cognizable only if the defendant can show deliberate action causing actual and substantial prejudice); see also United States v. Trombetta, No. CR 13-227-01, 2015 WL 7289407, at *2 (W.D. Pa. Nov. 16, 2015). Quite to the contrary, Agent Humphreys credibly testified that she may have reviewed "one or two" emails between Defendant and Bespalov (which did not appear privileged), and that the Government went to great lengths to ensure proper segregation of potentially privileged material. (Tr. at 20.)

Assuming, *arguendo*, the Government viewed even a few privileged communications, this *de minimis* "intrusion" does not warrant the wholesale suppression of the approximately 11,919 records at issue. As Agent Humphreys explained, the Government subpoenaed Chestnut Consulting Group (Defendant's company), seeking documents respecting the EBRD investigation. (Id.) In response and without asserting privilege, Chestnut disclosed responsive emails between Defendant and Bespalov that Agent Humphreys also reviewed. (Tr. at 20); see Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d 1414, 1429 (3d Cir. 1991) (disclosures in response to DOJ subpoena waived attorney-client privilege). Moreover, Bespalov testified during the grand jury proceedings as to, *inter alia*, his communications with Defendant, and I anticipate that Bespalov will testify at trial. See In re Grand Jury Subpoena, 745 F.3d 681, 690 (3d Cir.) (upholding ruling requiring Bespalov to testify before the grand jury based on an application of the crime-fraud exception to attorney-client privilege), cert. denied sub nom., Corp. & Client v. United States, 135 S. Ct. 510 (2014); see In re Grand Jury Subpoena, No. 10-127, 2013 WL 228115 (E.D. Pa. Jan. 18, 2013). In these circumstances, it is apparent that the Government would have inevitably learned of any information it purportedly viewed in emails between Defendant and Bespalov, thus vitiating any prejudice to Defendant. Accordingly, the drastic remedy of suppression is not required. See, e.g., Voigt, 89 F.3d at 1066; United States v. Squillacote, 221 F.3d 542, 556-560 (4th Cir. 2000) ("Appellants complain only about the manner by which the government executed the warrant, a complaint that is inadequate to justify the severe remedy of blanket suppression ... [W]e do not believe that suppression of any evidence derived from the privileged conversations would be proper in this case, given that the privilege is a testimonial or evidentiary one, and not constitutionally-based.")

Finally, to the extent Defendant asks me to suppress any fruits of the Government's review of the privileged emails, I decline to do. See United States v. Marashi, 913 F.2d 724, 731 n.11 (9th Cir. 1990) ("[N]o court has ever applied the [fruit of the poisonous trees] theory to *any* evidentiary privilege and ... we have indicated we would not be the first to do so.") (emphasis in original); cf. Nickel v. Hannigan, 97 F.3d 403, 409 (10th Cir. 1996) (refusing to suppress fruits of a seized privileged communication); United States v. Lefkowitz, 618 F.2d 1313, 1318 n. 8 (9th Cir. 1980) ("Because we reject ... [Defendant's] argument that the marital privileges are somehow constitutionally grounded in, among other locations, the Fourth Amendment, we doubt that a secondary source of information obtained through information protected by the confidential marital communications privilege would in any way be 'tainted.' ").

***7** Defendant is thus not entitled to suppression on this ground.

c. Probable Cause

Defendant argues that the warrants lacked probable cause "in the first instance." (Doc. No. 79 at 1, 17.) Defendant also argues that the affidavits supporting the warrant applications were based on purportedly illegally obtained information, namely the alleged custodial interrogation of Defendant at JFK Airport. (Id. at 18.) Defendant thus requests a "taint hearing" to determine whether the Government relied on illegally obtained information in its search warrant applications. (Doc. No. 79 at 10, 18.) I will deny Defendant's request.

In his supporting affidavits, Agent Gray detailed extensive probable cause that Defendant participated in, *inter alia*, complex bribery and money laundering schemes. The affidavits relied on, *inter alia*: a whistleblower report that Defendant bribed Ryjenko; banking records reflecting bribes; contracts between Defendant and its clients for "success fees"; interviews suggesting that neither Defendant nor Sanderson provided the bona fide consulting services they claimed to have provided; and an EBRD report finding that Defendant bribed Ryjenko. Agent Gray's affidavits thus amply made out probable cause, even without considering Defendant's statements during the JFK interview.

In any event, Defendant's argument respecting the JFK interview mistakenly assumes that the interview was illegal. I have already rejected this argument. (Doc. No. 123.) Accordingly, because the Airport interview was proper, the Government did not improperly rely on it in establishing probable cause for the email search warrants.

Finally, assuming, *arguendo*, the Airport interview was improper under the Fifth Amendment, Defendant is still not entitled to suppression of its physical fruits. See United States v. Patane, 542 U.S. 630, 634 (2004) (plurality opinion) (a failure to provide Miranda warnings does not require suppression of the physical fruits of the suspect's unwarned but voluntary statements); see also United States v. Latz, 162 Fed.Appx. 113, 118 (3d Cir. 2005) (same); United States v. DeSumma, 272 F.3d 176, 180–81 (3d Cir. 2001) (same). Accordingly, even assuming*, arguendo*, the JFK interview was improper (which it was not), Defendant has still not shown that I must suppress the fruits of that interview.

d. The Magistrate Judge's Authority

Defendant argues that Judge Restrepo impermissibly issued warrants to be executed in another district. (Doc. No. 79 at 23-24.) Defendant argues that this violated Rule 41, requiring the Government to obtain search warrants in the district where the items will be seized. Fed. R. Crim. P. 41(b)(1) ("A magistrate judge with authority in the district ... has authority to issue a warrant to search for and seize a person or property located within the district."). I disagree.

Defendant ignores the SCA's plain language, authorizing a court to issue search warrants for electronic communications provided the issuing court has jurisdiction over the offense under investigation. 18 U.S.C. § 2703(a); see United States v. Noyes, No. 1:08-CR-55-SJM-1, 2010 WL 5139859, at *9 n.9 (W.D. Pa. Dec. 8, 2010). This Court certainly had jurisdiction over this offense based on Defendant's alleged criminal conduct in this District.

***8** Defendant also ignores extensive case law permitting out-of-district electronic search warrants pursuant to the SCA. See, e.g., United States v. Bansal, 663 F.3d 634, 662 (3d Cir. 2011) ("[Defendant] contends that Rule 41(b), which limits a Magistrate Judge's jurisdiction to the District in which he or she sits, trumps § 2703(a). We, along with other courts to consider the question, reject that contention."); United States v. Berkos, 543 F.3d 392, 398 (7th Cir. 2008) ("Rule 41(b) deals with substantive judicial authority—not procedure—and thus does not apply to § 2703(a)."); Scully, 108 F. Supp. 3d at 83 ("[Section] 2703(a) authorizes electronic search warrants by a federal magistrate judge that extend outside his or her district ... the plain terms of Section 2703, considered with Rule 41, dictate this result."). Rule 41 thus provides no ground for suppression.

e. Notification

Defendant argues that the Government failed to inform him that it had seized his emails and so violated Rule 41. (Doc. No. 79 at 22-23.) He further argues that because it did not obtain a court order pursuant to 18 U.S.C. § 2705, the Government impermissibly directed Google and 1&1 to withhold notification of the Government's seizure. Again, I disagree.

The Government is not required to inform a defendant when it seizes his emails pursuant to the SCA. See 18 U.S.C. § 2703 (law enforcement may require disclosure of electronic communications "without required notice to the subscriber or customer, if [it] obtains a warrant issued ... by a court of competent jurisdiction."); see also Bansal, 663 F.3d at 662-63 ("The plain text of Rule 41... requires notice only "to the person from whom, *or* from whose premises, the property was taken."). Indeed, the Third Circuit has explicitly rejected that notice is necessary when the Government provides the internet service provider with a copy of the warrant, as it did here. See id. ("Because [Defendant] does not deny that the warrant was provided to the internet service providers upon whom the search warrants were executed, we conclude that notice was properly made in this case."); see also In re U.S., 665 F. Supp. 2d 1210, 1221 (D. Or. 2009) ("In this third party context, the Fourth Amendment notice requirement is satisfied when a valid warrant is obtained and served on the holder of the property to be seized, the ISP.").

Defendant next argues without factual basis that because the Government failed to obtain a protective order barring Google and 1&1 from disclosing the seizures, it could not properly direct the providers to withhold notice of the seizures. Apart from supposition, Defendant has offered no evidence suggesting that the Government so instructed Google and 1&1. Indeed, the warrants do not mention any such instruction. Moreover, Agent Humphreys testified credibly that the FBI did not instruct either Google or 1&1 to withhold notice to Defendant. (Tr. at 9.) Defendant has thus not shown that the Government acted improperly concerning notification.

f. Standing

Finally, to the extent that Defendant seeks suppression of Ryjenko's emails, he lacks standing to do so. See United States v. Stearn, 597 F.3d 540, 551 (3d Cir. 2010) ("To invoke the Fourth Amendment's exclusionary rule, a defendant must demonstrate that his own Fourth

Amendment rights were violated by the challenged search or seizure." (citation omitted)). Defendant has not shown that he has a reasonable expectation of privacy in Ryjenko's emails. Accordingly, Defendant is not entitled to suppression of the Google production relating to aryjenko@gmail.com.

IV. Conclusion

The Government has shown that the Google and 1&1 warrants comported with the Fourth Amendment. Moreover, the Government's application for and execution of the warrants fully complied with the law governing electronic seizures. Accordingly, I will deny Defendant's Motion.

***9 AND NOW**, this 18th day of April, 2016, upon consideration of Defendant's Motion to Suppress (Doc. No. 79), the Government's Opposition (Doc. No. 102), and all related submissions, and after a suppression hearing, it is hereby **ORDERED** that Defendant's Motion to Suppress Emails Obtained from Google and 1&1 Internet is **DENIED**.

AND IT IS SO ORDERED.

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737 F.3d 330
United States Court of Appeals,
Fourth Circuit.

UNITED STATES of America, Plaintiff–Appellee,
v.
UNDER SEAL, Defendant–Appellant.

No. 13–4267.
|
Argued: Oct. 29, 2013.
|
Decided: Dec. 13, 2013.

Synopsis
Background: Taxpayers, who were targets of a grand jury investigation seeking to determine whether they used secret Swiss bank accounts to conceal assets and income from the Internal Revenue Service (IRS) and the Treasury Department, appealed order of the United States District Court for the Eastern District of Virginia, at Alexandria, Leonie M. Brinkema, J., holding them in civil contempt for refusing to comply with grand jury subpoenas requesting that they produce certain foreign bank account records that they were required to keep pursuant to Treasury Department regulations governing offshore banking.

[Holding:] The Court of Appeals, Agee, Circuit Judge, held that records required to be maintained under the Bank Secrecy Act (BSA) fell within the required records doctrine, and therefore were outside the scope of the Fifth Amendment privilege.

Affirmed.

Attorneys and Law Firms

***331** **ARGUED:** Caroline Rule, Kostelanetz & Fink, LLP, New York, NY, for Appellant. Elissa Hart–Mahan, United States Department of Justice, Washington, D.C., for Appellee. **ON BRIEF:** Robert Steven Fink, Juliet Leah Fink, Kostelanetz & Fink, LLP, New York, New York; David G. Barger, Greenberg Traurig, LLP, McLean, VA, for Appellant. Neil H. MacBride, United States Attorney, Office of the United States Attorney, Alexandria, VA; Kathryn Keneally, Assistant Attorney General, Frank P. Cihlar, Chief, Criminal Appeals & Tax Enforcement Policy Section, Gregory Victor Davis, Tax Division, United States Department of Justice, Washington, D.C., for Appellee.

Before KING, GREGORY, and AGEE, Circuit Judges.

Opinion

Affirmed by published opinion. Judge AGEE wrote the opinion, in which Judge KING and Judge GREGORY joined.

AGEE, Circuit Judge:

John and Jane Doe (the "Does") appeal the district court's order holding them in civil contempt for refusing to comply with grand jury subpoenas. The Does contend that the district court erred in finding that the required records doctrine overrode their Fifth Amendment privilege against self-incrimination and required production of certain foreign bank records. For the reasons that follow, we affirm the judgment of the district court.

***332** I.

The underlying facts in this case are undisputed. The Does are the targets of a grand jury investigation in the United States District Court for the Eastern District of Virginia seeking to determine whether they used secret Swiss bank accounts to conceal assets and income from the Internal Revenue Service ("IRS") and the Treasury Department. The grand jury received evidence that on June 2, 2008, John Doe opened an account at the Swiss investment bank Clariden Leu (now Credit Suisse AG) in the name of [Redacted Corporation]. He was the beneficial owner of the account, which was valued in excess of $2.3 million at the close of 2008. The account was managed by the Swiss firm Beck Verwaltungen AG. When John Doe closed this account in January 2009, he transferred $1.5 million to Beck Verwaltungen AG's account at a different Swiss private bank, Bank Sarasin.

On May 18, 2012, the Does were served grand jury subpoenas requesting that they produce certain foreign bank account records that they were required to keep pursuant to Treasury Department regulations governing offshore banking. The subpoenas demanded production of

> [a]ny and all records required to be maintained pursuant to 31 C.F.R. § 1010.420 (formerly 31 C.F.R. § 103.32) for the past five (5) years relating to foreign financial bank, securities, or other financial accounts in a foreign country for which you had/have a financial interest in, or signature or other authority over and are required by law to file a Report of Foreign Bank and Financial Account (FBAR). The records required to be maintained pursuant to 31 C.F.R. § 1010.420 (formerly 31 C.F.R. § 103.32) include records that contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period.

(J.A. 10.) The Does timely moved to quash the subpoenas, citing their Fifth Amendment privilege against self-incrimination. The Government opposed the motion, arguing that under the required records doctrine, the privilege does not apply to financial records that the Does were required by law to retain.

After hearing argument, the district court denied the Does' motion to quash, finding that the required records doctrine overrode their Fifth Amendment privilege against self-incrimination, and ordered them to comply with the subpoenas. The Does refused to comply, and pursuant to a stipulation by the parties, the district court held the Does in civil contempt. [1]

The Does now appeal, and we have jurisdiction pursuant to 28 U.S.C. § 1291.

II.

A.

[1] We review the district court's denial of a motion to quash a subpoena for an abuse of discretion. [2] *In re Grand Jury Subpoena: John Doe, No. 05GJ1318,* 584 F.3d 175, 182 (4th Cir.2009). But "[i]nsofar as the district court's determination was based upon interpretations of law, ... ***333** we review those conclusions de novo." *In re Grand Jury Subpoena (T–112),* 597 F.3d 189, 195 (4th Cir.2010).

B.

The Bank Secrecy Act (the "BSA" or the "Act"), 31 U.S.C. §§ 5311–25, regulates offshore banking and contains a number of recordkeeping and inspection provisions. Among the purposes of the BSA is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." 31 U.S.C. § 5311. Section 241(a) of the Act instructs the Treasury Secretary to "require a resident or citizen of the United States ... to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction ... with a foreign financial agency." *Id.* § 5314(a). In furtherance of that statutory directive, the Treasury Secretary implemented regulations that require (1) U.S. citizens and residents to disclose their foreign bank accounts, *see* 31 C.F.R. § 1010.350, and (2) that the records for such accounts "be retained by each person having a financial interest in or signature or other authority over any such account" for at least five years and be kept "at all times available for inspection as authorized by law," *id.* § 1010.420. These recordkeeping regulations were in effect at all times relevant to this case.

III.

The Fifth Amendment to the United States Constitution provides that "[n]o person ... shall be compelled in any criminal case to be a witness against himself." U.S. Const. amend. V. The Supreme Court has held that the privilege against self-incrimination bars the government from "compelling a person to give 'testimony' that incriminates him." *Fisher v. United States,* 425 U.S. 391, 409, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976). Because "the privilege protects a person only against being incriminated by his own compelled testimonial communications," the Court has determined that it does not shield production of private papers voluntarily prepared or prepared by a third party. *Id.* at 409, 96 S.Ct. 1569.

The Does contend that the required records doctrine—which, if it applies, renders the Fifth Amendment privilege inapplicable—does not apply here and that the district court erred in finding otherwise. Essentially, the Does argue that "[w]here documents are *required* to be kept and then produced, they are arguably compelled." *In re M.H.,* 648 F.3d 1067, 1071 (9th Cir.2011) (emphasis in original). The Supreme Court, however, has held that the privilege against self-incrimination does not bar the government from imposing recordkeeping and inspection requirements as part of a valid regulatory scheme. *See Shapiro v. United States,* 335 U.S. 1, 17, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948) (noting that the nature of documents and the capacity in which they are held may indicate that "the custodian has voluntarily assumed a duty which overrides his claim of privilege").

In *Shapiro,* the Court required a wholesaler of fruit and produce to turn over certain records he was obliged to keep and maintain for examination pursuant to the Emergency Price Control Act ("EPCA"), which was enacted during World War II to prevent inflation and price gouging. *Id.* at 4–11, 68 S.Ct. 1375. The Court determined that the EPCA represented a valid exercise of Congress' regulatory authority and that the recordkeeping provisions of the EPCA were essential to the administration of the statute's objectives. *Id.* at 31–32, 68 S.Ct. 1375. Further, the Court reasoned that this "required records doctrine" ***334** applies "not only to public documents in public offices, but also to records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation, and the enforcement of restrictions validly established." *Id.* at 17, 68 S.Ct. 1375 (emphasis omitted).

[2] The Court revisited its decision in *Shapiro* twenty years later in *Marchetti v. United States,* 390 U.S. 39, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968) and *Grosso v. United States,* 390 U.S. 62, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968). In holding that the required records doctrine was inapplicable to the circumstances before it in both cases, the Court articulated three requirements—derived from *Shapiro* 's holding—for determining the applicability of the required records doctrine. As summarized in *Grosso,* those requirements are: (1) the purposes of the United States' inquiry must be essentially regulatory; (2) information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept; and (3) the records themselves must have assumed public aspects which render them at least analogous to a public document. 390 U.S. at 67–68, 88 S.Ct. 709.

[3] This Court has recognized that the foregoing three principles announced in *Grosso* define the required records doctrine, *see, e.g., United States v. Webb,* 398 F.2d 553, 556 (4th Cir.1968) (recognizing required records doctrine in context of regulation of interstate trucking), but has yet to address the applicability of the doctrine in the context of foreign bank records. We do so now and join the consensus of the courts of appeals to have considered the issue that the required records doctrine applies in concluding that records required to be maintained under the BSA fall within the required records doctrine.[3] We further conclude that all three requirements of the doctrine are met in this case.

A.

In order to fall under the required records doctrine, the purpose of the recordkeeping must be "essentially regulatory." *Grosso,* 390 U.S. at 68, 88 S.Ct. 709. We have held that a recordkeeping requirement is "essentially regulatory" if it is "imposed in an essentially noncriminal and regulatory area of inquiry and [is] not directed to a selective group inherently suspect of criminal activity." *Webb,* 398 F.2d at 556 (internal quotation marks omitted).

The Does argue that, for several reasons, the BSA's recordkeeping provision is criminal in nature, rather than regulatory. They contend that unlike truly regulatory schemes, such as those that condition employment or licensure on the retention of certain records, the BSA's purpose is prosecutorial—i.e., to grant law enforcement access to otherwise unavailable evidence of foreign financial transactions. The Does cite language referring to criminal investigation as one of the BSA's aims in the statute's declaration of purpose, legislative history, and descriptions on the IRS website, to support their position that the BSA's recordkeeping requirements prohibitively operate in a criminal area of inquiry against those suspected of tax fraud. Implicit in the Does' argument is that because the BSA lists first among its purposes the gathering of information that has “a high degree of usefulness in criminal ***335** ... investigations,” 31 U.S.C. § 5311, the Act's chief purpose is to fight crime.

These same arguments failed to persuade the other appellate courts which have considered the issue, and do not persuade us either. *See, e.g., In re M.H.,* 648 F.3d at 1073–74 (noting and rejecting party's citations to language in the BSA and the IRS website); *In re Grand Jury Subpoena,* 696 F.3d at 434–35 (same).

The Supreme Court has observed that a statute which includes a criminal law purpose in addition to civil regulatory matters does not strip the statute of its status as “essentially regulatory.” *See Cal. Bankers Ass'n v. Shultz,* 416 U.S. 21, 77, 94 S.Ct. 1494, 39 L.Ed.2d 812 (1974) (“[T]hat a legislative enactment manifests a concern for the enforcement of the criminal law does not cast any generalized pall of constitutional suspicion over it.”). Notwithstanding their own argument, the Does acknowledge that the BSA has purposes unrelated to criminal investigation. The plain language of the BSA verifies its concomitant tax, regulatory, and counterterrorism purposes in addition to its law enforcement goals. *See* 31 U.S.C. § 5311 (requiring records to be kept “where they have a high degree of usefulness in criminal, *tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis,* to protect against international terrorism” (emphasis added)). Elaborating on the non-criminal purposes of the BSA, the relevant House Report acknowledges that the Act's recordkeeping and reporting requirements “aid duly constituted authorities in lawful investigations” but also underscores that the requirements “facilitate the supervision of financial institutions properly subject to federal supervision” and “provide for the collection of statistics necessary for the formulation of monetary and economic policy.” H.R.Rep. No. 91–975 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4405. Consequently, the Treasury Department shares the information it collects pursuant to the requirements of the BSA with other agencies—including the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of Thrift Supervision—none of which are empowered to bring criminal prosecutions. *See* 31 U.S.C. § 5319; 31 C.F.R. § 1010.950(a)(b).

Further, the Supreme Court has noted, in discussing “the recordkeeping and reporting requirements of the [BSA],” that “Congress seems to have been equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported.” *Shultz,* 416 U.S. at 76, 94 S.Ct. 1494. Indeed, the BSA's comprehensive statutory scheme contains recordkeeping requirements that carry both civil and criminal penalties. *See* 31 U.S.C. §§ 5321, 5322 (individual's failure to report or retain required records of foreign bank accounts does not give rise to criminal liability unless that failure is proven “willful”). [4]

Additionally, the BSA's recordkeeping requirements broadly cover all those who maintain foreign bank accounts, rather then a particular subgroup. The Ninth Circuit has explained:

> There is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account. According to the Government, § 1010.420 applies to “hundreds of ***336** thousands of foreign bank accounts-over half a million in 2009.” Nothing about having a foreign bank account on its own suggests a person is engaged in illegal activity. The fact distinguishes this case from *Marchetti* and *Grosso,* where the activity being regulated—gambling—was almost universally illegal, so that paying a tax on gambling wagers necessarily implicated a person in criminal activity. Admitting to having a foreign bank account carries no such risk. That the information contained in the required record may ultimately lead to criminal charges does not convert an essentially regulatory regulation into a criminal one.

In re M.H., 648 F.3d at 1074–75.

