

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,

-against-

S1 05 Crim. 0888 (LAK)

JEFFREY STEIN, et al.,

Defendants.

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MEMORANDUM AND ORDER

LEWIS A. KAPLAN, *District Judge.*

The four remaining defendants move to dismiss the indictment on the basis of the government’s alleged violations of 26 U.S.C. § 6103, a provision of the Internal Revenue Code that provides for the confidentiality of tax return information.¹ They argue that these violations amount to a denial of due process, requiring dismissal.

Alleged Misconduct

Defendants allege that the government disclosed return information in violation of § 6103 on three occasions. Specifically, defendants challenge: (1) the disclosure of KPMG return information to attorneys in the Criminal Section of the Tax Division at the Department of Justice (“DOJ”) in 2003, before the matter was referred to the Criminal Section, (2) the disclosure of KPMG return information in a Tax Court case, and (3) the disclosure of KPMG return information to the Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs (“PSI”). The government disputes many of the factual allegations and the conclusion that the facts alleged make out violations of Section 6103.

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The docket sheet reflects two such motions: DI 1089 and DI 1098. DI 1089 was filed on behalf of all defendants. DI 1098 was filed on behalf of Defendant Makov and was joined by Ruble (DI 1122), Larson (DI 1125), and Pfaff (DI 1125).

Given the disposition of this motion, it is not necessary to resolve the disputed facts. For purposes of this motion, therefore, the Court assumes the truth of defendants' factual allegations, which are summarized below.²

In 2002, the IRS issued summonses to KPMG in connection with a civil investigation into whether KPMG was a "promoter" of tax shelters. In June 2002, the IRS referred the case to the Civil Section of the Tax Division at DOJ for a summons enforcement action. The IRS did not refer the case to the Criminal Section of the Tax Division at DOJ (the "Criminal Section") until December 2003. In February 2004, the Tax Division referred the matter to the U.S. Attorney for the Southern District of New York ("USAO") for a possible criminal prosecution.

1. Disclosure to Criminal Section of DOJ

In March 2003, attorneys with the Criminal Section, including Kevin Downing, began to meet with the IRS about the KPMG investigation and to review KPMG return information. Sometime later, Downing debriefed a confidential informant, alleged to be Mike Hamersley.³ In the fall of 2003, Downing again reviewed KPMG return information, including depositions of DeLap, Eischeid, Ritchie, and Stein taken in civil cases involving KPMG, that KPMG had provided to the IRS.

Defendants cite notes and emails of Sharon Katz-Pearlman as evidence that a criminal investigation beyond the scope of the civil enforcement action was underway by June 2003. These notes, defendants claim, reflect that Roland Barral of the IRS told Katz-Pearlman that the DOJ and USAO were involved in the investigation.⁴ They argue also that the notes show that Katz-Pearlman believed "the DOJ, the Commissioner of Internal Revenue, the IRS Chief Counsel, the Deputy Attorney General for Tax, and the General Counsel to the Treasury, were all meeting about KPMG in 'frantic' briefings. . . . [A]nd that the 'DOJ – wants to go nuts' in the summons enforcement action."⁵

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Defendants have requested an evidentiary hearing into their allegations that the government violated § 6103. No evidentiary hearing is warranted because the disputed issues of fact are not relevant to the disposition of this motion.

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Defendants allege further that any information Hamersley provided to Downing was disclosed in violation of § 7216 (imposing criminal penalties on tax preparers who knowingly or recklessly disclose information obtained in preparation of a client's return).

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DI 1075, at 10-11; DI 1148, at 10-11.

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DI 1148, at 22.

Finally, defendants suggest that DOJ “strung out” the settlement negotiation so it could continue to obtain information from KPMG via the IRS.⁶

2. *Disclosure in Civil Case*

On June 16, 2003, attorneys who represented the IRS in a civil tax court case filed Requests for Admissions, to which it attached KPMG return information – viz. a March 14, 1998 email from Stein to others at KPMG. According to defendants, this filing was made “solely in order to make the document public.”⁷

3. *Disclosure to the PSI*

Defendants allege that the IRS or DOJ provided KPMG return information – viz. a list of KPMG's shelter clients – to the PSI by July 2003.

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Id. at 23-24.

Defendants assert that this “would clearly be improper” and cite *United States v. La Salle National Bank*, 437 U.S. 298, 317 (1978) (prior to recommendation for prosecution to the DOJ, the IRS must use its summons authority in good-faith pursuit of congressionally authorized purposes). But “the precise question addressed in . . . *LaSalle National Bank* is no longer a live one.” *United States v. Millman*, 822 F.2d 305, 308 (2d Cir. 1987). As the Second Circuit described:

“At one time, the Internal Revenue Code allowed IRS summonses to be enforced only when the purpose of the investigation was to determine potential civil tax liability; courts then uniformly held that 26 U.S.C. § 7602 did not authorize the issuance of an IRS summons ‘for the improper purpose of obtaining evidence for use in a criminal prosecution.’ In 1982, however, congress amended § 7602 to permit the issuance of a summons for ‘the purpose of inquiring into any offense connected with the administration or enforcement of the internal revenue laws.’” *Id.* (internal citations omitted).