Moreover, § 1010.420 has a reporting requirement. The regulation mandates that the required records “shall be kept at all times available for inspection as authorized by law.” 31 C.F.R. § 1010.420. The Supreme Court has indicated that “no meaningful difference” exists “between an obligation to maintain records for inspection, and such an obligation supplemented by a requirement that those records be filed periodically with officers of the United States." *Marchetti,* 390 U.S. at 56 n. 14, 88 S.Ct. 697.

Because the BSA's recordkeeping requirements serve purposes unrelated to criminal law enforcement and the provisions do not apply exclusively to those engaged in criminal activity, we find that those requirements are "essentially regulatory." Accordingly, we conclude that the first prong of the required records doctrine is satisfied.

B.

The records must also be "of a kind which the regulated party has customarily kept." *Grosso,* 390 U.S. at 68, 88 S.Ct. 709. We find this prong of the required records doctrine to be easily satisfied here. The records sought are of the same type that the Does must report annually to the IRS pursuant to the regulation of offshore banking: the name, number, and type of account(s), the name and address of the bank where an account is held, and the maximum value of the account during the reporting period. *See* 31 C.F.R. §§ 1010.350, 1010.420.

Furthermore, the records sought are also of the same type that a reasonable account holder, foreign or domestic, would keep in order to access his or her account. *See In re M.H.,* 648 F.3d at 1076 (reasoning that foreign account holders routinely retain basic foreign bank records if only to access their own accounts). The Does argue that individuals are unlikely to keep account records for the five years required under 31 C.F.R. § 1010.420, given the three-year statute of limitations for civil tax adjustments, and because foreign banks are notorious for failing to provide customers with records. This argument fails, however, given the clear language in § 1010.420 that requires the retention of the account information that has been subpoenaed.[5] Because it is the *failure to maintain* such records that can be probative of criminal activity, rather than the *contents* of the records, foreign account holders can reasonably be expected to follow the law governing their choice to engage in offshore banking.

Accordingly, we conclude that the records sought are of a kind "customarily ***337** kept" and the second prong of the required records doctrine is satisfied.

C.

Finally, "the records [sought] must have assumed 'public aspects' which render them at least analogous to public documents." *Grosso,* 390 U.S. at 68, 88 S.Ct. 709. Two courts of appeals have held that "if the government's purpose in imposing the regulatory scheme is essentially regulatory, then it necessarily has some 'public aspects' " sufficient to satisfy the third prong of the required records doctrine. *In re M.H.,* 648 F.3d at 1076 (citing *Shapiro,* 335 U.S. at 33, 68 S.Ct. 1375); *accord Donovan v. Mehlenbacher,* 652 F.2d 228, 231 (2d Cir.1981). For purposes of this case, we agree.

Drawing a distinction between entities and individuals who publicly engage in business with the public and those who privately open a foreign bank account, the Does contend that there is "nothing public about the unlicensed private activity of owning a foreign bank account." (Appellant's Br. 49.) The Does argue that the subpoenaed records are private, personal financial records which are unrelated to legitimate regulatory goals.

This argument by the Does misapprehends this prong of the required records doctrine by conflating "public aspects" and "public access." Although the Does argue that substantive regulations designed to protect the public from harm and open to public access may imbue otherwise private documents with public aspects, it does not follow that public aspects exist *only* under these circumstances. That the records sought are typically considered private does not bar them from possessing the requisite public aspects. *See In re M.H.,* 648 F.3d at 1077 ("[T]hat the information sought is traditionally private and personal as opposed to business-related does not automatically implicate the Fifth Amendment."); *In re Kenny,* 715 F.2d 51, 52–54 (2d Cir.1983) (reasoning that subpoenaed medical records possessed sufficient "public aspects" to satisfy the third prong of the required records doctrine). As discussed above, the Treasury Department shares the information it collects pursuant to the Act's recordkeeping and reporting requirements with a number of other agencies. *See* 31 U.S.C. § 5319; 31 C.F.R. § 1010.950(a)-(b). This data sharing is designed to serve important public purposes, including the formation of economic, monetary, and regulatory policy, any of which are more than sufficient to imbue otherwise private foreign bank account records with "public aspects." *See In re Grand Jury Subpoena,* 696 F.3d at 436.

Finally, the Does contend that a requirement to retain records begets a more attenuated relationship with the government than a requirement to report their contents, such that documents maintained under a mere recordkeeping requirement have insufficient "public aspects." The Supreme Court, however, has squarely rejected this proposition. *See Marchetti,* 390 U.S. at 56 n. 14, 88 S.Ct. 697 ("We perceive no meaningful difference between an obligation to maintain records for inspection, and such an obligation supplemented by a requirement that those records be filed periodically with officers of the United States."). We therefore conclude that the records in question have "public aspects" sufficient to satisfy the third prong of the required records doctrine.

IV.

Because we find that the records sought in the grand jury subpoenas meet all the requirements of the required records doctrine, the Fifth Amendment privilege is inapplicable, and the Does may not invoke ***338** it to shield themselves from the subpoenas' commands. As the Does' Fifth Amendment privilege is not implicated, we need not address their request for immunity. Accordingly, the judgment of the district court is

AFFIRMED.

All Citations

737 F.3d 330, 112 A.F.T.R.2d 2013-7316

Footnotes

[1] The district court stayed the execution of the contempt order until this Court adjudicates the Does' appeal.

[2] Although the Does formally appeal the district court's order holding them in civil contempt, the underlying basis of the contempt order is the court's denial of their motion to quash the grand jury subpoenas.

[3] *See, e.g., In re Grand Jury Subpoena,* 696 F.3d 428, 433–34 (5th Cir.2012); *In re Special Feb. 2011–1 Grand Jury Subpoena Dated Sept. 12, 2011,* 691 F.3d 903, 909 (7th Cir.2012); *In re M.H.,* 648 F.3d at 1073; *In re Doe,* 711 F.2d 1187, 1191 (2d Cir.1983).

[4] 31 U.S.C. § 5321 permits the Secretary of Treasury to commence civil actions to recover monetary penalties for various violations of the BSA.

[5] We also find the Does' five-year argument dubious in view of 26 U.S.C. § 6501(e), which contains a six-year statute of limitations for many taxpayers and fosters a generally accepted accounting practice to advise taxpayers to keep their pertinent records until the § 6501(e) period has expired.

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908 F.Supp.2d 348
United States District Court,
E.D. New York.

In re GRAND JURY SUBPOENA
DATED FEBRUARY 2, 2012.
United States of America, Movant
v.
John Doe, Respondent.

No. 12–cv–00553 (JFB).
|
Dec. 10, 2012.

Synopsis
Background: United States sought order compelling John Doe respondent to comply with grand jury subpoena for foreign banking records.

Holdings: The District Court, Joseph F. Bianco, J., held that:

[1] there was no evidence to support respondent's claim that government was already in possession of records requested in grand jury subpoena, or that it issued the subpoena for purposes of preparing for trial, and

[2] foreign bank records were subject to the required records exception to the Fifth Amendment privilege against self-incrimination.

So ordered.

Attorneys and Law Firms

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Brian P. Ketcham, Kostelanetz & Fink, LLP, New York, NY, for Respondent.

MEMORANDUM AND ORDER

JOSEPH F. BIANCO, District Judge:

The United States of America (the "government") seeks an order compelling John Doe ("respondent") to comply with a grand jury subpoena dated February 2, 2012 (the "Subpoena"). Respondent opposes the government's motion on two grounds: (1) the government already possesses the records sought by the Subpoena and is improperly using the grand jury's subpoena power to prepare for trial; and (2) compelling compliance with the Subpoena would violate respondent's Fifth Amendment privilege against self-incrimination. For the reasons set forth on the record on November 20, 2012 and provided in detail herein, the Court orders respondent to comply with the Subpoena.

Specifically, the Court finds that no evidence supports the conclusion that the government is already in possession of the requested documents or that the government has issued the Subpoena for purposes of preparing for trial. Additionally, the Court holds that the requested documents fall within the required records exception and, thus, are outside the scope of respondent's Fifth Amendment privilege.

I. BACKGROUND

As part of its investigation, the grand jury in the Eastern District of New York issued a subpoena to respondent that sought the production of foreign bank records that account holders are required by law to keep and maintain for a period of five years. In particular, the Subpoena sought the following foreign bank account records:

> Any and all records required to be maintained pursuant to 31 C.F.R. § 1010.420 (formerly 31 C.F.R. § 103.32) for the past 5 years relating to foreign financial bank, securities, or other financial accounts in a foreign country for which you had/ have a financial interest in, or signature or other authority over and are required by law to file a Report of Foreign Bank and Financial Account (FBAR). The records required to be maintained pursuant to 31 C.F.R. § 1010.420

> (formerly 31 C.F.R. § 103.32) include records that contain the name in which each such account is maintained, the number or other designation of such account, the name and address of the foreign bank or other person with whom such account is maintained, the type of such account, and the maximum value of each such account during the reporting period.

The government served respondent with the Subpoena on February 8, 2012, and the Subpoena required compliance by February 23, 2012. Respondent has failed to respond to the Subpoena. On August 17, 2012, the government moved to compel respondent's compliance with the Subpoena. On September 27, 2012, respondent filed his opposition to the government's motion. On October 9, 2012, the government filed its reply. The Court heard oral argument on November 20, 2012 and, following the argument, issued an oral decision ***351** granting the government's motion to compel.

II. DISCUSSION

A. Issuance of Subpoena

Respondent argues that the government's motion to compel should be denied because (1) the government already possesses the records sought by the subpoena, and (2) the government may not use the grand jury to prepare for trial. For the reasons set forth below, the Court concludes that these arguments have no merit.

[1] As a threshold matter, although courts must ensure that the grand jury process is not being abused by the government, it is not the role of the courts to micromanage the government's presentation of evidence to the grand jury. *See, e.g., United States v. Kleen Laundry & Cleaners, Inc.,* 381 F.Supp. 519, 521–22 (E.D.N.Y.1974) ("It is now the United States Attorney who gathers the evidence for later presentation to the grand jury.... So broad is his role in practice that courts are loath to review prosecutorial actions."). Having carefully reviewed the submissions, the Court finds no evidence of abuse of the grand jury process by the government in any way.

[2] First, respondent's argument that the government already possesses the information requested by the Subpoena is based upon sheer speculation and is denied by the government. (*See* Gov't Reply Mem. of Law at 2) ("The respondent's argument begins with the false premise that the government already possesses the records sought by the Subpoena."); (*id.*) ("The respondent ... has no basis for his contention that the government 'already possesses the documents sought by the subpoena.' " (quoting Resp't's Mem. of Law in Opp'n at 3)). Although the government attached to its motion to compel a selection of documents from one foreign bank account with dates spanning from 1992 to August 2008, those documents are hardly (on their face) co-extensive with the scope of the Subpoena. Specifically, the Subpoena required the production of documents for a five-year period prior to February 2012. Thus, the government's selection does not contain any documents for the majority of the five-year period covered by the Subpoena. Moreover, there are no documents from other foreign banks at which the respondent, unbeknownst to the government, may have had accounts. In other words, it is self-evident that the government would have no way of ensuring that all such records from *all* foreign bank accounts—for which respondent has a financial interest, or is a signatory, or has authority over—have been uncovered unless respondent complies with the Subpoena. In short, there is no reason to believe that the government already possesses all documents sought by the Subpoena. Additionally, the fact that the government has some of respondent's foreign bank records clearly does not preclude it from seeking all such relevant foreign bank records. *See, e.g., United States v. Dionisio,* 410 U.S. 1, 13, 93 S.Ct. 764, 35 L.Ed.2d 67 (1973) ("The grand jury may well find it desirable to call numerous witnesses in the course of an investigation. It does not follow that each witness may resist a subpoena on the ground that too many witnesses have been called.").

Respondent seeks to counter this proposition by citing to *Application of Linen Supply Cos.,* 15 F.R.D. 115, 119 (S.D.N.Y.1953). However, that decision is clearly distinguishable. In that case, the court held that the recipients of a grand jury subpoena did not need to provide the originals of documents for which the government already possessed copies. *Id.* at 119. Here, the grand jury has not received any ***352** documents from respondent and, thus, it cannot be determined that the grand jury will have access to all potentially responsive documents. Accordingly, the above-referenced case is inapposite to the instant situation.

[3] Respondent's second argument, that the grand jury is being used by the government to prepare for trial, is similarly unavailing. This argument is a legal non-starter in the instant case because the grand jury has not returned an indictment. Stated differently, the concern that the government is abusing the grand jury by preparing for trial only arises after the grand jury has returned an indictment. *See, e.g., United States v. Leung,* 40 F.3d 577, 581 (2d Cir.1994) ("It is, of course, improper for the Government to use the grand jury for the sole or dominant purpose of preparing for trial *under a pending indictment.*" (emphasis added)); *see also United States v. Ohle,* 678 F.Supp.2d 215, 233 (S.D.N.Y.2010) (same); *United States v. Bin Laden,* 116 F.Supp.2d 489 (S.D.N.Y.2000) (citing cases). Here, there are no pending charges that have been returned by the grand jury; moreover, there is no trial. In short, no evidence supports the conclusion that the government has issued the Subpoena for the sole or dominant purpose of preparing for a trial, particularly when no charges have yet been brought. For this reason, respondent's argument does not provide a basis to deprive the government, and the grand jury, of these potentially relevant documents.

B. The Fifth Amendment and the Required Records Exception

[4] Respondent next argues that, if this Court were to compel compliance with the Subpoena, respondent's rights under the Fifth Amendment would be violated. Respondent additionally asserts that the required records exception is not applicable. For the following reasons, the Court disagrees with respondent's argument and concludes that the required records exception overrides any Fifth Amendment privilege.

1. Legal Standard

[5] The Fifth Amendment's protection against self-incrimination is well-established. *See* U.S. Const. amend. V ("No person ... shall be compelled in any criminal case to be a witness against himself."). Its protections are triggered "when the accused is compelled to make a [t]estimonial [c]ommunication that is incriminating." *Fisher v. United States,* 425 U.S. 391, 408, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976); *see also United States v. Hubbell,* 530 U.S. 27, 34, 120 S.Ct. 2037, 147 L.Ed.2d 24 (2000). Courts have interpreted what constitutes a "testimonial communication" broadly. In *Fisher,* the Supreme Court stated that "[t]he act of producing evidence in response to a subpoena ... has communicative aspects of its own, wholly aside from the contents of the papers produced." 425 U.S. at 410, 96 S.Ct. 1569; *see also United States v. Doe,* 465 U.S. 605, 612, 104 S.Ct. 1237, 79 L.Ed.2d 552 (1984) ("A government subpoena compels the holder of the document to perform an act that may have testimonial aspects and an incriminating effect."). For instance, by complying with a subpoena, the subpoena recipient may "tacitly concede[ ] the existence of the papers demanded and their possession or control," as well as his or her "belief that the papers are those described in the subpoena." *Fisher,* 425 U.S. at 410, 96 S.Ct. 1569. The question thus becomes whether the "tacit averments" made through the production of the requested materials are both " 'testimonial' and 'incriminating' for purposes of applying the Fifth Amendment." *Id.; see also In re Three Grand* ***353** *Jury Subpoenas Duces Tecum Dated January 29, 1999,* 191 F.3d 173, 178 (2d Cir.1999) ("[I]t is now settled that an individual may claim an act of production privilege to decline to produce documents, the contents of which are not privileged, where the act of production is, itself, (1) compelled, (2) testimonial, and (3) incriminating."). The answer to this question will often turn on the particular facts and circumstances of a given case. *See Fisher,* 425 U.S. at 410, 96 S.Ct. 1569.

[6] Although the Fifth Amendment guards an individual from self-incrimination by barring the government from "compelling a person to give 'testimony' that incriminates him," *id.* at 409, 96 S.Ct. 1569, its protective shield is not all-encompassing. The Supreme Court has made clear that the privilege against self-incrimination does not prevent the government from imposing record-keeping and inspection requirements as part of a valid regulatory scheme. *See Shapiro v. United States,* 335 U.S. 1, 32–33, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948). Generally referred to as the required records exception, the government may mandate the retention or inspection of records as "to public documents in public offices, [and] also [as] to records required by law to be kept in order that there may be suitable information of transactions which are the appropriate subjects of governmental regulation, and the enforcement of restrictions validly established." *Id.* at 17, 68 S.Ct. 1375 (quoting *Wilson v. United States,* 221 U.S.

361, 380, 31 S.Ct. 538, 55 L.Ed. 771 (1911)) (no internal quotation marks).

[7] The rationale underlying the required records exception is "twofold." *In re Two Grand Jury Subpoenae Duces Tecum,* 793 F.2d 69, 73 (2d Cir.1986). First, participation in an activity that, by law or statute, mandates record-keeping may be deemed a waiver of the act of production privilege, "at least in cases in which there is a nexus between the government's production request and the purpose of the record-keeping requirement." *Id.* Second, because such record-keeping is done pursuant to legal mandate (as opposed to an individual's voluntary choice), "the recordholder 'admits' little in the way of control or authentication by producing them." *Id.* (quoting *In re Grand Jury Subpoena Served Upon Underhill,* 781 F.2d 64, 65 (6th Cir.1986)); *cf. In re Grand Jury Investigation M.H.,* 648 F.3d 1067, 1071–72 (9th Cir.2011) (stating that "where documents are *voluntarily* created and kept, compelling their disclosure does not implicate the privilege against self-incrimination," but "[w]here documents are *required* to be kept and then produced, they are arguably compelled," and further noting that "the privilege does not extend to records required to be kept as a result of an individual's voluntary participation in a regulated activity").

[8] In order for documents "[t]o constitute 'required records' [they] must satisfy a three-part test," commonly referred to as the *Grosso* test, first set forth in the Supreme Court's *Grosso v. United States* decision: "(1) the requirement that [records] be kept must be essentially regulatory, (2) the records must be of a kind which the regulated party has customarily kept, and (3) the records themselves must have assumed 'public aspects' which render them analogous to public documents." *In re Doe,* 711 F.2d 1187, 1191 (2d Cir.1983) (citing *Grosso v. United States,* 390 U.S. 62, 67–68, 88 S.Ct. 709, 19 L.Ed.2d 906 (1968)); *see also Rajah v. Mukasey,* 544 F.3d 427, 442 (2d Cir.2008) (stating "the Fifth Amendment's act of production privilege does not cover records that are required to be kept pursuant to a civil regulatory regime").

***354** The record-keeping regulation that is at the center of this dispute is the Currency and Foreign Transactions Reporting Act of 1970, Pub.L. 91–508, 84 Stat. 1118 (1970), generally referred to as the Bank Secrecy Act ("BSA"). The purpose of this regulation is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." 31 U.S.C. § 5311. Section 241(a) of the Act provides that the "Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency." *Id.* § 5314(a). Pursuant to this instruction, the Secretary of the Treasury has implemented regulations that require U.S. citizens and residents to disclose their foreign bank accounts, *see* 31 C.F.R. § 1010.350; such regulations also mandate that "each person having a financial interest in or signature or other authority over any such account" retain such records for at least five years, making them "available for inspection as authorized by law," *id.* § 1010.420.

This Court has previously held that foreign bank records that are required to be maintained under the BSA, pursuant to 31 C.F.R. § 1010.420, 31 U.S.C. § 5311 *et seq.,* fall within the required records exception to the act of production privilege under the Fifth Amendment. *See In re Grand Jury Subpoena Dated September 9, 2011,* No. 2:11–mc–00747–JFB (E.D.N.Y. Dec. 30, 2011). That analysis, incorporated below, applies with equal force to the Subpoena at issue in this case. At the time of the Court's prior decision, the Second Circuit had not yet decided the issue; other courts, however, including the Ninth Circuit and several district courts, had reached the same conclusion. *See, e.g., In re Grand Jury Investigation M.H.,* 648 F.3d 1067 (9th Cir.2011); *In re Grand Jury Subpoena No. 10–04–400,* No. GJ 10–4 (D.Az. May 18, 2011) (annexed to government's motion papers); *In re Grand Jury Subpoenas dated January 3, 2011,* No. FGJ 10–403–073 (S.D.Fl. Mar. 4, 2011) (annexed to government's motion papers). Moreover, since this Court's decision in December 2011, both the Fifth and Seventh Circuits have reached the same conclusion. *See In re Grand Jury Subpoena,* 696 F.3d 428 (5th Cir.2012); *In re Special February 2011–1 Grand Jury Subpoena Dated September 12, 2011,* 691 F.3d 903 (7th Cir.2012). The Court finds the analysis contained in the above-referenced cases, although not binding, to be persuasive. [1]

For the reasons set forth below, the Court concludes that the government has met its burden of proving that the foreign financial account documents sought from respondent, which the BSA requires respondent to maintain, satisfy the three *Grosso* requirements.

Accordingly, the required records exception applies, and the documents fall outside the purview of the Fifth Amendment.

a. "Essentially Regulatory"

The first prong of the *Grosso* test requires that the statutory scheme giving rise to the record-keeping requirement be "essentially regulatory" and not criminal in nature. In *United States v. Dichne,* the Second Circuit held that a similar record-keeping requirement of the BSA did not violate the Fifth Amendment's privilege ***355** against self-incrimination. 612 F.2d 632, 638–41 (2d Cir.1979).

The provision at issue in *Dichne* required anyone exporting or importing monetary instruments worth more than $5,000 (now $10,000) to file a report with the Secretary of the Treasury. *See* 31 U.S.C. 1101. The Second Circuit noted that because "the transportation of such amounts of currency is by no means an illegal act, the District Court was correct in its finding that the reporting requirement was not addressed to a highly selective group inherently suspect of criminal activities." *Dichne,* 612 F.2d at 639 (internal quotation marks omitted). The court therefore held that "[i]n view of the lack of a direct linkage between the required disclosure and the potential criminal activity, and in view of the fact that the statute is not directed at an inherently suspect group, we conclude that the reporting requirement does not present such a substantial risk of incrimination so as to outweigh the governmental interest in requiring such a disclosure." *Id.* at 641 (internal quotation marks omitted). Consequently, the statute did not violate the Fifth Amendment's privilege against self-incrimination. *Id.; see also United States v. Sturman,* 951 F.2d 1466, 1487 (6th Cir.1991) ("The Bank Secrecy Act applies to all persons making foreign deposits, most of whom do so with legally obtained funds. The requirement is imposed in the banking regulatory field which is not infused with criminal statutes. In addition, the disclosures do not subject the defendant to a real danger of self-incrimination since the source of the funds is not disclosed.... Thus, the defendant has failed to show that the Bank Secrecy Act violated any individual right [that] ... *Grosso* seek to protect.").

Likewise, the provision at issue here, 31 C.F.R. § 1010.420, applies to hundreds of thousands of foreign bank accounts.[2] "There is nothing inherently illegal about having or being a beneficiary of an offshore foreign banking account." *In re Grand Jury Investigation M.H.,* 648 F.3d at 1074. Because the record-keeping requirements of 31 C.F.R. § 1010.420 do not target inherently illegal activity, the provision is essentially regulatory in nature.[3] *See In re Grand Jury Subpoena,* 696 F.3d at 435 (holding that "[b]ecause the BSA's record-keeping requirements serve purposes unrelated to criminal law enforcement and because the provisions do not exclusively target people engaged in criminal activity, we conclude that the requirements are 'essentially regulatory,' satisfying the [required records exception]'s first prong"); *In re Special February 2011–1 Grand Jury Subpoena Dated September 12, 2011,* 691 F.3d at 909 (finding first prong of *Grosso* test met); *In re Grand Jury Investigation M.H.,* 648 F.3d at 1075 (holding that records kept under 31 C.F.R. § 1010.420 were "essentially regulatory" because the information sought was "not inherently criminal," and therefore, "being required to provide that information would generally not establish a significant link in a chain of evidence tending to prove guilt."); *In re Grand Jury Subpoena No. 10–04–400,* No. GJ 10–04 (D.Ariz. May 18, 2011) (stating reporting requirements of 31 C.F.R. § 1010.420 are "essentially regulatory" ***356** because they are "directed to the public at large and are intended to advance the important public purposes inherent in the regulatory tax scheme"); *In re Grand Jury Subpoenas dated January 3, 2011,* No. FGJ 10–403–073 (S.D.Fla. Mar. 4, 2011) (stating "record-keeping and reporting requirements of the BSA have consistently been determined to be regulatory, and not criminal, in nature").

For these reasons, the Court concludes that the requested foreign financial records satisfy the first prong of the *Grosso* test and are "essentially regulatory" in nature.

b. "Customarily Kept"

Grosso's second prong asks whether the records are typically kept in connection with the regulated activity. The Ninth Circuit has held that the information required to be kept by 31 C.F.R. § 1010.420 is "basic account information that bank customers would customarily keep, in part because they must report it to the IRS every year as part of the IRS's regulation of offshore banking, and in part because they need the information to access their foreign bank accounts." *In re Grand Jury Investigation*

M.H., 648 F.3d at 1076. The Fifth Circuit has concluded similarly, stating that records are "customarily kept" in satisfaction of the required records exception's second prong where they "are of the same type that the witness must report annually to the IRS pursuant to the IRS's regulation of offshore banking: the name, number, and type of account(s), the name and address of the bank where an account is held, and the maximum value of the account during the reporting period." *In re Grand Jury Subpoena,* 696 F.3d at 435; *see also In re Grand Jury Investigation M.H.,* 648 F.3d at 1075 (holding in a nearly identical case that second prong of required records doctrine met). This Court agrees. Accordingly, the records the Subpoena seeks are of a kind "customarily kept" by respondent, thereby satisfying the second prong of the Grosso test.

c. "Public Aspects"

[9] The third *Grosso* factor requires that the requested records "have assumed 'public aspects' which render them at least analogous to public documents." *Grosso,* 390 U.S. at 68, 88 S.Ct. 709. Respondent asserts that an individual's personal financial records do not possess sufficient public aspects to satisfy this prong of the test. (Resp't's Mem. of Law in Opp'n at 22.) Generally, the fact "that the information sought is traditionally private and personal as opposed to business-related does not automatically implicate the Fifth Amendment." *In re Grand Jury Subpoena,* 696 F.3d at 436; *see also In re Grand Jury Investigation M.H.,* 648 F.3d at 1077. However, the Ninth Circuit accurately noted that "[w]here personal information is compelled in furtherance of a valid regulatory scheme, as is the case here, that information assumes a public aspect." *In re Grand Jury Investigation M.H.,* 648 F.3d at 1077.

Additionally, the fact that 31 C.F.R. § 1010.420 requires foreign bank-account holders to simply keep records, but not to file those records with the government, does not extinguish the public aspects of the records. *Id.* Indeed, the Supreme Court has acknowledged that there is no distinction between those records required to be kept by law and those regularly or "easily accessed" by the government. *See Marchetti v. United States,* 390 U.S. 39, 56 n. 14, 88 S.Ct. 697, 19 L.Ed.2d 889 (1968) ("We perceive no meaningful difference between an obligation to maintain records for inspection, and such an obligation supplemented by a requirement that those records be filed periodically with officers of the United States."). Thus, the Court finds that the record-keeping requirements ***357** of 31 C.F.R. § 1010.420 have "public aspects," satisfying the third and final prong of the *Grosso* test. *See In re Special February 2011–1 Grand Jury Subpoena,* 691 F.3d at 909 (concluding that respondent could not resist a subpoena on Fifth Amendment grounds because the requested records met the three prongs of the required records exception). [4]

In sum, because all three prongs of the *Grosso* test are met, the required records exception is applicable, and the Fifth Amendment's safeguards are not available to respondent in this instance.

C. Availability of Records From Foreign Banks

The Court briefly addresses respondent's argument that the government in this case could have sought to obtain the requested documents by means of foreign request, specifically, via such foreign treaties as "the Foreign Account Tax Compliance Act, new and/or updated bilateral tax treaties permitting the expanded exchange of tax information, Mutual Legal Assistance Treaties, Tax Information Exchange Agreements, and Simultaneous Criminal Investigation Programs." Resp't's Mem. of Law in Opp'n at 8. At oral argument, the government explained the impracticalities of such a process, emphasizing in particular the length of time generally associated with such requests, as well as the government's lack of information throughout the entire request process to the foreign government. [5] As the government accurately noted, Congress enacted the BSA so as to ameliorate the difficulties and challenges associated with obtaining records by means of a foreign treaty. The Court agrees with the government and finds no reason as to why a significantly longer process, with uncertain results, should have to be used in the instant case. There is no requirement that the government only subpoena foreign bank records from an individual as a last resort when other efforts to obtain such documents from the foreign bank have been exhausted. Such a rule has no basis in the law and could significantly delay criminal investigations. Accordingly, the Court rejects that argument by respondent.

III. CONCLUSION

Having carefully reviewed the respondent's arguments, the Court finds respondent's ***358** position unpersuasive. The Court rejects, due to lack of evidentiary support, respondent's contention that the government already possesses all documents sought by the Subpoena. The Court likewise rejects respondent's argument, also on grounds of insufficient evidence and the fact that there are no pending charges, that the government here issued the Subpoena for the sole or dominant purpose of preparing for a trial. The Court continues to hold that the record-keeping provision of the BSA meets the three requirements for the required records exception set forth in *Grosso.* Thus, the records sought by the Subpoena are "required records" exempt from the Fifth Amendment privilege against self-incrimination. Because the required records exception applies, respondent must comply with the Subpoena.

SO ORDERED.

All Citations

908 F.Supp.2d 348

Footnotes

[1] The language of the Subpoena in this case is identical in all material respects to those contained in the above-referenced cases.

[2] *See* Treasury Inspector General for Tax Administration, "New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues are Being Addressed," Ref. # 2010–30–125 (Sept. 29, 2010) at 7, *available at* http://www.treasury. gov/tigta/auditreports/2010reports/201030125fr.pdf.

[3] Indeed, the plaintiff's arguments to attempt to show otherwise are similar to those considered and rejected by the Fifth Circuit in *In re Grand Jury Subpoena,* 696 F.3d at 434–35.

[4] The Court also rejects respondent's argument that the required records exception is only triggered where there is some level of licensure or heightened government regulation at issue. (*See* Resp't's Mem. of Law in Opp'n at 8) (stating "the required records exception to the act of production privilege stems from exigent circumstances not present in the regulatory scheme issued under the [BSA]"). The Court agrees with the government's position, stated at oral argument, that it is up to Congress to determinate the appropriate level of regulation that should accompany a required records mandate. The Court likewise notes that the Fifth Circuit held similarly in its most recent decision, stating "adopting a rule that the legitimacy of a record-keeping requirement depends on Congress first enacting substantive restrictions would lead to absurd results." *In re Grand Jury Subpoena,* 696 F.3d at 436.

[5] The government offered several examples at oral argument of factors that would hinder the government's ability to obtain records through foreign request. These examples include, but are not limited to, the transmission and translation of the government's request to the appropriate foreign entity; that entity's seeking of the records from the appropriate bank; a foreign court's consideration of whether such records may in fact be produced; the corresponding appeal period applicable to any such determination; and the government's lack of any notification as to the status of its request following its initial transmittal, including lack of notification as to any judicial decisions issued or ongoing appeals concerning production of the documents. Each and all of these factors might significantly lengthen the record request process that the BSA sought to improve.

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UNITED STATES of America,
v.
Stefan BUCK, Defendant.

13 Cr. 0282 (VM)
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Signed 08/28/2017

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DECISION AND ORDER

Victor Marrero, U.S.D.J.

***1** Defendant Stefan Buck ("Buck") moves to dismiss the one-count indictment filed by the Government on April 16, 2013 (the "Indictment") charging him with conspiracy to defraud the United States in violation of 18 U.S.C. Section 371 ("Section 371"). ("Motion," Dkt. No. 59.) Having reviewed the parties' submissions and for the reasons set forth below, the Motion is DENIED.

I. BACKGROUND [1]

A. ALLEGATIONS

Buck is a citizen and resident of Switzerland. On or about June 2007, Buck began working as a client-facing relationship manager at Swiss Bank No. 1, also known as Bank Frey. Soon thereafter, in around December 2007, Buck became the head of Bank Frey's private banking and, in or about December 2012, was named to the institution's three-person executive board.

On April 16, 2013, the Government filed the Indictment charging Buck and one co-defendant, Edgar Paltzer ("Paltzer," together with Buck, "Defendants"), with defrauding the United States in connection with actions taken during the course of their employment at Swiss Bank No. 1. The Government alleges that, from about 2007 to 2012, [2] Buck participated in a scheme with Paltzer and United States taxpayers to evade tax obligations by creating, maintaining and/or managing undeclared bank accounts held at Swiss Bank No. 1—accounts not disclosed to the Internal Revenue Service ("IRS")—and enabling United States taxpayers to submit false and fraudulent income tax returns.

The Indictment outlines numerous allegations against Paltzer and Buck regarding six clients ("Client 1" through "Client 6"), all of whom were holders of undeclared accounts. The Government alleges that Buck committed at least two overt acts in furtherance of the conspiracy: (1) sending checks to Arizona for Client 4 drawn on a corresponding bank account located at another Swiss bank, Wegelin, in the United States, and (2) opening a new undeclared account at Swiss Bank No. 1 for Client 5.

***2** In addition, the Indictment alleges that, during the relevant period, Buck: (1) met and emailed with Client 3 prior to Paltzer opening several undeclared accounts; (2) advised Client 4 and his wife regarding steps to take "in order to avoid the IRS discovering the account" including, among other things, that "Client 4 and his wife should not conduct any transfers in or out of the account in U.S. dollars, because such transfers would 'clear' in the United States and were therefore detectable" (Indictment ¶ 65.b); (3) advised Client 4 and his wife, with respect to the account-opening documents, "to mark 'no' as to whether they required a tax statement" and "leave the section of the account-opening documents dealing with 'tax status' blank" (id. ¶ 65.c); (4) created and used the code word "PV" with Client 4 to refer to account statements, in case Client 4 wanted Buck to send account statements to the United States (id. ¶ 66); (5) told Client 4's wife, after learning Client 4 and his wife received a subpoena for documents and testimony in relation to an investigation of Wegelin, that if he had "sent wire transfers, rather than checks[,] Client 4's undeclared account would not have been detected" (id. ¶¶ 72-73); (6) advised Clients 5 and 6 that Swiss Bank No. 1 "was a private Swiss Bank with no connection to the United States and that Swiss Bank No. 1 was not bound to make any sort of disclosure to U.S. authorities[,]" after Clients 5 and 6 were referred to Buck when Swiss Bank No. 7 decided to close all accounts held by United States taxpayers (id. ¶ 77; see also id. at ¶

82-83); and (7) told Client 6 that he did not have to enter a voluntary disclosure program with the IRS regarding his undisclosed accounts, because the Bank's president was a lawyer who knew the rules and "the rules did not apply to Client 6's account" (id. ¶ 85).

Moreover, the Government alleges that, for all or part of the relevant period, Clients 3, 4, 5, and 6 did not disclose their Swiss Bank No. 1 accounts to the IRS in their income tax returns Forms 1040 or file the required Report of Foreign Bank and Financial Accounts ("FBAR").

The Government contends that Buck committed these acts in furtherance of a conspiracy to defraud the United States, namely the IRS. Specifically, the Government contends that it was a part and an object of the conspiracy, of which the Government alleges Buck was a part, to (1) willfully and knowingly attempt to evade or defeat United States income tax obligations, in violation of 27 U.S.C. Section 7201 (see Indictment ¶ 89), and (2) willfully and knowingly prepare tax returns, statements, and other documents made under penalties of perjury that Buck and his co-conspirators "did not believe to be true and correct as to every material matter," in violation of 26 U.S.C. Section 7206(1) (Indictment ¶ 90).

B. MOTION TO DISMISS THE INDICTMENT

Buck argues that the Indictment should be dismissed for the following reasons: (1) the "defraud the United States" object of the conspiracy offense is unconstitutionally vague; (2) the charged conspiracy does not apply extraterritorially; (3) application of the conspiracy offense would conflict with Swiss Bank-Client confidentiality laws; (4) Fifth Amendment Due Process principles preclude the prosecution of Buck; and (5) fundamental fairness requires that this matter be dismissed, because numerous non-prosecution agreements were reached with Swiss bankers involved in conduct equal to or worse than Buck's.

In particular, Buck argues that the "defraud the United States" object of the conspiracy is overly broad; that "such broad language must be limited to 'plainly and unmistakably' criminal conduct"; and that Buck's "conduct was not 'plainly and unmistakably' within the purview of the defraud provision." (Memorandum at 23 (citing Skilling v. United States, 561 U.S. 358, 364, 130 S.Ct. 2896, 177 L.Ed.2d 619 (2010) and United States v. Gradwell, 243 U.S. 476, 485, 37 S.Ct. 407, 61 L.Ed. 857 (1917).) In support, Buck cites several Supreme Court cases involving Section 371 and argues that "[t]he crux of these decisions is that ... conspiratorial liability is limited to those conspirators who themselves lie to, or engage in purposely deceptive conduct toward, the U.S. or an agency such as the IRS[,]" and that the Indictment does not allege that Buck engaged in the requisite conduct. (Id.)

Buck further argues that, because his conduct took place entirely in Switzerland, in order for the charged conspiracy offense to apply to his conduct, "this Court would have to find that Congress specifically intended it to apply to extraterritorial conduct." (Id. at 26 (citing Kiobel v. Royal Dutch Petroleum Co., 569 U.S. 108, 133 S.Ct. 1659, 185 L.Ed.2d 671 (2013) and Morrison v. National Australia Bank Ltd., 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010)).) Buck maintains that Congress did not so intend with respect to the tax evasion provision (26 U.S.C. Section 7201), the false declaration provision (26 U.S.C. Section 7206), or Section 371. Moreover, with respect to Section 371, Buck further argues that conspiracy to defraud the United States "is a common law crime, created by the courts rather than by Congress[,]" in which case Congress could not confer such extraterritorial reach on a statute it did not create. (Memorandum at 29 (quoting United States v. Coplan, 703 F.3d 46, 61 (2d Cir. 2012)).)

***3** Buck also asserts that any extraterritorial application of Section 371 would conflict with Swiss bank secrecy law. Buck contends that the Government's allegations show that "Buck did nothing more than what every Swiss banker did under the law of bank secrecy" by "inform[ing his] U.S. customers that he was not legally permitted to disclose their account at the bank." (Memorandum at 31.) Buck argues that, if he had disclosed the name of any account holder, such disclosure would have constituted a crime in Switzerland. (See id.) Buck contends that the application of Section 371 to his conduct would, therefore, create a conflict between Swiss and United States law, and that longstanding canons of statutory interpretation require that the statute be interpreted to avoid such a conflict. (See id. (citing Murray v. Schooner Charming Betsy, 6 U.S. 64, 2 Cranch 64, 2 L.Ed. 208 (1804) (Marshall, C.J.)).) Accordingly, Buck concludes, this Court should "narrowly interpret the scope of the charged conspiracy to preclude application to Swiss bankers such as Buck." (Memorandum at 31.)

Buck argues that, even if this Court finds that Section 371 applies extraterritorially, his prosecution should nonetheless be precluded on Fifth Amendment Due Process grounds, namely, that "Buck lacked fair notice that his particular conduct was unlawful in the United States ... [and] that there is an insufficient constitutional nexus between Buck's conduct and the [United States] given the facts alleged in the Indictment." (Id. at 32.) Buck maintains that he had no notice because his conduct was legal in Switzerland and because there is "no decision upholding the Government's theory of conspiracy." (Id.) Moreover, Buck claims that there is an insufficient constitutional nexus because (1) he provided "banking services from an office in Zurich, Switzerland"; (2) "he had no presence in the U.S.... [and] did not market his services to U.S. customers"; (3) "he did not provide affirmative tax advice to U.S. persons"; and (4) "he did not lie to or deceive the IRS [.]" (Id. at 33.)

Finally, Buck contends that fundamental fairness requires dismissal of this case. Because non-prosecution agreements were reached with over eighty Swiss banks that admitted they knowingly provided services to United States customers seeking to evade United States tax authorities and Buck's alleged conduct was less willful or directed than that of persons who were given the benefit of non-prosecution agreements, Buck argues that this case must be dismissed. (Id. at 33-37.)

In opposition, the Government asserts that (1) Buck's vagueness challenge is premature and unsupported by the factual allegations contained in the Indictment; (2) the charged conspiracy is not extraterritorial, though all of the objects charged would have extraterritorial application; (3) application of the charged conspiracy does not conflict with Swiss law; (4) application of the charged conspiracy does not violate Due Process; and (5) fundamental fairness does not require dismissal of this case.

The Government contends that the vagueness challenge is premature, because in challenges not implicating First Amendment rights, a statute "is assessed for vagueness only 'as applied,' i.e.[,] in light of the specific facts of the case at hand and not with regard to the statute's facial validity." (Opposition at 7 (quoting United States v. Rybicki, 354 F.3d 124, 129 (2d Cir. 2003)).) Accordingly, the Government argues that the merits of such a challenge cannot be assessed without evaluating the facts of the case, which cannot be done at this stage in a criminal proceeding. (See Opposition at 8.)

Nonetheless, the Government notes that the Second Circuit has held that "the conspiracy to defraud prong of [Section 371] 'not only includes the cheating of the Government out of property or money, but also the means to interfere with or obstruct one of its lawful governmental functions by deceit, craft or trickery, or at least by means that are dishonest.' " (Id. (quoting United States v. Klein, 247 F.2d 908, 916 (2d Cir. 1957)).) The government maintains that it has met this requirement by alleging that Buck "caus[ed] others to make 'false statement[s]' on their tax returns"; " 'provid[ed] ideas or means by which a U.S. taxpayer could evade the IRS' "; and "engaged in 'affirmative [acts] to actively aid, or conspire with, U.S. taxpayers [.]' " (Opposition at 9 (quoting and citing Indictment ¶¶ 14(f)-(g), 62, 65(b), 66, 70, 74, 79, 82, 85, 86).)

***4** The Government further argues that Buck and his co-conspirators committed several overt acts on United States soil that provide a sufficient domestic nexus to avoid the question of extraterritoriality. (See Opposition at 9-11.) Nonetheless, the Government contends that Section 371 would be applied extraterritorially here because the "presumption against extraterritoriality does not apply to a certain class of criminal statutes—ones that are 'not logically dependent on their locality,' but 'are enacted because of the right of the government to defend itself against obstruction, or fraud wherever perpetrated[.]' " (Id. at 11 (quoting United States v. Bowman, 260 U.S. 94, 98, 43 S.Ct. 39, 67 L.Ed. 149 (1922)).) Thus, because "[s]tatutes prohibiting crimes against the United States government may be applied extraterritorially even in the absence of 'clear evidence' that Congress so intended[,]" and the objects of the conspiracy alleged here were directed at the United States Government, specifically the IRS, the Government maintains that Section 371 applies extraterritorially here. (Opposition at 12 (emphasis in original)(quoting United States v. Vilar, 729 F.3d 62, 73 (2d Cir. 2013)).)

The Government also argues that Buck has constructed a false conflict of laws. The Government notes that "Swiss laws that require Buck to maintain the confidentiality of clients' information did not require him to support tax evasion in his role as a banker." (Opposition at 15.) The Government argues that "[t]here would only be a tension between Swiss and U.S. law if it were the case that Swiss law required its bankers to aid U.S. clients in avoiding their tax obligations," but Swiss law does not so require. (Id. (emphasis in original).) However, the Government contends that, even if such a conflict existed, international law would permit the prosecution in accordance with (1) the objective territorial principle, which permits "jurisdiction over conduct committed outside the state that has, or is intended to have, a substantial effect within its borders" and (2) the protective principle, which permits "criminal jurisdiction ... over acts committed outside the state that harm the state's interest." (Opposition at 15-16 (citing United States v. Yousef, 327 F.3d 56 (2d Cir. 2003)).)

The Government further argues that Buck's Fifth Amendment Due Process challenges are without merit. Regarding notice, the Government asserts that, "[g]iven his frequent contact with American clients, it is difficult to imagine that Buck was ignorant of basic U.S. tax laws or was unaware that other banks engaging in similar criminal conduct were being investigated by U.S. authorities." (Opposition at 17.) In addition, the Government notes that Buck "served as the head of private banking at [Swiss Bank No. 1 and] is alleged ... to have routinely opened accounts at Bank Frey for U.S. clients fleeing other Swiss banks" at around the same time that several well-known Swiss banks were being openly investigated by United States authorities. (Id. at 18.) The Government argues these circumstances are sufficient for Buck to have been given fair warning of the scope of the United States tax laws. (Id. at 17 (citing United States v. Al Kassar, 660 F.3d 108 (2d Cir. 2011)).)

Moreover, regarding constitutional nexus, the Government contends that "[g]iven the government's strong incentive to enforce its tax laws all around the globe, 'it cannot be argued seriously that the defendant['s] conduct was so unrelated to American interests as to render [his] prosecution in the United States arbitrary or fundamentally unfair.' " (Opposition at 19-20 (quoting United States v. Yousef, 327 F.3d 56, 111 (2d Cir. 2003)).)

Finally, in response to Buck's claim that the Indictment must be dismissed because other Swiss bankers have entered into non-prosecution agreements, the Government argues that this argument lacks legal basis. (See Opposition at 21.) Moreover, the Government notes that Buck is "far from the only Swiss person to be charged with conspiring with others to hide money from the IRS. Numerous Swiss bankers and asset managers have been indicted for this conduct[,]" and, accordingly, it is not fundamentally unfair to proceed with Buck's prosecution. (Id.)

***5** Buck argues in his reply that because the Indictment does not allege "that Buck lied, counseled another to lie, or provided false and misleading information to a U.S. taxing authority, this Indictment is unconstitutionally vague." ("Reply," Dkt. No. 64, at 7 (citing United States v. Coplan, 703 F.3d 46 (2d Cir. 2012)).)