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DI 1148, at 19; DI 1075, at 12.

Discussion

1. *Alleged Section 6103 Violations*

Section 6103 provides that “[r]eturns and return information shall be confidential” and shall not be disclosed except as authorized by federal law. Return information includes, *inter alia*, any information “received by, recorded by, prepared by, furnished to, or collected by” the IRS “with respect to . . . the determination of the existence or possible existence, of liability . . . of any person . . . for any tax, penalty interest, fine, forfeiture, or other imposition or offense.”⁸

Section 6103 permits disclosure of return information to DOJ employees for use in “any proceeding before a Federal grand jury or preparation for any proceeding (or investigation which may result in such a proceeding) before a Federal grand jury or any Federal or State court.”⁹ Such disclosures, however, may be made only “if the Secretary [of the Treasury, or his designees] has referred the case to the Department of Justice.”¹⁰ Defendants’ claims that the government violated Section 6103 therefore depend on when and to whom the KPMG investigation was referred.

It is not necessary, however, to decide whether the facts alleged constitute violations of Section 6103. Even assuming that the disclosures described above were prohibited by Section 6103, dismissal would not be an appropriate remedy. Congress has provided civil and criminal remedies for violations of Section 6103.¹¹ Courts therefore have declined to create additional

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26 U.S.C. § 6103(b)(2). “The plain language of the statute reveals that ‘return information’ must be information which has somehow passed through, is directly from, or generated by the IRS.” *Baskin v. United States*, 135 F.3d 338, 342 (5th Cir.1998). Thus, information that has not passed through the IRS, is not “return information,” even if it is identical to information that has passed through the IRS. *See Jade Trading, LLC v. United States*, 65 Fed. Cl. 188, 193-194 (2005).

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26 U.S.C. § 6103(h)(2).

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Id. § 6103(h)(3)(A).

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Id. § 7431 (establishing a private right of action for civil damages against the United States as a remedy if a federal officer knowingly or negligently violates § 6103); *Id.* § 7213(a)(1) (providing that the willful disclosure by a federal officer of any return or return information is a federal crime); *Id.* § 7213A (making it unlawful for any federal officer or employee to inspect records in violation of § 6103).

remedies such as suppression of evidence or dismissal.¹² This Court likewise declines to fashion a remedy beyond those Congress provided. Further, these defendants are not among those whom Section 6103 is meant to protect. According to defendants, the information disclosed improperly was KPMG return information, and it is KPMG that would have any claim based upon any Section 6103 violations. Indeed, defendants do not argue that dismissal is an appropriate remedy for any Section 6103 violations as such.¹³ They contend, rather, that the Section 6103 violations amount to a due process violation and that dismissal is an appropriate remedy for the due process violation.

2. *Alleged Due Process Violation*

“A defendant has a due process defense to prosecution where (1) the government violates a protected right of the defendant and (2) the government’s conduct is sufficiently outrageous.”¹⁴

Defendants argue that the government’s alleged violations of Section 6103 constitute sufficiently outrageous conduct requiring dismissal. They rely on cases in which the courts, according to the defendants, “found that governmental deceit and trickery, particularly in gathering evidence using civil or administrative process for a secret criminal investigation, amount[ed] to a departure from the ‘proper standards in the administration of justice’ and a due process violation warranting dismissal.”¹⁵ Thus, defendants seem to argue that the alleged Section 6103 violations are episodes of “governmental deceit and trickery.”

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United States v. Orlando, 281 F.3d 586, 595-96 (6th Cir. 2002) (suppression is not appropriate remedy for 6103 violation); *Nowicki v. Comm’r of Internal Revenue*, 262 F.3d 1162, 1163 (11th Cir.2001) (violation of § 6103 does not require the application of the exclusionary rule); *United States v. Michaelian*, 803 F.2d 1042, 1050 (9th Cir.1986) (suppression of evidence or dismissal are not required to remedy a violation of § 6103). *But see United States v. Chemical Bank*, 593 F.2d 451, 458 (2d Cir. 1979) (if a § 6103 violation is found, “[t]here will be time . . . to move for suppression of the evidence so obtained if grounds for such a motion exist.” (emphasis added)).

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DI 1075, at 6 n.7; DI 1148, at 26.

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United States v. Williams, 372 F.3d 96, 111 (2d Cir. 2004) (citing *United States v. Cuervelo*, 949 F.2d 559, 565 (2d Cir.1991)).