The Reply also disputes the Government's contention that certain statements by Buck alleged in the Indictment were intended for the purposes of tax-avoidance, and argues that those statements are too ambiguous to support such inference. (See id. at 3-5.) Buck notes that several of the statements mentioned in the Indictment were "truthful statement[s] ... not indicative of criminal conduct." (Id. at 6.) Buck states that these factual concerns highlight that the Indictment fails to show willfulness, which "under the tax laws requires a voluntary, intentional violation of a known legal duty." (Id. at 5 (internal citation and quotation marks omitted).) Buck argues that these principles "apply to a court's review of the sufficiency of an indictment." (Reply at 6 (citing United States v. Pirro, 212 F.3d 86 (2d Cir. 2000)).)

Buck further argues that the viability of case law cited by the Government in support of extraterritoriality is doubtful. Namely, Buck contends that Morrison, 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010), and RJR Nabisco, Inc. v. European Cmty., ––– U.S. ––––, 136 S.Ct. 2090, 195 L.Ed.2d 476 (2016), cast a shadow of doubt over Bowman, 260 U.S. 94, 43 S.Ct. 39, 67 L.Ed. 149 (1922), and stand for the proposition that " '[a]bsent clearly expressed congressional intent to the contrary, federal laws will be construed to have only domestic application[.]' " (Id. at 8 (quoting RJR Nabisco, 136 S.Ct. at 2100).)

Finally, Buck disputes the Government's contentions and reiterates his positions regarding conflict of laws, due process, and fundamental fairness. Buck notes in particular that the Government's reliance on United States v. Al Kassar, 660 F.3d 108 (2d Cir. 2011), and United States v. Bin Laden, 92 F.Supp.2d 189 (S.D.N.Y. 2000), is misguided and does not support the proposition that

Buck was on notice of potential prosecution. (See id. at 9.) Lastly, Buck closes with a new argument, namely that, to the extent the Court may find any ambiguity in the applicable criminal statutes as applied here, the Court should interpret that ambiguity in favor of Buck, as permitted by the rule of lenity. (See id. at 10.)

II. LEGAL STANDARD

On a pretrial motion to dismiss an indictment pursuant to Rule 12(b) of the Federal Rules of Criminal Procedure, the Court takes the allegations in the indictment as true. See United States v. Goldberg, 756 F.2d 949, 950 (2d Cir. 1985). In addition, "[a]n indictment must be read to include facts which are necessarily implied by the specific allegations made." United States v. Stavroulakis, 952 F.2d 686, 693 (2d Cir. 1992).

Under the applicable standard, the Court does not consider the sufficiency of the evidence at this early stage in the proceedings, but rather focuses on the legal sufficiency of the indictment itself without looking any further. See United States v. Alfonso, 143 F.3d 772, 776-77 (2d Cir. 1998). Rule 7(c) of the Federal Rules of Criminal Procedure provides that the indictment "must be a plain, concise, and definite written statement of the essential facts constituting the offense charged." Fed. R. Crim. P. 7(c).

***6** "[A]n indictment is sufficient if it, first, contains the elements of the offense charged and fairly informs a defendant of the charge against which he must defend, and, second, enables him to plead an acquittal or conviction in bar of future prosecutions for the same offense." Hamling v. United States, 418 U.S. 87, 117, 94 S.Ct. 2887, 41 L.Ed.2d 590 (1974); see also United States v. D'Amelio, 683 F.3d 412, 418 (2d Cir. 2012) (holding that the "core of criminality" of an offense about which a defendant must be on notice "involves the essence of a crime, in general terms ... [and] the particulars of how a defendant effected the crime falls [sic] outside that purview.") Thus, "an indictment need do little more than to track the language of the statute charged and state the time and place (in approximate terms) of the alleged crime." Alfonso, 143 F.3d at 776 (quoting Stavroulakis, 952 F.2d at 693).

III. DISCUSSION

Upon review of the parties' respective submissions on Buck's Motion and relevant law, the Court is not persuaded that the Indictment should be dismissed.

Buck argues that the "defraud the United States" object of the conspiracy is unconstitutionally vague and "must be limited to 'plainly and unmistakably' criminal conduct[,]" and, moreover, that Buck's "conduct was not 'plainly and unmistakably' within the purview of the defraud provision." (Memorandum at 23.) However, evaluating Section 371 as applied and taking the allegations in the Indictment as true, as the Court must at this stage, a conspiracy with United States taxpayers to avoid reporting overseas bank accounts and evade income tax obligations would plainly and unmistakably defraud the IRS, and thus the United States, of money to which the Government is entitled. See United States v. Rosengarten, 857 F.2d 76, 79 (2d Cir. 1988) ("A conspiracy to frustrate or obstruct the IRS's function of ascertaining and collecting income taxes falls clearly within the ban of section 371."); Klein, 247 F.2d at 916 (finding that Section 371 "not only includes the cheating of the Government out of property or money, but also means to interfere with or obstruct one of its lawful governmental functions by deceit, craft or trickery, or at least by means that are dishonest") (internal quotation marks omitted). Buck's arguments on this point ultimately amount to challenging the truth of the allegations or his lack of intent to defraud. Such contentions raise questions of fact that are more appropriately addressed at trial and constitute insufficient bases to dismiss the Indictment.

Moreover, the cases on which Buck relies on this point do not support his argument. First, Hammerschmidt and Gradwell are inapposite. See Hammerschmidt v. United States, 265 U.S. 182, 44 S.Ct. 511, 68 L.Ed. 968 (1924) (holding that advocating for disobeying the Selective Service Act was insufficient to support a conviction for conspiracy to defraud the United States); United States v. Gradwell, 243 U.S. 476, 478, 37 S.Ct. 407, 61 L.Ed. 857 (1917) (holding that engaging in a scheme arranging for unqualified voters to vote at all or more than once was not "plainly and unmistakably" prohibited by the statute). Next, in the tax fraud context, Buck argues that United States v. Klein, 247 F.2d 908 (2d Cir. 1957), is distinguishable from the instant case because the attorneys in that case lied "directly to Treasury officials in order to falsely minimize a client's tax obligation" and, accordingly, does not support the broad applicability of the defraud provision in this case. In a similar vein, Buck relies on United States v. Coplan, 703 F.3d 46 (2d Cir. 2012), in which the Second Circuit reversed the conspiracy convictions of two defendants due to "insufficient evidence that they had lied, coached another to lie, or otherwise provided misleading information about a tax shelter at issue." (Memorandum at 25.) But these cases are unavailing under the circumstances presented here. The Indictment need not allege that Buck lied directly to a United States Treasury official or IRS agent in order to sufficiently allege a violation of Section 371. See, e.g., Rosengarten, 857 F.2d at 79. Moreover, Coplan invalidated the defendants' convictions, not the sufficiency of the indictment.

***7** Regarding extraterritoriality, it is possible that the alleged transactions involving checks Buck or co-conspirators sent to Arizona are sufficient to show a domestic connection, in which case Section 371 need not be applied extraterritorially to reach Buck's conduct in this case. See United States v. Zarrab, No. 15 Cr. 867, 2016 WL 6820737 (S.D.N.Y. Oct. 17, 2016) (finding sufficient domestic connection where a defendant "caused an international wire transfer from the U.A.E. to [a] Canadian company in the amount of approximately $953,289, which was processed by a United States bank").

Regardless of whether there is a domestic connection, however, the Court finds that Section 371 has extraterritorial application in this case insofar as "[s]tatutes prohibiting crimes against the United States government may be applied extraterritorially even in the absence of 'clear evidence' that Congress so intended[.]" Vilar, 729 F.3d at 73. Here, the alleged conspiracy is directed at an agency of the United States, namely the IRS, and thus as warranted by Vilar, Section 371 may be applied extraterritorially.

The Court is not convinced that Kiobel, Morrison, or RJR Nabisco compel a different result. All three of those cases involved civil suits brought by private parties, and thus did not encompass fraud against the United States government. Kiobel concerned a lawsuit brought by Nigerian nationals residing in the United States against Dutch, British, and Nigerian corporations, pursuant to the Alien Tort Statute ("ATS"), alleging unlawful conduct that occurred in Nigeria. There, the Supreme Court held that Congress had not expressly provided for the ATS to apply extraterritorially and, therefore, Plaintiffs did not overcome the presumption against extraterritoriality. 569 U.S. 108, 133 S.Ct. 1659, 185 L.Ed.2d 671. Morrison was a putative class action brought by foreign investors against an Australian bank, claiming violations of the Securities and Exchange Act of 1934. 561 U.S. at 251-53, 130 S.Ct. 2869. While the Supreme Court held in Morrison that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none[,]" that proposition was stated in the context of a private civil action. Id. at 255, 130 S.Ct. 2869. Likewise, RJR Nabisco involved a civil action under the Racketeering Influenced and Corrupt Organizations Act ("RICO") brought by the European Community, acting on behalf of its member states, against RJR Nabisco, a cigarette manufacturer. 136 S.Ct. at 2098. In that case, the Supreme Court held that RICO does apply extraterritorially, but that the statute's private right of action "does not overcome the presumption against extraterritorially" and thus "[a] private RICO plaintiff ... must allege and prove a domestic injury to its business or property." Id. at 2095 (emphasis in original omitted).

Relevant here, all three of these cases are silent with respect to the application of extraterritoriality in the context of criminal prosecution. Indeed, none of the decisions refers to Bowman or calls the holding of that case into question, as Buck contends. Thus, the Court finds that Kiobel, Morrison, and RJR Nabisco have no bearing on criminal actions brought by the United States Government to prosecute criminal offenses committed abroad that defraud the United States.

The Court is also not convinced that this case, as Buck contends, presents a conflict between Swiss and United States laws. While Buck states that the conflict exists because the Swiss law of bank secrecy requires that he not disclose the name of any account holder, even in the context of a criminal prosecution, the Indictment does not allege that Buck violated Section 371 because he failed to disclose the names of his clients to the IRS. Rather, the Indictment charges that Buck made many statements and took several actions in furtherance of a conspiracy to evade the obligations of United States taxpayers, including by, assisting United States taxpayers in the nondisclosure of their own accounts, in filing untruthful tax documents, or in failing to file required tax documents altogether.

***8** Buck argues that any "[c]riminal liability for Swiss bankers must be fact-intensive and based on the particular actions committed by the particular person. It cannot be the case that all Swiss bankers are guilty of conspiring to commit U.S. tax evasion merely because they opened and managed accounts for U.S. beneficial owners[.]" (Memorandum at 35.) Buck may be right on this score, but his argument misses the point. The Indictment does not charge all Swiss bankers and it does not allege that Buck merely opened and managed traditional Swiss bank accounts for United States taxpayers. As the Government notes, it "has not sought to 'criminalize a broad array of conduct encompassing all activities engaged in by Swiss bankers[,]' but rather has brought a case against a specific Swiss banker—Buck—based on his [alleged] conduct [.]" (Opposition at 3.)

Specifically relating to Buck, the Indictment charges he made numerous statements to clients regarding whether they should or should not report their accounts; sent checks to the United States; and allegedly told clients facing subpoenas that wire-transfers would have prevented accounts from being detected, among other things. The Indictment further alleges that Buck's statements and actions in this regard were willful or knowing. (See Indictment ¶¶ 89-90.) Whether these accusations are true or what intent underlay Buck's statements and actions are precisely the kinds of evidentiary questions that should be evaluated by a jury, and not by this Court as a pre-trial matter.

Regarding Buck's Fifth Amendment Due Process claims, the Court finds that Buck received adequate notice of the possibility of prosecution and that there is a sufficient constitutional link to the United States and United States interests involving Buck and the criminal conduct he is charged with having engaged in outside of this country. Buck argues that he did not receive notice because he "did not market his services to U.S. customers"; "provide affirmative tax advice to U.S. persons"; or "lie to or deceive the IRS[.]" (Memorandum at 33.) But, the Indictment alleges that several Swiss Bank No. 1 clients were referred to Buck by other Swiss banks that were closing all accounts of United States taxpayers, and that Buck and Swiss Bank No. 1 readily accepted their business. Moreover, while Buck disputes the intent behind his statements informing clients regarding whether or not they must disclose the accounts to United States authorities or file appropriate tax forms, the Indictment's allegations, taken as true, are sufficient to give Buck notice of charges of unlawful conduct. Any factual disputes Buck may have in this connection are better addressed to a jury.

Furthermore, while the Indictment does not allege that Buck personally lied to or directly deceived the IRS, it does allege that Buck made statements to co-conspirator clients as to how detection of accounts could have been avoided, and discouraged them from voluntarily disclosing their accounts. Again, while these accusations have not been proven at this stage, the allegations are sufficient, and, if true, would have provided Buck appropriate notice in general terms about the essence of the crime of which he is accused. See D'Amelio, 683 F.3d at 418 (2d Cir. 2012) (finding a defendant must be on notice of "the essence of a crime, in general terms" but that "the particulars of how a defendant effected the crime falls [sic] outside that purview").

Regarding the constitutional connection to the United States in this case, the Second Circuit has adopted the standard used by the Ninth Circuit for determining "the extent to which the Due Process Clause limits the United States' assertion of jurisdiction over criminal conduct committed outside our borders." Yousef, 327 F.3d at 111. That standard requires "that '[i]n order to apply extraterritorially a federal criminal statute to a defendant consistently with due process, there must be a sufficient nexus between the defendant and the United States, so that such application would not be arbitrary or fundamentally unfair.' " Id. (quoting United States v. Davis, 905 F.2d 245, 248-49 (9th Cir. 1990)). The Court agrees with the Government that, given the United States' significant interest in enforcing its tax laws against taxpayers not only in the United States but also abroad, Buck's alleged conduct is not "so unrelated to American interests as to render [his] prosecution in the United States arbitrary or fundamentally unfair." Yousef, 327 F.3d at 111.

***9** Finally, the Court finds Buck's arguments that fundamental fairness and the rule of lenity require dismissal of the Indictment unavailing.

Accordingly, the Court holds that the Indictment is legally sufficient and declines to dismiss it at this stage.

IV. ORDER

For the reasons set forth above, it is hereby

ORDERED that the motion (Docket No. 59) of defendant Stefan Buck to dismiss the underlying indictment is DENIED.

SO ORDERED.

All Citations

Slip Copy, 2017 WL 4174931

Footnotes

[1] The factual summary that follows derives from the Indictment, and the following documents, including any documents or exhibits attached thereto or referenced therein: the Memorandum of Law in Support of the Motion to Dismiss the Indictment ("Memorandum in Support," Dkt. No. 60); the Government's Memorandum of Law in Opposition ("Opposition," Dkt. No. 62); and the Reply in Support of the Motion for Dismissal ("Reply," Dkt. No. 64). Except where specifically referenced, no further citation to these sources will be made.

[2] The Indictment states that the Defendants participated in the conspiracy "[f]rom at least in or about 2000 through in or about at least 2012[.]" (Indictment ¶ 13.) However, the Indictment also states Buck began working at Swiss Bank No. 1 "[s]tarting in or about June 2007[.]" (Id. ¶ 6.) To the extent the former statement is intended to encompass the entire extent of the conspiracy involving either Paltzer or Buck or both, the Court considers only 2007 to 2012 as the relevant period regarding Buck's alleged role in the conspiracy.

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498 Fed.Appx. 284
This case was not selected for
publication in the Federal Reporter.
Not for Publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial decisions
issued on or after Jan. 1, 2007. See also Fourth
Circuit Rule 32.1 (Find CTA4 Rule 32.1)
United States Court of Appeals,
Fourth Circuit.

Joseph B. WILLIAMS, III, Petitioner–Appellant,
v.
COMMISSIONER OF INTERNAL
REVENUE, Respondent–Appellee.

No. 11–1804.
|
Argued: Sept. 19, 2012.
|
Decided: Dec. 4, 2012.

Synopsis
Background: Taxpayer petitioned for a redetermination of income tax deficiencies and fraud and accuracy-related penalties arising from his failure to report investment income and consulting fees and his disallowed charitable deductions for gifts of art. The Tax Court, David D. Gustafson, J., 2011 WL 1518581, entered an order upholding notice of deficiency, and taxpayer appealed.

Holdings: The Court of Appeals, Urbanski, District Judge, held that:

[1] taxpayer's guilty plea to criminal tax evasion collaterally estopped him from denying his liability for civil tax fraud penalties;

[2] income generated by taxpayer's consulting services was attributable to taxpayer individually; and

[3] taxpayer's charitable deduction was limited to his basis in art he donated.

Affirmed.

***285** Appeal from the United States Tax Court. (Tax Ct. No. 2202–08).

Attorneys and Law Firms

ARGUED: David Harold Dickieson, Schertler & Onorato, LLP, Washington, D.C., for Appellant. Damon William Taaffe, United States Department of Justice, Washington, D.C., for Appellee. **ON BRIEF:** Pamela Satterfield, Schertler & Onorato, LLP, Washington, D.C., for Appellant. **ON BRIEF:** Tamara W. Ashford, Deputy Assistant Attorney General, Robert W. Metzler, United States Department of Justice, Washington, D.C., for Appellee.

Before WILKINSON and THACKER, Circuit Judges, and MICHAEL F. URBANSKI, United States District Judge for the Western District of Virginia, sitting by designation.

Opinion

Affirmed by unpublished opinion. Judge URBANSKI wrote the opinion, in which Judge WILKINSON and Judge THACKER joined.

Unpublished opinions are not binding precedent in this circuit.

URBANSKI, District Judge:

****1** Joseph B. Williams, III, challenges the notice of tax deficiency issued to him by the Commissioner of Internal Revenue for tax years 1993 through 2000. The Tax Court upheld the Commissioner's notice of deficiency. Williams now appeals.

Williams argues that the Tax Court erred in three ways: (1) by holding Williams' guilty plea to criminal tax evasion collaterally estops him from denying liability for civil fraud penalties for tax years 1993 through 2000; (2) by attributing income generated by Williams' consulting services to Williams individually instead of to the foreign corporation he formed; and (3) by disallowing certain charitable deductions taken by Williams for art donations made to two universities over the course of three years. Finding each of Williams' arguments to be without merit, we affirm.

I.

A.

Williams worked for Mobil Oil Corporation from 1973 until his retirement in 1998. In the 1990s, he was tasked with developing strategic business relationships in Russia and former Soviet republics. In 1993, separate and apart from his work with Mobil, Williams began providing consulting and other services concerning pipeline-related contracts to foreign governments. Alika Smekhova, a Russian actress and celebrity, arranged introductions and provided interpretation services for Williams in connection with his consulting work. That same year, Williams formed ALQI Holdings, Inc. ("ALQI"), a British Virgin Islands corporation. Williams was the sole owner, operational director, and officer of ALQI. Neither Williams nor Smekhova had a written employment contract with ALQI.

Two accounts were opened in ALQI's name at a Swiss bank, Banque Indosuez ("the ALQI accounts"). Williams had ***286** complete authority over the ALQI accounts. The bank provided Williams with use of its office space, as well as a Swiss mobile telephone and credit card that were issued and billed in Williams' name. All monies deposited into the ALQI accounts between 1993 and 2000 were received for Williams' oil and pipeline-related consulting services. There are no consulting agreements documenting the services rendered. Williams did not use the ALQI name in his dealings with third parties and did not maintain corporate accounting records.

Smekhova was paid a stipend of $5,000 to $10,000 per month from the ALQI accounts, but Williams did not pay himself a salary or commission. Funds were transferred from the ALQI accounts at Williams' direction, however, and were used to pay credit cards and other bills reflecting Williams' personal expenses, such as a $30,000 shopping spree in Paris and a family ski vacation. Williams also made gifts to family and friends from these accounts, including over $41,000 in payments to his former secretary and a $15,000 gift to the wife of Williams' deceased father.

More than $7 million in consulting fees were deposited into the Swiss accounts during the relevant period and over $1.1 million in interest, dividends and capital gains was earned on these deposits. Williams did not report any of the consulting fee or investment income on his individual tax returns for tax years 1993 through 2000, nor did he disclose the existence of ALQI or its Swiss accounts.

****2** In 2000, at the request of the United States government, the Swiss government froze the ALQI accounts. Subsequently, Williams disclosed his ownership interest in ALQI and the existence of the ALQI accounts on his 2001 tax return.[1] In 2003, Williams amended his 1999 and 2000 tax returns[2] to report the investment income earned on the funds in the ALQI accounts, and he paid the additional tax due. Williams did not include as income on either his original or amended returns the corpus of the accounts.

In 2003, Williams was charged in a two-count superseding criminal information with conspiracy to defraud the government, in violation of 18 U.S.C. § 371, and tax evasion, in violation of 26 U.S.C. § 7201. On June 12, 2003, Williams entered a guilty plea to both counts. The court accepted the guilty plea, sentenced Williams to 46 months' incarceration, and ordered him to pay $3,512,000 in restitution. Williams was released from federal custody on May 21, 2006.

B.

In 1996, Williams signed an Art Purchase Agreement in which he purportedly committed to purchasing at a discount from Abbey Art Consultants, Inc. ("Abbey Art") certain works of art that, at Williams' direction, were to be donated at fair market value to charitable institutions. The Agreement recited that Williams "desire[d] to purchase" $72,000 worth of art, but did not identify specific pieces of art, and provided that the purchase price would not exceed 24% of the appraised fair market value of the art. The Agreement ***287** required Williams to pay only $3,600 upon signing; the balance of the purchase price was to be paid on or before such time as the art was donated to charity.

Abbey Art was to facilitate all aspects of the art donation and incur all expense, including paperwork, appraisal, packaging, shipping, and storage costs. The Agreement provided that Abbey Art would arrange for the donation "after the required holding period of one (1) year." While Williams could request a donation be made to a certain charitable institution, Abbey Art ultimately had the discretion to choose the donee. If Abbey Art was unable to facilitate the art donation for any reason, the Agreement required Abbey Art to refund Williams' payments. Additionally, Abbey Art's sole remedy under the Agreement for Williams' non-payment was to retain payments already received and retake possession of the art.[3] In the event of a reduction in the fair market value of the art, Abbey Art agreed to pay Williams an amount equal to “the percentage of the dollars paid for each dollar the fair market value of the Art has been reduced.” Finally, the Agreement provided that it was the entire agreement between the parties and that it was to be interpreted under New York law.

In December 1997, Abbey Art, at Williams' direction, donated certain pieces of art with an appraised fair market value of $425,625 to Drexel University. Williams received an invoice from Abbey Art in the amount of $98,400, representing a purchase price of $102,000 (approximately 24% of the appraised fair market value of the art) less Williams' $3,600 deposit. Williams paid Abbey Art $98,400 before the end of 1997 and on his federal income tax return for that year, Williams claimed a charitable contribution deduction of $425,625.

****3** In December 1999, Williams wrote Abbey Art requesting that a gift of art be made on his behalf to Florida International University for the current tax year. Williams enclosed with this letter a check in the amount of $57,500. Certain pieces of art with an appraised value of $250,525 were donated at Williams' request prior to the end of the year. On his 1999 federal tax return, Williams claimed the full fair market value of the art as a charitable contribution deduction.

In 1999, Williams paid Abbey Art $4,600, and in October 2000, Abbey Art arranged a gift of additional artwork with an appraised value of $98,900 to Drexel University. Williams paid Abbey Art the balance due on this donation, $17,158, on December 8, 2000. Williams again claimed the fair market value of the donated art as a charitable contribution deduction on his 2000 federal income tax return.

C.

On October 29, 2007, the Commissioner of Internal Revenue issued a notice of tax deficiency to Williams. The Commissioner found the consulting fees deposited into the ALQI accounts between 1993 and 2000, as well as the investment income earned on those funds, to be taxable income to Williams and assessed civil fraud penalties for each of the eight years he failed to report this income on his tax returns. The Commissioner also determined that Williams was only entitled to charitable contribution deductions in the amount of his basis in the art donated through Abbey Art, because Williams had not owned the art for at least one year prior to the ***288** donations. The Commissioner assessed accuracy-related penalties on the underpayments resulting from the disallowed charitable deductions.

Williams challenged the notice of deficiency by filing a petition in the Tax Court. The Tax Court granted partial summary judgment in favor of the Commissioner, holding Williams was collaterally estopped from denying that he had committed civil tax fraud during each of the years 1993 through 2000. *Williams v. Comm'r,* No. 2202–08, 2009 WL 1033354 (U.S.Tax Ct. Apr. 16, 2009). Following a bench trial, the Tax Court found that the consulting fee and investment income deposited into the ALQI accounts between 1993 and 2000 was attributable to Williams individually. The Tax Court further held that Williams was not entitled to a charitable contribution deduction in the amount of the fair market value of the donated art because Williams did not hold the art for more than one year before donating it. Accordingly, the Tax Court upheld the Commissioner's notice of deficiency and assessment of civil tax fraud and accuracy-related penalties. *Williams v. Comm'r,* No. 2202–08, 2011 WL 1518581 (U.S.Tax Ct. Apr. 21, 2011). This appeal followed.

We review the Tax Court's decision applying the same standard of review as we would to a civil bench trial in the United States district court. *Waterman v. Comm'r,* 179 F.3d 123, 126 (4th Cir.1999). Questions of law and statutory interpretation are reviewed *de novo* and findings of fact for clear error. *Id.* The grant of the Commissioner's motion for partial summary judgment on the collateral estoppel issue is reviewed *de novo. Henson v. Liggett Grp., Inc.,* 61 F.3d 270, 274 (4th Cir.1995). The Commissioner's notice of deficiency is presumed to be correct, and the taxpayer bears the burden of proving it wrong. *McHan v. Comm'r,* 558 F.3d 326, 332 (4th Cir.2009); *see also Welch v. Helvering,* 290 U.S. 111, 115, 54 S.Ct. 8, 78 L.Ed. 212 (1933).

II.

****4** **[1]** Williams first argues on appeal that the Tax Court erred in holding that his guilty plea to criminal tax evasion in violation of 26 U.S.C. § 7201 collaterally estops him from denying his liability for civil tax fraud penalties under 26 U.S.C. § 6663 for the years 1993 through 2000.[4]

The doctrine of collateral estoppel applies "where (1) the 'identical issue' (2) was actually litigated (3) and was 'critical and necessary' to a(4) 'final and valid' judgment (5) resulting from a prior proceeding in which the party against whom the doctrine is asserted had a full and fair opportunity to litigate the issue." *McHan,* 558 F.3d at 331 (quoting *Collins v. Pond Creek Mining Co.,* 468 F.3d 213, 217 (4th Cir.2006) (citation and quotation marks omitted)). "[O]nce an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States,* 440 U.S. 147, 153, 99 S.Ct. 970, 59 L.Ed.2d 210 (1979).

A taxpayer is collaterally estopped from denying civil tax fraud when convicted for criminal tax evasion under 26 U.S.C. § 7201 for the same taxable year. ***289** *Moore v. United States,* 360 F.2d 353, 355 (4th Cir.1966); *DiLeo v. Comm'r,* 96 T.C. 858, 885–86 (1991), *aff'd,* 959 F.2d 16 (2d Cir.1992); *see generally United States v. Wight,* 839 F.2d 193, 196 (4th Cir.1988) ("The doctrine of collateral estoppel may apply to issues litigated in a criminal case which a party seeks to relitigate in a subsequent civil proceeding."). "[W]hile the criminal evasion statute does not explicitly require a finding of fraud, the case-by-case process of construction of the civil and criminal tax provisions has demonstrated that their constituent elements are identical." *Moore,* 360 F.2d at 356.

A.

[2] Williams argues that the Tax Court misinterpreted the terms of his guilty plea in barring him from denying civil tax fraud liability for the years 1993 through 2000. Williams contends that he did not plead guilty to tax evasion, but rather to evasion of *payment* of taxes, the elements of which are not dependent upon any specific tax year.[5] As such, Williams argues that he is not collaterally estopped from denying civil tax fraud for the entire eight year period set forth in the notice of deficiency, or for any particular year therein.

We reject this argument because, in addition to lacking merit, it has been waived. Williams failed to raise this argument before the Tax Court. Ordinarily, we will not consider an issue raised for the first time on appeal except in limited circumstances, *Nat'l Wildlife Fed'n v. Hanson,* 859 F.2d 313, 318 (4th Cir.1988), and this rule is applied equally by courts of appeals reviewing Tax Court decisions, *Karpa v. Comm'r,* 909 F.2d 784, 788 (4th Cir.1990) (citing *Grauvogel v. Comm'r,* 768 F.2d 1087, 1090 (9th Cir.1985)). Williams has not suggested any reason why we should depart from our ordinary rule in this case, and we see no reason to do so.

B.

****5** Williams also takes issue with the Tax Court's finding that his conviction for tax evasion collaterally estops him from denying civil fraud for each year from 1993 through 2000. Williams disputes that he pled guilty to tax evasion for each and every one of these years. The record, however, proves fatal to this claim. The plain language of the superseding criminal information charges Williams with tax evasion for each year from 1993 through 2000:

> From in or about 1993, through in or about April 2001, ... J. BRYAN WILLIAMS, the defendant, unlawfully, willfully and knowingly did attempt to evade and defeat a substantial part of the income tax due and owing by J. BRYAN WILLIAMS ... for the calendar years 1993 through 2000, by various means, including, among others by (a) arranging for approximately $7.98 million in payments which were income to Williams to be made into the secret Alqi accounts in Switzerland he controlled; and (b) preparing and causing to be prepared, signing and causing to be signed, and filing

> and causing to be filed, false and fraudulent U.S. Individual Income Tax Returns, Forms 1040, for the calendar years 1993 through 2000, on ***290** which he failed to disclose his interest in the secret Alqi bank accounts in Switzerland, and on which, in the years set forth below, he failed to report the approximate amounts of income set forth below, and upon which income there was a substantial additional tax due and owing to the United States of America:

Calendar Year	Approximate Amount of Income
1993	$1,029,518.72
1994	$ 752,479.52
1995	$ 998,723.14
1996	$3,917,762.57
1997	$1,670,891.49
1998	$ 133,371.90
1999	$ 109,167.59
2000	$ 256,234.64

(Title 26, United States Code, Section 7201).

Williams pled guilty to this tax evasion count, as well as to conspiracy to defraud the government in violation of 18 U.S.C. § 371. Pursuant to a written plea agreement, Williams agreed to "file accurate amended personal tax returns for the calendar years 1993 through 2000" and "pay past taxes due and owing to the [IRS] by him for calendar years 1993 through 2000, including any applicable penalties."

Additionally, Williams admitted during his allocution at his guilty plea hearing that he knew the funds deposited into the ALQI accounts were taxable to him. Williams acknowledged that for "the calendar year tax returns for #93 through 2000, [he] chose not to report the income to [the IRS] in order to evade the substantial taxes owed thereon, until [he] filed [his] 2001 tax return." Williams continued: "I therefore believe that I am guilty of evading the payment of taxes for the tax years 1993 through 2000." As the Tax Court observed, there is no question that Williams pled guilty to and was convicted of tax evasion for each of the eight calendar years 1993 through 2000.

Williams insists he made clear to the district court that he was pleading to a narrower statement of facts concerning tax evasion than those contained in the superseding information. The record proves otherwise. At the plea hearing, Williams' counsel told the district judge:

> ****6** [W]e're not adopting or accepting the facts as stated in the conspiracy count, which I think is the recitation of what was in the original indictment in this case. What we have agreed is that Mr. Williams would plead guilty to conspiracy counts, but based upon the factual allocution, which he has given to the Court.

This statement plainly refers to the conspiracy count, not to the tax evasion count. Williams pled guilty to both conspiracy and tax evasion. While he raised a concern at the plea hearing about the factual allegations surrounding the conspiracy count, Williams did not deny any fact or allegation concerning tax evasion, nor raise any issue whatsoever with respect to that count. On the contrary, Williams expressly admitted to facts that demonstrate his tax evasion scheme continued from 1993 until the time he filed his 2001 tax return, as charged in the information.

C.

Williams' final contention with respect to collateral estoppel is that he did not have a full and fair opportunity to litigate the issue previously, because at the time he entered his guilty plea, neither the Commissioner nor Williams had analyzed the actual tax implications arising from the ALQI accounts and the amount of deficiencies ***291** for each tax year.[6] Thus, argues Williams, the fraud penalties were not actually and necessarily decided by the court in his criminal case.

Williams confuses the issues. It matters not whether civil fraud penalties and interest had been calculated as of the date of his guilty plea or sentencing.[7] These determinations are not required to secure a criminal conviction for tax evasion. What matters for purposes of collateral estoppel is that Williams was indeed convicted of evasion for the years in question. As we held in *Moore,* that conviction "supplies the basis for a finding of fraud in [a] civil proceeding to determine tax liability." 360 F.2d at 355 (citing *Tomlinson v. Lefkowitz,* 334 F.2d 262 (5th Cir.1964)).

Williams pled guilty to a tax evasion scheme that continued from 1993 until 2000. In so doing, Williams admitted that he committed tax fraud in each of those eight years. In light of his guilty plea and allocution, Williams cannot now deny liability for civil tax fraud penalties for the years in question. We find the Tax Court correctly applied the doctrine of collateral estoppel in this case.

III.

[3] Williams next argues that the Tax Court erred in finding him individually liable for tax on the consulting fee income deposited into the ALQI accounts between 1993 and 2000. Williams asserts that ALQI was a legitimate business for which he performed consulting work and contends that he acted on the company's behalf when he earned the consulting fees at issue. We are not persuaded.

"The principle that income is taxed to the one who earns it is basic to our system of income taxation." *Haag v. Comm'r,* 88 T.C. 604, 610 (1987), *aff'd,* 855 F.2d 855 (8th Cir.1988) (unpublished table decision); ***292** *see also Lucas v. Earl,* 281 U.S. 111, 50 S.Ct. 241, 74 L.Ed. 731 (1930). For income to be taxable to a corporation: (1) the service-performer must be an employee of the corporation whom the corporation has the right to direct or control in some meaningful sense; and (2) there must exist between the corporation and the person a contract or similar indicium recognizing the corporation's controlling position. *Haag,* 88 T.C. at 611 (citing *Johnson v. Comm'r,* 78 T.C. 882, 891 (1982)). No such employer-employee relationship exists here.

****7** Williams testified that he had no written employment agreement and received no regular salary or commission payments from ALQI. He stipulated that he was the sole operational director and officer of ALQI and the only person with authority to act on the company's behalf in its business activities. Williams had exclusive signature authority over the ALQI accounts from 1993 through 2000 and was the sole person from whom Banque Indosuez would accept instructions with respect to those accounts. There is simply no indication that ALQI wielded any form of control over Williams as an employee.

Beyond that, the evidence strongly suggests that Williams did not act on behalf of ALQI when he earned the income in question and merely used ALQI as a bank account. Apart from Williams' testimony, there is no evidence that Williams' consulting clients even knew ALQI existed. There are no consulting agreements, notes or other records that reflect ALQI's business dealings. In fact, there are no ALQI business records at all for the period at issue, except for bank records maintained by Banque Indosuez and a single balance sheet and profit and loss statement dated June 30, 2000. Williams' accountant, Donald Williamson, testified that while he reviewed voluminous bank records and incorporation documents in the course of his work, he did not see any general ledgers, profit and loss statements or balance sheets for ALQI, nor did he see any consulting contracts. Williamson testified that he relied on the representations of Williams and Williams' counsel that ALQI earned the consulting fees in question, and he took those representations at face value.

In an effort to legitimize ALQI's operations, Williams points to ALQI's use of Banque Indosuez's office space, its Swiss cell phone and credit card, as well as the fact that clients deposited consulting fees directly into the ALQI accounts. Williams insists that ALQI employed Smekhova to arrange, attend and translate at meetings conducted for ALQI business, and that ALQI, not Williams, paid her for her services. But Smekhova, like Williams, had no written employment agreement with ALQI. As the Tax Court noted, "[t]he fact that Mr. Williams' business and personal expenses were paid out of these same Swiss bank accounts does not prove that his clients contracted with ALQI or that ALQI was anything other than the receptacle into which Mr. Williams diverted his consulting income." *Williams,* 2011 WL 1518581, at *14.

Williams argues that because ALQI is not a "sham" corporation—and the Tax Court assumed that it is not—it must follow that the consulting fee income is taxable to ALQI. But Williams' reasoning is flawed. As the Tax Court persuasively explained, whether ALQI is a legitimate business entity is irrelevant; ALQI simply did not earn the income at issue. [8] *Id.; see* ***293** *Haag,* 88 T.C. at 611 ("A finding that the [corporation] is not a sham does not preclude application of the assignment of income doctrine because a taxpayer can assign income to a corporation with real and substantial businesses to avoid tax liability.").

****8** Moreover, Williams cannot rise above his own admissions at his guilty plea hearing that the "purpose of the [ALQI] accounts was to hold funds and income [he] received from foreign sources during the years 1993 to 2000." Williams further acknowledged that he "knew that most of the funds deposited into the A[LQI] accounts, and all of the interest income were taxable income to [him]," but admitted he "chose not to report the income to the Internal Revenue Service in order to evade the substantial taxes owed thereon."

The Commissioner's determinations of income are entitled to a presumption of correctness, and the taxpayer bears the burden of proving them wrong. *McHan v. Comm'r,* 558 F.3d 326, 332 (4th Cir.2009). "The IRS is not given free rein, however: the taxpayer can rebut the presumption of correctness by proving, by a preponderance of the evidence, that the IRS's income determination is arbitrary or erroneous." *Id.* Williams has not rebutted the presumption in this case. For these reasons, we find that Williams is liable for tax on the corpus of the ALQI accounts, in addition to the passive income earned on those funds. [9]

IV.

[4] Williams' final argument on appeal is that the Tax Court erred in limiting his charitable contribution deductions to his basis in the art donated through Abbey Art, rather than allowing deduction of the art's fair market value. Williams contends that the Tax Court erroneously found the Art Purchase Agreement to be an option contract, ignoring both the mutual understanding of the parties and the plain language of the Agreement. For the reasons that follow, we find Williams' arguments unavailing.

A.

Generally, a deduction is allowed for any charitable contribution for which payment is made within the taxable year. 26 U.S.C. § 170(a)(1). The deduction is allowable, however, only if the contribution is "verified under the regulations prescribed by the Secretary." *Id.* When a contribution involves property other than money, the amount of the charitable contribution is the fair market value of the property at the time the donation is made. 26 C.F.R. § 1.170A–1(c)(1). This rule is modified in situations involving donations of appreciated ***294** property. In those circumstances, the amount of any charitable contribution is reduced by the amount of gain that would not have qualified as long-term capital gain if the property had been sold by the taxpayer at its fair market value, determined as of the time of the contribution. 26 U.S.C. § 170(e)(1)(A). In other words, section 170(e)(1)(A) permits the deduction of long-term capital gain appreciation but if the property is not long-term capital gain property, the charitable contribution deduction is limited to the taxpayer's basis at the time of the contribution. Long-term capital gain is defined as gain from the sale or exchange of a capital asset [10] held for more than one year. 26 U.S.C. § 1222(3). The taxpayer bears the burden of proving he is entitled to a charitable deduction in the amount of the fair market value of the donated property. *See INDOPCO, Inc. v. Comm'r,* 503 U.S. 79, 84, 112 S.Ct. 1039, 117 L.Ed.2d 226 (1992).

B.

****9** The issue to be resolved is whether Williams held the art in question for more than one year before donating it. "In common understanding to hold property is to own it. In order to own or hold one must acquire. The date of acquisition is, then, that from which to compute the duration of ownership or the length of holding." *McFeely v. Comm'r,* 296 U.S. 102, 107, 56 S.Ct. 54, 80 L.Ed. 83 (1935). Williams argues that he acquired the art when he executed the Art Purchase Agreement in December 1996. The Commissioner asserts that Williams did not acquire the art until he paid for it, which in each case was within a year of the donation.

In determining the date of acquisition of property:

> [N]o hard-and-fast rules of thumb can be used, and no single factor is controlling. "Ownership of property is not a single indivisible concept but a collection or bundle of rights with respect to the property;" consequently, we must examine the transaction in its entirety. The date of the passage of legal title is not the sole criteria; the date on which "the benefits and burdens or the incidents of ownership of the property" were passed must also be considered, and the legal consequence of particular contract provisions must be examined in the light of the applicable State law.

Hoven v. Comm'r, 56 T.C. 50, 55 (1971) (internal citations omitted).

The Tax Court did not look to state law in resolving this issue, however, and the Commissioner insists that state law has no applicability here. Both the Commissioner and the Tax Court cite *United States v. Heller,* 866 F.2d 1336, 1341 (11th Cir.1989), for the proposition that "federal tax law disregards transactions lacking an economic purpose which are undertaken only to generate a tax savings. Federal tax law is concerned with the economic substance of the transaction under scrutiny and not the form by which it is masked." Indeed, the Fifth Circuit has recognized that "[t]he application and interpretation of the Internal Revenue Code is a matter of federal law. The form of a document and its effect under state law are therefore not controlling in these federal determinations." *Deshotels v. United States,* 450 F.2d 961, 964 (5th Cir.1972). The Fifth Circuit found it appropriate to look to Louisiana law in *Deshotels,* however, in order to understand the agreement at the heart of the parties' dispute. *Id.* Williams argues we should do the same here and look to New York law [11] in interpreting the Art ***295** Purchase Agreement, and he cites to our decision in *Volvo Cars of North America, LLC v. United States,* 571 F.3d 373 (4th Cir.2009), in support of that contention.

In that case, Volvo had written-off excess inventory that it purportedly sold to a warehouser pursuant to the terms of a 1983 contract, thereby reducing its taxable income for the 1983 tax year. The IRS found these were not bona fide sales because Volvo retained control over the inventory even after it was transferred. Volvo brought suit seeking a refund of the tax paid due to the disallowed write-offs, and the jury returned a verdict in Volvo's favor. The district court entered judgment notwithstanding the verdict as to transfers of inventory made prior to execution of the 1983 contract, finding as a matter of law that the contract did not address inventory previously transferred to the warehouser. Volvo appealed. In determining whether the 1983 contract covered inventory previously transferred, we looked to state law "because 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property.' " *Id.* at 378 (citing *United States v. Nat'l Bank of Commerce,* 472 U.S. 713, 722, 105 S.Ct. 2919, 86 L.Ed.2d 565 (1985)). As the Supreme Court stated in *National Bank,* "[t]his follows from the fact that the federal statute 'creates no property rights but merely attaches consequences, federally defined, to rights created under state law.' " 472 U.S. at 722, 105 S.Ct. 2919 (quoting *United States v. Bess,* 357 U.S. 51, 55, 78 S.Ct. 1054, 2 L.Ed.2d 1135 (1958)).

****10** To be sure, the economic substance of the transaction is the primary concern in the instant case. We need not accept that the parties contracted for the sale of art simply because their signatures appear on a document entitled "Art Purchase Agreement." Even if we look to state law to help determine the nature of the legal interest conveyed by the Agreement, as Williams urges us to do, we remain convinced that the Tax Court correctly determined that Williams' charitable contribution deduction is limited to his basis in the donated art.

C.

The Tax Court examined the rights, duties and obligations the parties assumed when they executed the Art Purchase Agreement and concluded that by signing the Agreement and paying $3,600 up front, Williams purchased an option to buy art. Under New York law, "whether an agreement is a binding contract or an option is to be determined like any other issue of contract interpretation from all four corners of the agreement." *Interactive Prop. Corp. v. Blue Cross & Blue Shield,* 114 Misc.2d 255, 450 N.Y.S.2d 1001, 1002 (1982). Although a "contract for sale" can encompass both a present sale of goods and a contract to sell goods at a future time, a "sale" requires the passing of title from the seller to the buyer for a price, N.Y. U.C.C. Law § 2–106, and "[t]itle to goods cannot pass under a contract for sale prior to their identification to the contract," *id.* at § 2–401(1). Indeed, "title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods ... even though a document of title is to be delivered at a different time or place...." *Id.* at § 2–401(2).

An option contract, on the other hand, "is an agreement to hold an offer open; it confers upon the optionee, for consideration paid, the right to purchase at a later ***296** date." *Kaplan v. Lippman,* 75 N.Y.2d 320, 324, 552 N.Y.S.2d 903, 552 N.E.2d 151 (1990). "[U]ntil the optionee gives notice of his intent to exercise the option, the optionee is free to accept or reject the terms of the option." *Id.* at 325, 552 N.Y.S.2d 903, 552 N.E.2d 151. The contract ripens into a fully enforceable bilateral contract once the optionee gives notice of his intent to exercise the option in accordance with the agreement. *Id.*

The following leads us to believe the Tax Court correctly concluded that the Art Purchase Agreement is not a contract for sale that triggered the holding period required for long-term capital gain.[12]

1.

Title to the art did not pass upon execution of the Agreement in 1996, and delivery was not made. In fact, the art in question was not even identified in the Agreement. Rather, "[t]he specific items purchased by the Client [were to] be described in written appraisals" and given to Williams once he received physical possession of the art or donated it to a charitable institution. This could not occur, pursuant to the Agreement's terms, until Williams paid the balance of the purchase price. While he asserts art was segregated for him in Abbey Art's warehouse, Williams does not have an inventory of this segregated art, nor did he ever visit the warehouse to view it.

2.

****11** The Agreement provides that $3,600, five percent of the total agreed purchase price of the art ($72,000), was to be paid up front and would be held in escrow pending satisfaction of the Agreement's provisions. The balance of the purchase price was due at the time Williams received physical possession of the art or when it was donated, an act which was to occur in the future but at no specified time.

Aside from the initial $3,600 payment, Williams had no obligation to perform under the contract. Williams was not required to follow through with the purchase, and Abbey Art had no right to require specific performance of the full balance of the purchase price. Its sole remedy for Williams' non-payment was to retain as liquidated damages any monies that Williams had paid towards the purchase of the art and to reclaim ownership over it.