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DI 1090, at 4.

Courts have “emphatically upheld” the propriety of parallel civil and criminal investigations absent unusual circumstances.¹⁶ And “[i]t is well-established that as a general rule, [t]he prosecution may use evidence acquired in a civil action in a subsequent criminal proceeding unless the defendant demonstrates that such use would violate his constitutional rights or depart from the proper administration of criminal justice.”¹⁷ The Supreme Court, in *United States v. Kordel*, identified several examples of conduct that might amount to such a departure, including “where the Government has brought a civil action solely to obtain evidence for its criminal prosecution, or has failed to advise the defendant in its civil proceeding that it contemplates his criminal prosecution.”¹⁸

Defendants identify three district courts that have applied this principle to dismiss an indictment or suppress evidence.¹⁹ In *United States v. Carriles*,²⁰ the district court dismissed an indictment charging defendant with false statements in naturalization proceedings, finding that the naturalization interview was “a pretext for a criminal investigation” and that the government engaged in “fraud, deceit, and trickery” during the naturalization interview.²¹ In *United States v. Stringer*,²² the district court dismissed indictments charging criminal securities violations after a lengthy civil investigation by the SEC. It found that the civil investigation was not *bona fide*²³ and that “the government engaged in deceit and trickery to keep the criminal investigation concealed.”²⁴ And in

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United States v. Stringer, 535 F.3d 929 (9th Cir. 2008) (citing *SEC v. Dresser Industries, Inc.*, 628 F.2d 1368, 1376-77 (D.C. Cir. 1980) (en banc)).

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United States v. Mahaffy, 446 F. Supp. 2d 115, 123 (E.D.N.Y. 2006) (quoting *United States v. Teyibo*, 877 F. Supp. 846, 855 (S.D.N.Y. 1995)).

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397 U.S. 1, 11-12 (1970)

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DI 1148, at 26-27.

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United States v. Carriles, 486 F. Supp. 2d 599 (W.D. Tex. 2007), *rev'd*, No. 07-50737 (5th Cir. Aug. 14, 2008).

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Id. at 619-20.

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United States v. Stringer, 408 F. Supp. 2d 1083 (D.Or.2006), *rev'd* 535 F.3d 929 (9th Cir. 2008).

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Id. at 1087-88.

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Id. at 1089.

United States v. Scrushy,²⁵ the district court suppressed a deposition given by the defendant in a SEC civil investigation because the government “departed from the proper administration of criminal justice in procuring the Defendant’s deposition testimony.”²⁶ In reaching that conclusion, the court observed that the civil and criminal investigations had “merged” and that the defendant was prejudiced because he was unaware that he was the target of both a civil and criminal investigation.²⁷

Defendants’ reliance on these cases is misplaced. In each case, the court emphasized that (1) there was no *bona fide* civil investigation, and (2) the defendant was deceived by the government during the civil investigation. There are no such allegations in this case. Defendants do not deny that there was a *bona fide* civil investigation, they complain merely that there was a criminal investigation as well. And defendants, who were not the targets of the civil investigation, do not claim to have been deceived by the government.²⁸ Neither do they claim that the government deceived KPMG.²⁹ Moreover, two of the three cases relied on by defendants—*Carriles* and *Stringer*—were reversed on appeal. In each case, the court of appeals rejected the lower court’s conclusions that (1) there was no *bona fide* civil investigation,³⁰ and (2) the government affirmatively misrepresented whether a criminal investigation was pending.³¹

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United States v. Scrushy, 366 F. Supp. 2d 1134 (N.D. Ala. 2005).

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Id. at 1137.

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Id. at 1139. The finding that the investigations had merged was based on the fact that (1) the USAO had instructed the SEC on how to tailor the deposition questions, and (2) the SEC, at the USAO’s request, moved the deposition in order to secure a particular venue for the USAO. *Id.* at 1139.

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Defendants suggest that DeLap, Eischeid, Ritchie, and Stein, gave deposition testimony unaware of the criminal investigation, but they do not suggest that the government deceived these individuals.

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In fact, defendants ask the Court to assume that the DOJ and USAO was engaged in a criminal investigation in 2003 based on evidence that KPMG was aware that the DOJ and USAO were participating in the investigation at that time.

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United States v. Carriles, No. 07-50737, slip op. at 19-25 (5th Cir. Aug. 14, 2008); *United States v. Stringer*, 535 F.3d 929, 938-39 (9th Cir. 2008).

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Carriles, slip op. at 25-26; *Stringer*, 535 F.3d at 940.

Conclusion

For the foregoing reasons, defendants motions to dismiss the indictment [docket items 1089 and 1098] are denied.

SO ORDERED.

Dated: September 10, 2008



Lewis A. Kaplan
United States District Judge

(The manuscript signature above is not an image of the signature on the original document in the Court file.)