Indeed, Abbey Art bore all of the expense and all of the risk in this transaction. It was responsible for selecting and paying the appraiser, packaging and shipping the art, and completing all the necessary paperwork. Even in storing the art, Abbey Art bore the risk of loss. *See* N.Y. U.C.C. Law § 2–509. Moreover, if the fair market value of the art fell below what was reflected in the appraisal, reducing the tax benefit to Williams, Abbey Art was required to refund Williams the percentage of his dollars paid for each dollar in reduction of the fair market value.

3.

The Agreement provides that the total purchase price of the art would not exceed 24% of the cumulative appraised fair market value of the art purchased.[13] The purchase price set forth in the agreement is ***297** $72,000, which is 24% of $300,000. Thus, the Agreement contemplates $300,000 worth of art would be purchased. Yet the fair market value of the first art donation Williams made ($425,625) far exceeded that amount. Arguably, even if title did pass for $300,000 worth of art upon execution of the Agreement in 1996, it still would not account for the extra $125,000 worth of art donated to Drexel University in 1997, the $250,525 worth of art donated to Florida International University in 1999, and the $98,900 worth of art donated to Drexel in 2000.

D.

In sum, the 1996 Art Purchase Agreement was not a contract for sale. Therefore, Williams' holding period for purposes of the long-term gain calculation did not begin until he paid for and acquired a present interest in the art. In each instance, this occurred less than one year from the date of his donation. Williams paid for the December 1997 donation to Drexel University in December 1997. He paid for the December 1999 donation to Florida International University in December 1999. And he paid for the October 2000 donation to Drexel in full in December of that same year. For these reasons, we find the Tax Court did not err in concluding that Williams' charitable contribution deduction is limited to his basis in the art.

V.

Because Williams has not met his burden of proving the Commissioner's notice of deficiency is erroneous, we affirm.

****12** *AFFIRMED.*

All Citations

498 Fed.Appx. 284, 2012 WL 6014572, 110 A.F.T.R.2d 2012-6904, 2012-2 USTC P 50,706

Footnotes

[1] Earlier this year we determined that Williams willfully violated 31 U.S.C. § 5314(a) by failing to file for tax year 2000 the form TDF 90–22.1 (“FBAR”), on which he was required to disclose his interest in the ALQI accounts. *United States v. Williams,* No. 10–2230, 2012 WL 2948569 (4th Cir. July 20, 2012).

[2] Amended returns for 1993 through 1998 were prepared but were never filed.

[3] A term of the Agreement requiring specific performance of the unpaid portion of the purchase price was crossed out and initialed by Williams and his wife who, while a signatory to this Agreement, is not a party to this case.

[4] Generally, the Commissioner must assess a deficiency within three years of the filing of the tax return from which the deficiency stems. 26 U.S.C. § 6501(a). If a deficiency is determined in the case of a false or fraudulent return with the intent to evade tax, however, the Commissioner can assess such a deficiency at any time. *Id.* at § 6501(c)(1). The Commissioner bears the burden of proving civil tax fraud. 26 U.S.C. § 7454(a).

[5] Section § 7201 “includes the offense of willfully attempting to evade or defeat the assessment of a tax as well as the offense of willfully attempting to evade or defeat the payment of a tax.” *Sansone v. United States,* 380 U.S. 343, 354, 85 S.Ct. 1004, 13 L.Ed.2d 882 (1965). As the Third Circuit in *United States v. McGill,* 964 F.2d 222, 230 (1992), explained, the willful filing of a false return satisfies the elements of evasion of assessment. Such cases are far more common than evasion of payment cases, which are rare and generally require an affirmative act that occurs after any filing, such as placing assets in the name of others or causing debts to be paid through and in the name of others. *Id.*

[6] Any suggestion that Williams' conviction following a guilty plea, rather than a trial, renders collateral estoppel inapplicable misses the mark. “[T]here is no difference between a judgment of conviction based upon a guilty plea and a judgment rendered after a trial on the merits,” for purposes of applying the doctrine of collateral estoppel, as the conclusive effect is the same. *Blohm v. Comm'r,* 994 F.2d 1542, 1554 (11th Cir.1993).

Moreover, Williams' reliance on *United States v. International Building Co.,* 345 U.S. 502, 505–06, 73 S.Ct. 807, 97 L.Ed. 1182 (1953), is misplaced. Williams claims *International Building* stands for the proposition that collateral estoppel is not appropriate when the decision of a prior court is the result of compromise or negotiation rather than a full review of the facts. But *International Building* involved “a pro forma acceptance by the Tax Court of an agreement between the parties to settle their controversy for reasons undisclosed.” *Id.* at 505, 73 S.Ct. 807. Indeed, in *International Building,* the Commissioner agreed to withdraw his proofs of claim for tax deficiencies filed in International Building's bankruptcy proceeding, upon a stipulation that the withdrawal was “ ‘without prejudice’ and did not constitute a determination of or prejudice the rights of the United States to any taxes with respect to any year other than those involved in the claim.” *Id.*

at 503, 73 S.Ct. 807. The parties filed stipulations in the pending Tax Court proceedings that there was no tax liability for the years 1933, 1938, and 1939, and the Tax Court entered formal decisions to that effect. No factual findings were made, no briefs were filed, and no hearings were held. The Supreme Court held that while the Tax Court's decisions were res judicata with respect to tax claims for 1933, 1938, and 1939, they did not collaterally estop the Commissioner from assessing deficiencies for the years 1943, 1944, and 1945. *Id.* at 505, 73 S.Ct. 807. *International Building* is plainly distinguishable from the instant case.

7 Moreover, the record makes clear it was Williams' counsel who advocated for proceeding with the guilty plea and sentencing hearings before a sum certain in penalties and interest had been calculated. Williams cannot now argue that he was rushed into pleading guilty before a final figure had been determined.

8 Williams argues *Moline Properties, Inc. v. Comm'r,* 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943), supports his position, but his argument falls short. In that case, petitioner Moline Properties claimed that gain on sales of its real property should be treated, and therefore taxed, as the gain of its sole stockholder, and that its corporate existence should be ignored as fictitious. Notwithstanding the fact that Moline "kept no books and maintained no bank account during its existence," the Supreme Court held that it was a separate entity with a tax identity distinct from its stockholder. In reaching this conclusion, the Court noted the fact that the stockholder exercised negligible control over the entity, that Moline mortgaged and sold portions of its property, and that Moline entered into its own business venture by leasing part of its property and collecting rental income. *Id.* at 440, 63 S.Ct. 1132. On the contrary, in the instant case, Williams exercised exclusive and complete control over ALQI, and there is no evidence that ALQI carried on any business activity apart from serving as Williams' bank account.

9 Given this holding, we see no reason to address Williams' challenge to the validity of the Controlled Foreign Corporation regulations, as this argument only becomes relevant if the consulting fee income were attributable to ALQI.

10 The art in question qualifies as a capital asset pursuant to 26 U.S.C. § 1221(a).

11 The parties do not dispute that if state law is to be invoked in the context of this analysis, New York law applies per the terms of the Agreement.

12 We note that paragraph 12 of the Agreement provides that it is "the entire agreement between the respective parties hereto and there are no other provisions, obligations, representations, oral or otherwise, of any nature whatsoever."

13 It goes without saying that the appreciation guaranteed to Williams by virtue of this Agreement is suspect, to say the least. The Commissioner has not challenged the valuation of the art, however, and that issue is not before us.

End of Document

T.C. Memo. 2011-89
United States Tax Court.

Joseph B. WILLIAMS, III, Petitioner
v.
COMMISSIONER of INTERNAL
REVENUE, Respondent.

No. 2202–08.
|
April 21, 2011.

Synopsis
Background: Taxpayer petitioned for redetermination of income tax deficiencies and fraud and accuracy–related penalties for several tax years, arising from IRS decision that taxpayer was liable for tax on services and investment income and that taxpayer's deductions for art contributions were limited to his basis in that art.

Holdings: The Tax Court, Gustafson, J., held that:

[1] taxpayer, and not corporation, was responsible for paying tax on consulting fee income;

[2] taxpayer's conviction for tax evasion satisfied IRS's burden of proving fraud and estopped taxpayer from denying fraud;

[3] taxpayer owned art for less than one year, precluding entitlement to long–term capital gain treatment on any gain when he sold or donated art; and

[4] imposition of accuracy–related penalty for negligence was warranted.

Decision for IRS.

***1** In 1993 P established a British Virgin Islands (BVI) corporation, A, and placed the shares in a BVI trust of which he was the sole beneficiary. P opened accounts in the name of A with a bank in Switzerland. P provided consulting, negotiation, and other services to companies and governments, and his clients transferred money into A's accounts to pay for those services. P did not report any of this income on any U.S. Federal income tax return for 1993 through 2000, except that in 2003 he amended his 1999 and 2000 individual income tax returns to report investment income earned on the amounts in the Swiss bank accounts. P did not include the payments for services in income on any of those original or amended returns. Also in 2003 P pleaded guilty to one count of tax evasion for all 8 years from 1993 through 2000 and to one count of conspiracy to defraud the IRS for those same years.

In 1996 P signed an agreement purporting to commit to purchasing works of art. The seller, S, ostensibly agreed to hold the art for 1 year before donating it on P's behalf to charity and promised that the art would cost P no more than 24 percent of the final appraised value of the art. S donated works of art on P's behalf in 1997, 1999, and 2000; P paid for the art close in time to the donations (within a year of each donation); and he claimed charitable contribution deductions for the full value determined in appraisals that S arranged.

By a notice of deficiency issued in 2007, R determined deficiencies in P's original returns for all 8 years, determining that P is liable for tax on the services and investment income deposited into A's accounts and allowing P deductions for the contributions of art only to the extent of P's basis in the art. R determined fraud penalties related to the unreported income deposited in A's Swiss bank accounts and also determined accuracy-related penalties on the disallowed portions of P's charitable contribution deductions.

Held: P is liable for tax on the net amounts deposited into A's accounts in each year, and P is liable for the fraud penalties on the underpayments resulting from this unreported income.

Held, further, P is entitled to charitable contribution deductions only in the amount of his basis in the art contributed, and he is liable for the accuracy-related penalties on the underpayments resulting from the disallowed deductions.

Attorneys and Law Firms

David H. Dickieson, for petitioner.

John C. McDougal, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GUSTAFSON, Judge:

The Internal Revenue Service (IRS) issued to petitioner Joseph B. Williams III a notice of deficiency pursuant to section 6212,[1] showing the IRS's determination of the following deficiencies and penalties for tax years 1993 through 2000:

		Penalties	
Year	***Deficiency***	***Sec. 6663***	***Sec. 6662***
1993	$417,652	$313,038.00	—
1994	304,740	226,206.75	—
1995	417,354	313,015.50	—
1996	1,572,673	1,179,504.75	—
1997	809,620	511,143.00	$25,619.20
1998	52,733	39,549.75	—
1999	113,049	33,395.25	13,704.40
2000	120,391	74,093.25	4,320.00

***2** Mr. Williams brings this case pursuant to section 6213(a), asking this Court to redetermine those deficiencies and penalties.[2]

The issues for decision are:[3]

1. Whether Mr. Williams is individually liable for Federal income tax on the payments made to ALQI Holdings, Ltd. (ALQI), during each year in issue; or whether he is individually liable only for tax on the investment income earned during each year (on funds held and invested by ALQI), pursuant to sections 951(a) and 954(c). We hold that his liability is not limited to tax on the investment income paid to ALQI each year; rather, he is liable for tax on the entire net amount deposited into the ALQI accounts during each year in issue.

2. Whether section 6663 civil fraud penalties apply to the underpayments resulting from the unreported income from ALQI. We hold that the fact of Mr. Williams's fraud is established by his criminal conviction, that he is collaterally estopped from denying that fraud, see *supra* note 3, and that he did not establish that any portion of his underpayment attributable to the unreported ALQI income is not attributable to fraud.

3. Whether Mr. Williams is entitled to charitable contribution deductions for his contributions of art in the amounts claimed—i.e., the appraised values of the art—or whether his deductions are limited by section 170(e) to his basis in the art donated. We hold that his deductions are limited to his basis in the art.

4. Whether Mr. Williams is liable for accuracy-related penalties on the underpayments resulting from his deducting the appraised value of the donated art rather than his basis in the art. We hold that he is liable for the accuracy-related penalties.

FINDINGS OF FACT

The parties stipulated some of the facts, and we incorporate the stipulation of facts by this reference. The record also includes the stipulated exhibits, the testimony offered at trial, and the exhibits admitted at trial. When he filed his petition, Mr. Williams resided in Virginia.

Oil-related activities and Swiss bank accounts

Mr. Williams earned his undergraduate degree from the University of North Carolina and his law degree from New York University School of Law. He began working in the corporate legal department of Mobil Oil Corp. (Mobil) around 1973. Mr. Williams worked for Mobil in Saudi Arabia from 1979 to 1985, and while there he met Jean–Jaques Bovay, a banker representing Banque Indosuez, a bank in Switzerland. [4] He continued working for Mobil until 1998. In the 1990s Mobil tasked Mr. Williams with developing strategic business relationships in Russia and some of the former Soviet republics, including Azerbaijan, Turkmenistan, and Kazakhstan. When he retired from Mobil in 1998, Mr. Williams held the position of general manager for strategic business development and government crude, in which he bought and sold crude oil internationally on behalf of Mobil, and he assisted with the negotiation and closing of major business deals for Mobil.

***3** At Mr. Williams's request, in 1993 Mr. Bovay arranged for the formation of ALQI in the British Virgin Islands. The Swiss bank formed ALQI as a British Virgin Islands International Business Company, authorized to conduct business anywhere except the British Virgin Islands.

The record is unclear as to whether Mr. Williams directly owned the shares of ALQI or whether the shares were held in a British Virgin Islands trust of which Mr. Williams was the sole beneficiary. The Swiss bank used Overseas Management Trust (B.V.I.), Ltd., to form ALQI, and Overseas Management appointed Saturn Corporate Services, Inc. (Panama), as the sole director of ALQI. Saturn authorized the Swiss bank to establish accounts in ALQI's name. Saturn operated as Mr. Williams's nominee, and Mr. Williams was the only operational director and officer of ALQI; only he had authority to act on behalf of ALQI, and only he could instruct the Swiss bank with respect to the ALQI accounts. The documents submitted to the Swiss bank to open the ALQI accounts identify Mr. Williams as the only beneficial owner of all assets deposited into ALQI's accounts. Whether Mr. Williams owned ALQI directly or as the sole beneficiary of a trust, we find that he directly or indirectly owned and controlled all the shares of ALQI stock.

The Swiss bank also provided Mr. Williams and ALQI with a Swiss mobile telephone, credit cards, and the use of office space at the bank for business meetings. The credit cards and mobile telephone were issued and billed in Mr. Williams's name.

Mr. Williams did not maintain formal books of account recording income and expenses related to his international consulting and services activity. However, the Swiss bank maintained records of deposits, transfers, and payments involving the ALQI accounts. Mr. Williams instructed the Swiss bank to draw on those accounts to pay the mobile telephone bills, the credit card bills, and various other bills, and to transfer funds at his direction. The transfers included several $10,000 and $20,000 transfers from the Swiss bank to a branch of the same bank in London, to be held for pickup by Mr. Williams. The payments included payments totaling $41,409.44 to a former Mobil secretary who had worked for Mr. Williams. A $15,000 gift to the to the wife of Mr. Williams's deceased father was also paid for from the ALQI accounts. Some of the credit card charges ALQI paid reflect Mr. Williams's vacationing with his children and a nearly $30,000 shopping spree in Paris, France. The instructions Mr. Williams sent to Mr. Bovay consistently refer to the Swiss bank account(s) as “my account”; when requesting transfers or payments from these accounts, Mr. Williams did not refer to them as ALQI's accounts or as corporate accounts. We find that Mr. Williams paid personal, family, and living expenses and made gifts to family and friends from the ALQI accounts.

Beginning in 1993 Mr. Williams found business opportunities separate from his work for Mobil, and he pursued those opportunities and earned fees for his consulting and negotiation services. One particular project he facilitated, on behalf of the Khazakhstan Government, was the building of a new pipeline from the Tengiz oil field in Kazakhstan through Russia to the Black Sea. Mr. Williams admits that none of his clients had written agreements with ALQI. He did not correspond or deal with his clients using the ALQI name. He performed services for these clients in his individual capacity and not on behalf of ALQI.

***4** Alika Smekhova, a Russian actress, singer, and celebrity, worked as a consultant with Mr. Williams, translating at meetings and helping arrange introductions and appointments with Russian government officials.

Beginning in 1996 Mr. Williams paid Ms. Smekhova a stipend of $5,000 to $10,000 per month from the ALQI accounts, and he also paid for her shopping in Paris. Mr. Williams did not pay himself a salary or commissions from ALQI, and he retained most of the amounts deposited into the ALQI accounts in the Swiss bank accounts; but, as noted, he made gifts and paid some personal expenses from the ALQI accounts.

ALQI had no written employment or other contracts with Mr. Williams or Ms. Smekhova, and neither of them was an employee of ALQI. ALQI did not have any staff and had no ability to perform oil- and pipeline-related consulting services without Mr. Williams's providing those services directly; and although Ms. Smekhova rendered services to Mr. Williams, she did not render services to Mr. Williams's clients on his or ALQI's behalf.

All amounts deposited into the ALQI accounts during 1993 through 2000 were received for services that Mr. Williams rendered to third parties, generally in connection with the negotiation of oil- and pipeline-related contracts. Ms. Smekhova facilitated Mr. Williams's provision of services by translating and making introductions. The ALQI accounts received approximately $8 million in deposits between 1993 and 2000. Between 1993 and 2000, deposits (payments for services) and earnings (interest, dividends, and capital gains) in the ALQI accounts included the following: [5]

Year	***Deposits***	***Earnings***	***Total***
1993	$993,837	$35,754	$1,029,591
1994	693,699	58,781	752,480
1995	887,964	110,759	998,723
1996	3,752,879	164,884	3,917,763
1997	1,344,637	326,254	1,670,891
1998	41,248	92,124	133,372
1999	——	109,168	109,168
2000	——	*256,235*	*256,235*
Total	7,714,264	1,153,959	8,868,223

Reporting ALQI's income on Mr. Williams's tax returns

On his Federal income tax returns for 1993 through 2000, Mr. Williams did not report any of the services income deposited into the ALQI accounts, nor did he report any of the interest, dividends, or capital gain income earned on those deposits. He did not inform his return preparer of the accounts in the Swiss bank or of his interest in ALQI, nor did he discuss with his return preparer whether he was required to report income from ALQI for the years in issue.

On November 14, 2000, at the request of the United States Government, the Government of Switzerland froze the ALQI accounts. Mr. Williams disclosed his ownership interest in ALQI and the existence of the Swiss bank accounts on his Federal income tax return for 2001, which he filed in 2002—after the Swiss authorities froze the accounts. [6]

In 2003 Mr. Williams filed amended Federal income tax returns for 1999 and 2000. Mr. Williams also had prepared and entered into evidence amended returns for 1993 through 1998. Mr. Williams's counsel provided unsigned copies of these returns to the IRS agents during the examination. These unsigned amended returns were not filed with the IRS.

***5** On these unfiled amended returns, Mr. Williams reported additional income (representing ALQI's capital gains, dividends, and interest), and he reported net increases in income as follows:

Year	***Inte rest***	***Dividends***	***Short-term capital gains***	***Long-term capital gains***	***Total earnings***	***Increased income***
1993	$8,722	$135	–0–	$26,608	$35,465	$35,466
1994	30,590	9,379	22,718	1,952	64,639	64,639
1995	101,783	2,093	2,184	3,777	109,837	109,837
1996	135,492	8	19,961	3,659	159,120	159,120
1997	207,981	–0–	102,004	–0–	309,985	309,985
1998	19,933	42	5,920	–0–	25,895	25,895
1999	53,199	101	39,879	67,495	160,674	160,674
2000	190,249	80	995	708,626	899,950	[1] 751,848

Mr. Williams's amended returns included Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, and on Schedule C, Income Statement, of those forms he reported income, earnings, and deductions as follows, which he attributed to ALQI:

Year	***Gross receipts or sales***	***Passive income (earnings)***	***Deductions***	***Net income***
1993	$1,467,092	$35,754	$12,123	$1,490,723
1994	725,000	58,781	20,097	763,684
1995	940,000	110,759	8,753	1,042,007
1996	3,681,000	164,884	134,442	3,711,442
1997	1,473,000	326,254	89,718	1,709,536
1998	25,000	92,124	83,386	33,738
1999	–0–	255,023	94,349	160,674
2000	–0–	899,951	–0–	899,951

The net change to his own income that Mr. Williams reported on these amended returns did not include any of the gross receipts he listed for ALQI on Forms 5471, and the 2000 Form 5471 does not shed any light upon the discrepancy noted above with respect to increased income reported for 2000. On the amended returns Mr. Williams included in income only the passive income earned on the deposits and investments in ALQI's accounts at the Swiss bank; none of these amended returns includes in Mr. Williams's income any of the services income transferred or deposited into the ALQI accounts.

As noted, Mr. Williams prepared but did not file amended returns for 1993 through 1998, even though each showed additional income and additional taxes owed. However, his amended returns for 1999 and 2000, which he did file, reported additional tax due of $40,462 and $203,148, respectively, and Mr. Williams paid those additional amounts. [7]

Criminal prosecution

On April 14, 2003, the Department of Justice filed a two-count superseding criminal information charging Mr. Williams with one count of conspiracy to defraud the United States and the IRS and one count of tax evasion for the period from 1993 through 2000. On June 12, 2003, Mr. Williams pleaded guilty to conspiring to defraud the United States and the IRS and to evading taxes for each year from 1993 through 2000.

***6** In connection with entering his guilty plea, Mr. Williams allocuted as follows:

> In 1993, with the assistance of a banker at Bank Indosuez, I opened two bank accounts in the name of a corporation ALQI Holdings, Ltd. ALQI was created at that time as a British Virgin Islands Corporation. The purpose of that account was to hold funds and *income I received* from foreign sources during the years 1993 to 2000. [Emphasis added.]
>
> Between 1993 and 2000, more than seven million dollars was deposited in the ALQI accounts and more than $800,000 in income was earned on those deposits.
>
> *I knew that most of the funds deposited into the ALQI accounts and all the interest income were taxable income to me.* However, [on] the calendar year tax returns for #93 through 2000, I chose not to report the income to my—to the Internal Revenue Service in order to evade the substantial taxes owed thereon, until I filed my 2001 tax return. [Emphasis added.]
>
> I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return.
>
> Some of the payments I received in the ALQI accounts, including a two million payment I received in 1996, were paid to me by people, organizations or governments with whom I did business on Mobil's behalf while I[was] an employee of Mobil Oil. I did not disclose these business relationships to Mobil Oil, although I understood I had an obligation to do so.
>
> I suspect people, organizations, governments paying the money to me were not notifying Mobil Oil of the payments. None of the people, organizations or governments who made payments into my ALQI accounts provided any tax reporting documents to me or to the IRS.
>
> Similarly Bank Indosuez provided me with no tax reporting documents for the interest and other income earned within the ALQI accounts.
>
> Over the course of several years I came to expect that the people with whom I dealt with regularly regarding the payments into the ALQI accounts would not provide tax reporting information to the United States government regarding these transactions, thus allowing me to evade taxes on the payments received.
>
> I knew what I was doing was wrong and unlawful. I, therefore, believe that I am guilty of evading the payment of taxes for the tax years 1993 through 2000. I also believe that I acted in concert with others to create a mechanism, the ALQI accounts, which I intended to allow me to escape detection by the IRS. Therefore, I am-I believe that I'm guilty of conspiring with the people would [sic] whom I dealt regarding the ALQI accounts to defraud the United States of taxes which I owed.

The judge of the U.S. District Court for the Southern District of New York accepted Mr. Williams's allocution and plea and sentenced him to 46 months' incarceration. Mr. Williams and the Government stipulated that the readily provable tax loss the United States suffered as a result of Mr. Williams's tax evasion was at least $3.512 million, and they expected the District Court to order restitution in that amount. The District Court ordered Mr. Williams to pay the entire balance in the ALQI accounts to the Clerk of the Court, with $3.512 million of that amount paid to the IRS as restitution and the balance held by the clerk pending resolution of the amounts Mr. Williams owes the IRS for 1993 through 2000.

***7** The Swiss bank transferred a total of $7,943,051.33 to the District Court in November 2003, and the clerk credited $3.512 million to the IRS on January 7, 2004. The IRS has held that amount pending the resolution of this case. The clerk has held the balance of the funds pending the final determination of Mr. Williams's liability for the years in issue, including interest and penalties.

The Department of Corrections released Mr. Williams on May 21, 2006.

Charitable contributions

Sometime in the summer of 1996, Mr. Williams began speaking with personnel of Abbey Art Consultants, Inc. (Abbey), a corporation in New York City, about buying art at a discount and donating it at full fair market value to charitable institutions.

On December 10, 1996, Mr. Williams signed an agreement with Abbey [8] which refers to Mr. Williams as "Client" and provides, in relevant part:

> 1. Client desires to purchase from Abbey the monetary quantity of Art specified in Paragraph 2 below. The specific items purchased by the Client will be described in written appraisals prepared by a qualified appraiser selected by Abbey. The appraisal(s) will be submitted to the Client when the Client receives physical possession of the Art or when the Art is donated to a charitable institution.
>
> 2. The total purchase price or consideration for the Art shall be $72,000.00 provided, however, that the total purchase price shall not exceed twenty-four (24%) percent of the cumulative appraised fair market value of the Art purchased herein, as determined by the qualified appraiser selected by Abbey.
>
> 3. The purchase price shall be paid to Abbey in the following manner:
>
>> a) ten (5%) [sic] percent of the total purchase price $3,600.00 shall be paid by check at the signing of this agreement. * * * Said monies shall be held in an escrow account pending satisfaction of the provisions contained in this Agreement.
>>
>> b) the balance of the price shall be paid by good check on or before the time when client receives physical possession of the Art or when the Art is delivered to and accepted [by the] charitable institution where the art is being donated. In the event that Abbey is unable to facilitate the donation of the Art, client may request physical possession of the Art or, monies previously paid, in which case Abbey shall immediately comply with such request.

5. Within thirty (30) days after the Client has paid to Abbey the deposit payment of the purchase price, the Client shall notify Abbey of the Client's wishes with regard to the dispensation [sic] of the Art. Client may elect one of the following:

> a) to take physical possession of the Art, in which case Abbey will package and ship the Art to the Client at Abbey's expense, provided that full payment has been received, or
>
> b) to retain Abbey as its agent to facilitate the donation of the Art to a charitable institution(s), in which case Abbey at its sole cost and expense will arrange the donation and handle all the requisite paperwork needed to consummate the desired donation, including the packaging and shipping of the Art to the charitable institution(s) after the required holding period of one (1) year.

***8** 6. In the event Client fails to make any payment required herein for the purchase of the Art at any time prior to the time Client executes a Bill of Sale transferring ownership of the Art to a charitable institution, Abbey's sole remedy shall be to retain as liquidated damages all previous payments Client has made toward the purchase of the Art and, in addition, to reclaim ownership of the Art. * * * [9]

7. In the event Client elects to donate the Art to a charitable institution(s), upon such election Client may list three charitable institutions Client wishes to be the possible donees. Abbey will endeavor to facilitate the donation to one of the specified institutions; provided, however, that if Abbey in its sole opinion determines that a donation to the requested institution(s) is not practical, Abbey may without prior notice to Client, facilitate the donation of the Art to qualifying charitable institution(s) chosen by Abbey.

8. If at any time after the donation of the Art to qualifying charitable institution(s) any governmental body or panel makes a final determination that the cumulative fair market value of the Art herein purchased is less than the value which is reflected in the Appraisal(s), and, as a result of such determination, the tax benefit to the Client resulting from such donation is reduced, Abbey, within thirty (30) days of the submission to Abbey by the Client of written documentation evidencing the adjudicated reduction of

> the original fair market value of the Art, shall pay to the Client in cash or by check an amount of monies equal to the percentage of the dollars paid for each dollar the fair market value of the Art has been reduced; provided however, that before doing so Abbey reserves the right to lawfully challenge any such reduction.
>
> 9. This agreement shall be interpreted under the laws of the State of New York.
>
> 12. This Agreement contains the entire agreement between the respective parties hereto and there are no other provisions, obligations, representations, oral or otherwise, of any nature whatsoever.

Thus, under this agreement—

- Mr. Williams expressed interest in paying $72,000 for art, but he committed only to pay $3,600—the deposit paid with the agreement.

- Abbey promised to provide a qualified appraiser and to provide art with a purchase price of no more than 24 percent of the appraised fair market value.

- Mr. Williams was not selecting specific pieces; rather, Abbey agreed that when Mr. Williams took possession of art or when it was donated to charity, Abbey would identify and describe that art in an appraisal.

- Abbey agreed to bear all the expense—including paperwork, appraisal, packing and shipping costs—of donating the art to charity, and to refund all of Mr. Williams's payments if it was unable to facilitate the donation.

- Abbey agreed that its sole remedy for Mr. Williams's non-payment would be to retain any payments already received and to retake possession of the art. (I.e., Abbey could not force Mr. Williams to perform, and the only risk Mr. Williams bore for non-performance was the loss of his deposit.)

***9** • Although Mr. Williams could propose donees, Abbey retained discretion to select the donee.

- Abbey agreed to share the risk of inflated appraised values by promising a pro-rata refund of the discounted purchase price.

1997 Contribution

In November and December of 1997 (i.e., almost a year after the date of the agreement between Abbey and Mr. Williams), Abbey arranged for appraisals of three different sets of art, and Mr. Williams introduced at trial the following appraisals, reciting the following fair market values:

Appraisal date	*Appraiser*	*Value of art*
November 17, 1997	Shari Cavin	$34,800
November 23, 1997	Lawrence Roseman	18,150
December 1997	Kenneth Jay Linsner	*372,675*
Total		425,625

On December 23, 1997, Mr. Williams signed a deed of gift to Drexel University, and a representative of Drexel University signed the deed to accept the gift on December 29, 1997. The deed provides a very brief description of the art described in the November and December 1997 appraisals, and it recites a total appraised value of $425,625—i.e., an amount greater than the $300,000 contemplated in the agreement. [10] The record includes no evidence as to when Abbey first acquired the art appraised in late 1997.

The record includes a letter from Abbey to Mr. Williams, dated December 29, 1997, reporting that Abbey had delivered his donation to Drexel. The letter included an undated invoice that recites a purchase date of December 10, 1996 (i.e., the date of the agreement), a description of “art objects as attached”, appraised value of $425,000, and purchase price of $102,000. The invoice lists a $3,600 deposit, and indicates a balance due of $98,400 (an amount obviously greater than the $72,000 required in the agreement, but consistent with the invoice purchase price of $102,000 and also consistent with the discount promised in the agreement; $102,000 is 24 percent of the $425,000 appraised value). The December 29, 2007, letter asks Mr. Williams to remit $98,400 in the enclosed envelope and instructs him to date and tender his check in 1997, "the year of the donation". Finally, the letter promises that early in 1998 Abbey would send Mr. Williams the original appraisals and the required IRS forms signed by the appraisers and Drexel. Mr. Williams paid Abbey $98,400 before the end of 1997. (It would appear that at this point the agreement had been more than fulfilled, but Mr. Williams and Abbey behaved otherwise in 1999 and 2000, as we show below.)

On his 1997 Federal income tax return, Mr. Williams claimed deductions for the following charitable contributions:

Item	***Amount***
Gifts by cash or check	$2,000
Gifts other than by cash or check	*425,625*
Total	427,625

Mr. Williams's return preparer informed him that so long as he had a 1–year holding period and appropriate appraisals of the art, his charitable contribution deduction should not pose a problem.

1999 contribution

***10** Mr. Williams wrote Abbey on December 17, 1999, stating:

> I have just returned from a trip to London and would like your assistance once again to complete another gift of art. As I am sure you remember, in December 1996, I purchased from Abbey Art approximately $800,000 plus [[[[11] of appraised value art and antiquities originating from South America, South East Asia, Haiti and North Africa. As you also know, I gifted in [1997] [12] $425,000 in appraised value of art and antiquities to Drexel University in Philadelphia, Pa. with your assistance. The remaining art has in the meantime been stored with you in your wharehouse [sic]. I would now like to gift approximately $250,000.00 of the remaining art to Florida International University in Miami for the Tax Year 1999 and ask your assistance in completing this gift ASAP. I also ask you to continue to wharehouse [sic] the remaining art that I previously purchased.
>
> I hereby enclose a check in the amount of $57,500 made out to Abbey Art which I understand should cover the expenses of the shipping, packing, warehousing, updated appraisals and any other expenses related to the gift of this art to FIU. I would appreciate an itemized list of these expenses once you have completed the delivery of the gift.

Mr. Williams signed the letter and included a check for $57,500.

In December 1999 Abbey arranged for appraisals of two different sets of art, and Mr. Williams introduced at trial the following appraisals, reciting the following fair market values:

Appraisal date	***Appraiser***	***Value of art***
December 3, 1999	Shari Cavin	$15,100
December 12, 1999	Jane Werner–Aye	*235,425*
Total		250,525

The record does not explain why the December 1999 appraisals both predate Mr. Williams's December 17, 1999, letter instructing Abbey to facilitate a donation for 1999. The record includes no evidence as to when Abbey first acquired the art appraised in late 1999.

On December 21, 1999, Mr. Williams signed a deed of gift reciting his donation of art appraised at $250,525 to the art museum at Florida International University, and a representative of the museum at the university signed the deed to certify receipt and acceptance of the donation on December 23, 1999.

Mr. Williams claimed a charitable contribution deduction for the following contributions for 1999:

Item	***Amount***
Gifts by cash or check	$3,874
Gifts other than by cash or check	*250,825*
Total	254,699

The non-cash charitable contribution for 2000 includes $300 for clothing that Mr. Williams reported donating to charity.

2000 contribution

With two separate checks, Mr. Williams paid Abbey $4,600 and $17,158 toward a 2000 contribution of art. Other than the already fulfilled December 1996 agreement, the record does not include any agreement pursuant to which Mr. Williams might have made these payments, and he does not allege that there was another written agreement.

***11** In November 2000 Abbey arranged the appraisal of another set of art, and at trial Mr. Williams introduced the following appraisal, reciting the following fair market value:

Appraisal date	***Appraiser***	***Value of art***
November 16, 2000	Jane Werner–Aye	$98,900

Mr. Williams introduced a deed of gift reciting his gift of $98,900 of art to Drexel University in December 2000. His signature is dated December 15, 2000, and a representative of the university appears to have signed the document on December 24, 2000. The record includes no evidence as to when Abbey first acquired the art appraised in late 1999.

Mr. Williams claimed a deduction for the following charitable contributions for 2000:

Item	***Amount***
Gifts by cash or check	$1,135
Gifts other than by cash or check	*102,825*
Total	103,960

The non-cash charitable contributions for 2000 include $500 for clothing and $3,425 for a BMW automobile Mr. Williams reported donating to charity.

On December 9, 2000, Abbey sent Mr. Williams a letter that stated:

> I am writing to remind you that we still have art and antiquities held in a segregated manner in our warehouse located in New York City from 1997. We thank you for your recent $1,000 check for storage etc. Sometime in the first half of 2001 we will send you an itemized bill and a description of your objects which

> remain. Based upon our last inventory we believe that you still have over $200,000 worth of appraised items.
>
> In the event you wish to gift objects in 2001, we would be pleased to work with you in this regard.

We find that Mr. Williams paid the following amounts and that his costs represent the following percentages of the appraised values of the art he donated:

Payment date	***1997 gift***	***1999 gift***	***2000 gift***	***Percent of appraised value***
12/10/1996	$3,600			
12/26/1997	*98,400*			
Total	102,000			23.96
12/21/1999		$57,500		22.95
03/17/2000			$4,600	
Illegible			*17,158*	
Total			21,758	22.00

Notice of deficiency

During Mr. Williams's incarceration, the IRS examined his returns for the years in issue. The IRS issued the notice of deficiency for 1993 through 2000 on October 29, 2007. The issues now before us for decision were addressed as follows in the notice of deficiency:

Unreported foreign income

The IRS determined that the amounts deposited into the ALQI accounts (not only the earnings on deposits and investments held at the Swiss bank but also the consulting fees paid for services rendered, net of allowable expenses) were includable taxable income to Mr. Williams during the year of deposit, that he failed to report that income on his returns, and that pursuant to section 6663, the civil fraud penalty applies to all of that omitted income. [13]

***12** In the notice of deficiency, the IRS stated:

> The amount shown on your return as a deduction for charitable contributions is not allowable in full because it has not been established that the total amount was paid during the tax year or that the unallowable items met the requirements of Section 170 of the Internal Revenue Code. As a result, your contributions deduction is decreased in tax year 1997, 1999, and 2000.

The IRS disallowed the amounts shown below and determined accuracy-related penalties under section 6662 on the underpayments resulting from the disallowed charitable contribution deductions: [14]

Disallowed charitable contribution deductions

Year	***Claimed***	***Allowed***	***Disallowed***	***Accuracy-related penalty***
1997	$427,625	$104,150	$323,475	$25,619.20
1999	254,699	61,796	192,903	13,704.40
2000	103,960	26,818	77,142	4,320.00

Trial

At trial in Washington, D.C., on September 28, 2009, Mr. Williams testified, and he called as a witness Mr. Donald Williamson, the C.P .A. whom Mr. Williams's lawyers retained in 2002 to assist in the preparation of tax returns reporting Mr. Williams's ownership interest and income from ALQI. Mr. Williams did not call any representative from Abbey or anyone affiliated with ALQI or involved with his consulting activities, nor did he call the return preparer who prepared his original Federal income tax returns for 1993 through 2000.

OPINION

[1] **[2]** The Commissioner's deficiency determinations are generally presumed correct, and Mr. Williams, as the petitioner in this case, has the burden of establishing that the deficiencies determined in the notice of deficiency are erroneous. See Rule 142(a). Similarly, Mr. Williams bears the burden of proving he is entitled to any disallowed deductions that would reduce his deficiency. See *INDOPCO, Inc. v. Commissioner,* 503 U.S. 79, 84, 112 S.Ct. 1039, 117 L.Ed.2d 226 (1992). [15]

[3] **[4]** Conversely, the Commissioner has the burden of proof with respect to the issue of fraud with intent to evade tax, and that burden of proof must be carried by clear and convincing evidence. Sec. 7454(a); Rule 142(b). Section 6663(b) provides that a determination that any portion of an underpayment is attributable to fraud results in the entire underpayment's being treated as attributable to fraud, except any portion the taxpayer proves is not so attributable.

I. *Consulting fee income*

A. *The parties' contentions*

Mr. Williams contends that his amended returns properly report his income from the Swiss bank accounts he opened in 1993 and maintained throughout the years in issue. He maintains that he is liable for tax only on the investment earnings realized during those years on the amounts deposited and invested in the ALQI accounts; and he maintains that because he is liable for tax only on that omitted passive income, he is therefore liable for the civil fraud penalty only as to the deficiencies resulting from the omission of that passive income. Mr. Williams concedes that sections 951(a) and 954(c) require that he include in income each year the earnings on deposits and investments in the Swiss bank accounts.

***13** The IRS agrees, of course, that the passive income earned on the ALQI accounts is taxable to Mr. Williams in each year earned. However, the IRS also contends that the consulting fee income—i.e., the corpus of the ALQI accounts—is taxable to Mr. Williams—because it was his income and not ALQI's, or, in the alternative, because of ALQI's status as a controlled foreign corporation. The IRS contends that even if the consulting income is properly attributable to ALQI, it is taxable to Mr. Williams pursuant to sections 951(a) and 954(c) because Mr. Williams was a related person to ALQI; that to the extent ALQI performed any services, ALQI performed those services "for or on behalf of" Mr. Williams as that concept is defined in 26 C.F.R. section 1.954–4(b)(1)(iv), Income Tax Regs.; and that but for Mr. Williams's substantial assistance, ALQI could not have performed any of those services.

Mr. Williams counters that he is not liable for tax on the consulting fees paid into the ALQI accounts until those amounts were distributed to him (which did not occur during the years in issue) because (1) ALQI is a legitimate corporation and ALQI provided the services, (2) the income from those services is not foreign base company services income under section 954(e), and (3) section 1.954–4(b)(1)(iv), Income Tax Regs., is invalid.

The IRS defends section 1.954–4(b)(1)(iv) as a valid interpretive regulation. As a result, the IRS contends that all the services income paid to ALQI during the years in issue is foreign base company services income and that income, net of allowable expenses, see *supra* note 5, is taxable to Mr. Williams in the year it was deposited into the ALQI accounts.

The IRS further contends that because Mr. Williams evaded tax both on the investment income earned on the ALQI deposits and on the services income deposited into the ALQI accounts during the years in issue, he is liable for civil fraud penalties on the entire underpayment resulting from the investment income and the services income he omitted in 1993 through 2000. As discussed, *supra* note 3, Mr. Williams's conviction estops him from denying his liability for civil fraud. This entire underpayment is deemed attributable to fraud and subject to the 75–percent penalty unless he proves some part of the underpayment is not attributable to fraud. See sec. 6663(a) and (b).

B. *Discussion*

We have found that the consulting fees deposited into ALQI's accounts were in fact the income of Mr. Williams, funneled through ALQI's bank accounts only in order to (unsuccessfully) evade tax. During his allocution for his guilty plea, Mr. Williams admitted that the purpose of opening the ALQI accounts "was to hold funds and *income I received* " and that "most of the funds deposited into the ALQI accounts and all the interest income were *taxable to me* ", [16] that he made this admission. (Emphasis added.) He had no employment contract with ALQI and reported no wages from ALQI; and the consulting clients did not have agreements with ALQI and did not even have any awareness of ALQI. Apart from his own general testimony, he presented no evidence that any client even knew that ALQI existed. The clients were Mr. Williams's clients, and their payments were for him.

***14** It is apparently true that Mr. Williams and his banker directed his earnings to an ALQI account, but that fact does not excuse him from liability for tax on his earnings. His use of ALQI was, at most, an impermissible assignment of income. See *Lucas v. Earl,* 281 U.S. 111, 50 S.Ct. 241, 74 L.Ed. 731 (1930); *Vercio v. Commissioner,* 73 T.C. 1246, 1253, 1980 WL 3859 (1980) ("income must be taxed to the one that earns it").

[5] Mr. Williams resists this conclusion by arguing that the IRS has not established that ALQI was a sham, and by pointing out that the tax law respects the existence of corporations. See *Moline Props., Inc. v. Commissioner,* 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943). A corporation is by definition a fictitious legal person, but Mr. Williams is right that we honor this legal fiction. Thus, when a corporation enters into a contract and becomes entitled to compensation under the contract, we understand that it is the corporation (and not its owners or principals) that is the party to the contract and that is entitled to receive (and is obliged to pay tax on) the income generated by that contract.

[6] However, Mr. Williams misses the mark when he resists a "sham" contention that the IRS did not make and did not need to make. We assume that ALQI is a real corporation and would be the taxpayer responsible for any income that it earns. That assumption is unhelpful here to Mr. Williams, because ALQI simply did not earn the income at issue. The difficulty that Mr. Williams's position meets is not that ALQI is treated as a sham but that ALQI was not a party to the consulting agreements that produced the income. We would respect ALQI as a fictitious legal person, but we do not assume the existence of factually fictitious agreements between ALQI and Mr. Williams's clients. This is not an instance in which we sham a corporation, or invoke substance over form, in order to deem an individual taxpayer to be the actual recipient of money nominally earned by a corporation; rather, in this instance ALQI can be assumed to have its own valid, legal existence, but we are missing both the substance *and* the form of consulting agreements that involve ALQI. Mr. Williams earned consulting fees from his clients, and ALQI's only role was to be a conduit for Mr. Williams's earnings (to evade tax).

Mr. Williams's contention that Ms. Smekhova and his Swiss bankers also provided valuable services is misplaced. We assume that they provided assistance to Mr. Williams's consulting activity, but there is no evidence that they provided any services to Mr. Williams's clients, nor any evidence that ALQI contracted with the bankers or Ms. Smekhova to provide those services on ALQI's behalf. Mr. Williams provided all the consulting services to his clients, and he directed his clients to deposit his compensation into Swiss bank accounts that belonged to ALQI. The fact that Mr. Williams's business and personal expenses were paid out of these same Swiss bank accounts does not prove that his clients contracted with ALQI or that ALQI was anything other than the receptacle into which Mr. Williams diverted his consulting income. We therefore hold Mr. Williams liable for the consulting fee income deposited into the ALQI accounts.

***15** That being the case, we need not reach the IRS's alternative argument—i.e., that even if the income was earned by ALQI, Mr. Williams owed tax on it pursuant to the controlled foreign corporation provisions of subchapter F of the Code. Resolving that alternative theory would require us to address issues (such as Mr. Williams's challenge to the validity of the regulation) that we need not reach in order to decide the case.

II. *Civil fraud penalty*

[7] Mr. Williams concedes that he is liable for tax on the ALQI investment income he omitted, and we have found that he is also liable for tax on the net services income. His conviction for tax evasion for 1993 through 2000 satisfies the IRS's burden of proving fraud and estops him from denying the fact that he committed tax fraud in those same years. Mr. Williams is liable for the civil fraud penalty except to the extent that he proves part of the underpayment was not attributable to fraud. See sec. 6663(a) and (b).

Mr. Williams has not shown that his failure to report any of the ALQI income was not attributable to fraud. Therefore, the civil fraud penalty applies to the entire underpayment related to his omitted consulting fee and investment income for each year from 1993 through 2000.

III. *Charitable contribution deductions*

A. *The parties' contentions*

Mr. Williams contends that he signed the art purchase agreement with Abbey in December 1996, that he obligated himself in that agreement (and oral agreements that preceded his signing the agreement) to purchase all the art he donated in 1997, 1999, and 2000, that Abbey segregated art appraised at approximately $800,000 in its warehouse in 1996 on the basis of the 1996 agreement, that he owned all of that art as of December 1996, and that he is entitled to charitable contribution deductions for the appraised values of the art as claimed on his 1997, 1999, and 2000 returns.

Mr. Williams further contends that his return preparer approved his deducting the appraised fair market values, provided that he held the art for more than 1 year and the art was properly appraised; and he argues that therefore, even if he is not entitled to the charitable contribution deductions in full, he is not liable for any accuracy-related penalties.

The IRS does not challenge the fact that Mr. Williams and Abbey signed the agreement, that Mr. Williams made the payments he alleges, that Abbey made the gifts on Mr. Williams's behalf, that the recipients of the gifts were qualified charities, that the appraisers' valuations were reasonable, or that Mr. Williams complied with the procedures for substantiating and reporting the charitable contribution deductions. However, the IRS contends that Mr. Williams did not own the specific art he donated for more than a year before the dates of his gifts of that art and that therefore section 170(e) limits Mr. Williams's donation to his basis in the art, rather than the fair market values of the art.

***16** The IRS further contends that Mr. Williams is liable for accuracy-related penalties for the underpayments resulting from the disallowed portions of his charitable contribution deductions.

B. *Statutory framework*

Section 170(a)(1) generally allows a deduction for any charitable contribution made during the tax year, but the deduction is allowable only if the contribution is verified under regulations provided by the Secretary. A charitable contribution includes a contribution or gift to or for the use of a government organization for public purposes or to a charitable organization. Sec. 170(c).

Generally, the amount of the charitable contribution is the fair market value of the contributed property at the time of donation. 26 C.F.R. sec. 1.170A–1(a), (c)(1), Income Tax Regs.

In some situations involving the donation of appreciated property, the general rule for determining the amount of a charitable contribution is modified. Section 170(e)(1)(A) provides:

> SEC. 170(e). Certain Contributions of Ordinary Income and Capital Gain Property.—
>
> > (1) General rule.—The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by * * *
> >
> > (A) the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution) * * *.

Thus, the effect of section 170(e)(1)(A) is to *permit* the deduction of *long*—term capital gain appreciation but, when the contributed property is *not* long-term capital gain property, to limit the deduction to the taxpayer's basis at the time of contribution. See *Lary v. United States,* 787 F.2d 1538, 1540 (11th Cir.1986).

Section 1221(a) defines capital assets, and the art at issue qualified as a capital asset in Mr. Williams's hands. Section 1222(3) defines long-term capital gain as “gain from the sale or exchange of a capital asset held for more than 1 year”. It follows that when a taxpayer donates appreciated art that he held for 1 year or less, the amount of the deduction must be determined with regard to section 170(e)(1)(A); i.e., the deduction is limited to the taxpayer's basis, rather than the art's (higher) fair market value.

C. *Discussion*

[8] As noted, the IRS challenges only Mr. Williams's claim that he owned the art for more than a year before the donation. Mr. Williams alleges that he committed to purchasing art from Abbey, and he argues that his holding period for the art began in December 1996 when he and Abbey executed the agreement.

[9] "Federal tax law is concerned with the economic substance of the transaction under scrutiny and not the form by which it is masked." *United States v. Heller,* 866 F.2d 1336, 1341 (11th Cir.1989). Accordingly, although the parties titled the agreement "Art Purchase Agreement", we will consider the rights, duties, and obligations the parties actually assumed when they executed the agreement—whatever its title.

***17** The agreement clearly states that Mr. Williams paid $3,600 to Abbey and that Abbey would hold that amount in escrow to apply against the $72,000 purchase price. Paragraph 6 of the agreement discusses Abbey's rights in the event Mr. Williams failed to pay amounts owed to Abbey. If he failed to pay before he executed a bill of sale transferring art to a charity, the agreement provides (also in paragraph 6) that Abbey's sole remedy was "to retain as liquidated damages all previous payments Client has made toward the purchase of the Art and, in addition, to reclaim ownership of the Art." [17] The draft agreement originally provided that, in the event that Mr. Williams failed to pay Abbey after he executed documents transferring art to a charity, Abbey could require specific performance, i.e., payment. However, Mr. Williams crossed out that sentence, and Abbey thus accepted the agreement without any explicit right to force Mr. Williams's payment. [18]

Because Mr. Williams had the power unilaterally to decide whether to pay the remainder of the $72,000 purchase price and execute a bill of sale, in effect his $3,600 payment purchased an option to buy art—with the full option price applied to the price of the art.

[10] An option normally provides a person a right to sell or to purchase " 'at a fixed price within a limited period of time but imposes no obligation on the person to do so' ". See *Elrod v. Commissioner,* 87 T.C. 1046, 1067, 1986 WL 22052 (1986) (quoting *Koch v. Commissioner,* 67 T.C. at 82). "Options have been characterized as unilateral contracts because one party to the contract is obligated to perform, while the other party may decide whether or not to exercise his rights under the contract." *Fed. Home Loan Mortg. Corp. v. Commissioner,* 125 T.C. 248, 259, 2005 WL 3110640 (2005). Although the agreement placed no time restriction on Mr. Williams's right to purchase the art, it also imposed no binding commitment on him to follow through with the purchase.

[11] In contrast to an option agreement, "a contract of sale contains mutual and reciprocal obligations, the seller being obligated to sell and the purchaser being obligated to buy." *Koch v. Commissioner,* 67 T.C. at 82. The agreement at issue obligated Abbey to sell, but it did not obligate Mr. Williams to buy; thus, all he purchased in December 1996 was a contractual right to require Abbey to perform and to apply his $3,600 option payment against the $72,000 total purchase price recited in the agreement. Even without a time limit on Mr. Williams's right to require performance, in substance the agreement was an option to purchase art, regardless of the title the parties gave to their agreement.

Mr. Williams's holding period for the art he had the option either to buy or not to buy did not begin until he exercised the option, committed himself to paying for the art, and acquired a present interest in the art. See *Crane v. Commissioner,* 45 T.C. 397, 404, 1966 WL 1309 (1966), affd. 368 F.2d 800 (1st Cir.1966). In each instance, this occurred within *less than* a year of his donations.

***18** Mr. Williams testified that oral discussions he had with Abbey before signing the agreement did obligate him to purchase roughly $800,000 of appraised art and that he intended that the initial commitment described in the agreement—$72,000 total payment to purchase art with roughly $300,000 of appraised value—would cover his 1997 donations, while he would pay additional amounts to donate the remaining art in subsequent years. He did not explain how any such oral agreement could have survived paragraph 12 of the agreement he and Abbey had executed, which stated that the agreement contains the entire agreement between him and Abbey. He also did not explain why Abbey would segregate $800,000 worth of art on the basis of his signing an agreement that required him to make a $3,600 deposit and pay the remainder of the $72,000 total purchase price if and only if he chose to proceed. Nor did he explain how an agreement for

$300,000 of appraised-value art came to be an agreement for $800,000 of appraised-value art.

Mr. Williams testified that he asked Abbey to put together a collection of the kind of art he appreciated and that he believed Abbey had a large quantity of such art which Abbey would segregate and hold for his donation program. Although he claims that he believed that Abbey segregated almost $1 million of art in its warehouse someplace in New York City, he did not have and did not even profess actual personal knowledge of the timing of Abbey's acquisition of the art. He never requested or received an inventory of the items segregated on his behalf, and he never visited the warehouse to inspect the art purportedly purchased and set aside for his contribution program. [19]

Moreover, while it is clear from the age of the art listed in the appraisals that the pieces certainly existed long before their dates of donation, there is no evidence, aside from hearsay [20] and Mr. Williams's testimony, which is not competent on the point, that even Abbey owned any of this art before the dates of appraisals.

The evidence does not show that Mr. Williams owned the art as of the date of the initial agreement with Abbey in 1996 or at any other time earlier than a year before the donations. We find that Mr. Williams acquired a present interest in the art only when he agreed to pay Abbey for each batch of appraised art, and this occurred within less than a year of each donation. Thus, we agree with the IRS that because Mr. Williams owned the art for less than one year, he would not have been entitled to long-term capital gain treatment on any gain on the art if he had sold it, and therefore section 170(e)(1) limits his charitable contribution deduction to his basis in the art.

IV. *Accuracy-related penalty*

[12] The IRS determined that Mr. Williams is liable for accuracy-related penalties for the overstated charitable contribution deductions. The Commissioner bears the burden of producing sufficient evidence showing the imposition of a penalty is appropriate. Once the Commissioner meets this burden, the taxpayer must produce persuasive evidence that the Commissioner's determination is incorrect. Rule 142(a); *Higbee v. Commissioner,* 116 T.C. 438, 446–447, 2001 WL 617230 (2001).

A. *Negligence*

***19** Section 6662(a) and (b)(1) imposes an accuracy-related penalty equal to 20 percent of the portion of an underpayment that is attributable to the taxpayer's negligence or disregard of rules or regulations. [21] Section 6662(c) provides that “the term ‘negligence’ includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term ‘disregard’ includes any careless, reckless, or intentional disregard.” 26 C.F .R. section 1.6662–3(b)(1)(ii), Income Tax Regs., provides that negligence is strongly indicated where a “taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return which would seem to a reasonable and prudent person to be ‘too good to be true’ under the circumstances”. Negligence connotes a lack of due care or a failure to do what a reasonable and prudent person would do under the circumstances. See *Allen v. Commissioner,* 92 T.C. 1, 12, 1989 WL 147 (1989), affd. 925 F.2d 348 (9th Cir.1991). “[C]ourts have found that a taxpayer is negligent if he puts his faith in a scheme that, on its face, offers improbably high tax advantages, without obtaining an objective, independent opinion on its validity.” *Barlow v. Commissioner,* 301 F.3d 714, 723 (6th Cir.2002), affg. T.C. Memo.2000–339.

[13] Commencing a holding period for hundreds of thousands of dollars of art donated in 1997, 1999, and 2000 by making a modest deposit in 1996 on an agreement that allowed Mr. Williams unfettered flexibility to chose whether or not to actually buy and donate any art at all was too good to be true. This manufactured tax benefit was enough to alert a reasonable and prudent person that additional scrutiny was required. Mr. Williams did not seek independent advice to verify the propriety of his Abbey agreement or the validity of the anticipated tax benefits. Accordingly, the negligence penalty applies.

B. *Defenses*

A taxpayer who is otherwise liable for the accuracy-related penalty may avoid the liability if he successfully invokes one of three other provisions: Section 6662(d)(2)(B) provides that an understatement may be reduced, first, where the taxpayer had substantial authority for his treatment of any item giving rise to the understatement or, second, where the relevant facts affecting the item's treatment are adequately disclosed and the taxpayer had a reasonable basis for his treatment of that item. Third, section 6664(c)(1) provides that, if the taxpayer shows that there was reasonable cause for a portion of an underpayment and that he acted in good faith with respect to such portion, no accuracy-related penalty shall be imposed with respect to that portion. Whether the taxpayer acted with reasonable cause and in good faith depends on the pertinent facts and circumstances, including his efforts to assess his proper tax liability, his knowledge and experience, and the extent to which he relied on the advice of a tax professional. 26 C.F.R. sec. 1.6664–4(b)(1), Income Tax Regs.

1. *Substantial authority*

***20** Mr. Williams did not claim that he relied upon substantial authority holding that an option to purchase art with guaranteed appreciation would commence his holding period.

2. *Disclosure and reasonable basis for treatment*

[14] The IRS does not dispute that Mr. Williams followed the procedural requirements for claiming the deductions for his charitable contribution deductions, and the IRS does not challenge the verification he provided with his returns. However, considering the contingent nature of Mr. Williams's obligation to purchase art from Abbey and the issue that raises about when he actually began to hold the art, we find that Mr. Williams's returns did not include sufficient facts to provide the IRS with actual or constructive knowledge of the potential controversy involved with Mr. Williams's deducting the entire appraised value of the art he donated. The adequate disclosure exception does not apply.

3. *Reasonable cause and good faith*

Where reasonable cause existed and the taxpayer acted in good faith, section 6664(c)(1) provides a defense to the section 6662 penalty. Generally, the most important factor is the extent of the taxpayer's effort to assess the proper tax liability. 26 C.F.R. sec. 1.6664–4(b)(1), Income Tax Regs.

[15] **[16]** For purposes of section 6664(c), a taxpayer may be able to demonstrate reasonable cause and good faith (and thereby escape the accuracy-related penalty of section 6662) by showing his reliance on professional advice. See sec. 1.6664–4(b)(1), Income Tax Regs. However, reliance on professional advice is not an absolute defense to the section 6662(a) penalty. *Freytag v. Commissioner,* 89 T.C. 849, 888, 1987 WL 45307 (1987), affd. 904 F.2d 1011 (5th Cir.1990), affd. 501 U.S. 868, 111 S.Ct. 2631, 115 L.Ed.2d 764 (1991). A taxpayer asserting reliance on professional advice must prove: (1) that his adviser was a competent professional with sufficient expertise to justify reliance; (2) that the taxpayer provided the adviser necessary and accurate information; and (3) that the taxpayer actually relied in good faith on the adviser's judgment. See *Neonatology Associates, P.A. v. Commissioner,* 115 T.C. 43, 99, 2000 WL 1048512 (2000), affd. 299 F.3d 221 (3d Cir.2002).

[17] Mr. Williams testified that his return preparer advised him that, given appropriate appraisals and a 1–year holding period, his charitable contribution deductions "shouldn't be an issue". The record includes no evidence on the return preparer's qualifications nor on what information Mr. Williams gave his return preparer in order to obtain his approval of the deduction. Mr. Williams did not testify whether he provided a copy of the agreement, explained to the preparer the contingent nature of his obligation to purchase, or admitted his lack of knowledge of whether Abbey actually owned the art more than a year before his contributions.

Mr. Williams testified that he believed Abbey's appraisals were legitimate, that the promised appreciation of the art resulted from Abbey's economies of scale from bulk purchases, and that his return preparer approved the deductions. We need not decide—though we doubt—whether Mr. Williams honestly held these beliefs; it is enough that he failed to demonstrate that he provided a competent tax professional all the information about his deal with Abbey and that he actually relied upon an objective professional's advice rather than his perception of the deal or Abbey's representation of the tax deductions it could manufacture for him.

***21** The reasonable cause exception does not apply.

Mr. Williams is therefore liable for the accuracy-related penalty on the underpayments resulting from the disallowed charitable contribution deductions for 1997, 1999, and 2000.

V. *Conclusion*

Mr. Williams is liable for tax in each year on the investment income earned in the ALQI accounts because, as the parties have agreed, that income is foreign personal holding company income, pursuant to section 954(a)(1). He is also liable for tax in each year on the net consulting income paid into the ALQI accounts because that income was his own. Moreover, Mr. Williams is liable for the civil fraud penalty under section 6663(a) on the entire underpayment resulting from his unreported ALQI income (both investment income and consulting income) for each year in issue.

Mr. Williams is not entitled to charitable contribution deductions in excess of those the IRS allowed, and he is liable for the accuracy-related penalties under section 6662(a) and (b)(1) on the underpayments resulting from the disallowed charitable contribution deductions.

To reflect the foregoing,

An appropriate order and decision will be entered.

All Citations

T.C. Memo. 2011-89, 2011 WL 1518581, 101 T.C.M. (CCH) 1408, T.C.M. (RIA) 2011-089, 2011 RIA TC Memo 2011-089

Footnotes

[1] The record does not explain why the increased income reported on the amended return for 2000 was less than the earnings reported on the amended return. On this and subsequent tables, we do not correct discrepancies that apparently result from rounding.

[1] Unless otherwise indicated, all citations of sections refer to the Internal Revenue Code (Code, 26 U.S.C.) in effect for the years in issue, and all citations of Rules refer to the Tax Court Rules of Practice and Procedure.

[2] Although Mr. Williams and his wife filed joint Federal income tax returns for 1993 through 2000, the IRS determined that section 6015(c) applies to Meredith Williams and that she is not liable for the deficiencies determined for any of those years.

[3] In earlier opinions in this case, we held that this Court lacks jurisdiction to redetermine Mr. Williams's income tax liability for 2001, his liability for unassessed interest, and his liability for penalties for failing to file Forms TD F 90–22.1, Report of Foreign Bank and Financial Accounts (FBARs), *Williams v. Commissioner,* 131 T.C. 54, 2008 WL 4443057 (2008); and we held that Mr. Williams's conviction for tax evasion under section 7201 for 1993 through 2000 collaterally estops him for each of those years from denying that for each of these years there was an underpayment of his income tax attributable to civil fraud for purposes of the statute of limitations and the section 6663(a) fraud penalty, *Williams v. Commissioner,* T.C. Memo.2009–81.

[4] Credit Agricole Group acquired Banque Indosuez in 1996 and changed its name to Credit Agricole Indosuez. For convenience, we will refer to the bank Mr. Williams used in Switzerland as the Swiss bank.

[5] The parties stipulated that the deposits and earnings listed are “net of all expenses”. Mr. Williams does not allege deductible business expenses beyond any to which the parties stipulated. We accept the parties' stipulation (correcting errors of arithmetic) and refer to the net income or amounts deposited without analyzing any deductions to which the parties have agreed.

[6] The record does not reflect what ALQI income Mr. Williams reported on his 2001 return (services income, investment income, both, or neither). The 2001 tax year is not before us in this case. See *supra* note 3.

[7] The IRS disputes that the amended returns for 1999 and 2000 correctly reported the appropriate method of taxing ALQI's income.

[8] Mrs. Williams also signed the agreement. However, she is not a party to this case. See *supra* note 2.

[9] Paragraph 6 of the agreement included the following sentence, which was crossed out by hand and initialed:

> All payments owing by Client after Client's execution of the Bill of Sale shall be subject to Abbey's right to require specific performance of Client with respect to Clients [sic] obligation to pay Abbey the full balance

[10] The agreement recited a total purchase price of $72,000 and stated that the purchase price shall not exceed 24 percent of the cumulative appraised fair market value of the art. ($72,000/24 percent) = $300,000.

[11] The record does not show any basis for this “$800,000 plus” figure. The agreement between Abbey and Mr. Williams provided for art with a total value of $300,000.

[12] On the photocopy of the December 17, 1999, letter introduced into evidence, the last digit of the year Mr. Williams references is illegible, but we infer that he refers to 1997. of the purchase price.

13 The notice of deficiency appears to determine deficiencies relative to the original returns Mr. Williams filed for 1999 and 2000, not the amended returns he filed in 2003 for 1999 and 2000. We presume that the IRS is holding the payments made with Mr. Williams's amended 1999 and 2000 returns as advance payments against his liabilities—along with the $3,512,000 restitution payment.

Moreover, certain adjustments in the notice of deficiency result from mechanical application of limitations based on Mr. Williams's adjusted gross income for each year. These include a reduction in allowed exemptions for 1993 and limitations in itemized deductions. These adjustments are computational and do not require further analysis.

14 The amounts the IRS allowed include not only the amounts Mr. Williams paid for the art he donated through Abbey but also the amounts he claimed for other non-cash charitable contributions.

15 Under certain circumstances the burden of proof can shift to the Commissioner with respect to factual disputes, pursuant to section 7491(a). However, Mr. Williams does not contend that the burden has shifted, and the record does not suggest any basis for such a shift. For example, Mr. Williams has not demonstrated compliance with the requirements of section 7491(a)(2)—specifically, substantiating items and maintaining required records.

16 Respondent contends that Mr. Williams's guilty plea collaterally estops him from denying that the consulting income is taxable to him. However, we have held that, even after the application of collateral estoppel, “the *amounts* of the deficiencies of tax and penalties for 1993 through 2000, and the issue of accuracy-related penalties, remain for trial”, *Williams v. Commissioner,* T.C. Memo.2009–81, slip op. at 21 (emphasis in original), since that would require addressing subordinate issues as to which collateral estoppel does not clearly apply. We therefore treat Mr. Williams's allocution testimony not as something that estops his contentions but as evidence. It is, however, weighty evidence that he was not able to plausibly contradict at trial.

17 From the documents in the record acknowledging the charities' receipt of the art, it appears that Abbey delivered art on loan to charities to hold until Mr. Williams signed and Abbey delivered the bill of sale or deed of gift. Abbey appears to have processed the final paperwork only after receiving Mr. Williams's payments for the art.

18 Considering that Abbey controlled the paperwork, including the bill of sale or deed of gift, Abbey remained in a position to reclaim any art delivered on loan to a charity if Mr. Williams had defaulted on payment after Abbey delivered the art to a charity. But Mr. Williams was not obligated to proceed.

19 Mr. Williams also claimed that he believed the appraisals Abbey obtained were valid and accurate and that the 416–percent jump in value legitimately resulted from Abbey's purchasing the art oversees in third-world countries and in bulk. Abbey's guaranteed appreciation is suspect; and if the art is available at such deep discounts, the appraisals—purporting to represent prices a willing buyer and willing seller would negotiate—are also suspect. However, as the IRS is not challenging valuation, we need not decide these questions.

20 Mr. Williams introduced a December 9, 2000, letter from Abbey asserting that Abbey still had items “held in a segregated manner in our warehouse located in New York City from 1997”, promising to send a description of those remaining objects, and estimating the appraised value of the objects at over $200,000. If offered to prove the quoted fact, the letter is inadmissible hearsay, see Fed.R.Evid. 801(c), 802, and Mr. Williams did not offer into evidence any actual business records substantiating Abbey's holdings or any description of any segregated art, nor did he call any representative of Abbey to testify. Moreover, Mr. Williams did not reconcile Abbey's letter's reference to art segregated “from 1997” with his assertion that Abbey segregated all $800,000 of appraised-value art in 1996. We are entitled to infer from Mr. Williams's failure to offer evidence proving purchase in 1996 and segregation thereafter that probative evidence about the time of purchase and segregation would have been unfavorable to Mr. Williams's case. See *Wichita Terminal Elevator Co. v. Commissioner,* 6 T.C. 1158, 1165, 1946 WL 298 (1946), affd. 162 F.2d 513 (10th Cir.1947).

21 The accuracy-related penalty is also imposed on the portion of an underpayment attributable to a “substantial understatement of income tax.” Sec. 6662(b)(2). By definition, an understatement of income tax for an individual is substantial if it exceeds the greater of $5,000 or 10 percent of the tax required to be shown on the return. Sec. 6662(d)(1)(A).

The understatements of income tax resulting from the disallowed charitable contribution deductions and the amounts of tax required to be shown on the returns follow:

	1997	***1999***	***2000***
Understatement of tax attributable to overstated charitable contribution	$128,096	$68,522	$21,600
Tax required to be shown	1,537,542	366,424	252,159

Although each understatement exceeds $5,000, only the understatement for 1999 is greater than 10 percent of the tax required to be shown on the return, and thus there is a substantial understatement for 1999 only. We need address the substantial understatement accuracy-related penalty only to the extent we determine Mr. Williams is not liable for the negligence accuracy-related penalty under section 6662(b)(1).

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