IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

DAVID A. COHEN, et al.,	:	CIVIL ACTION
Petitioners	:	
v.	:	NO. 03-CV-3234
UNITED STATES,	:	
Respondent	:	(Consolidated with Case Nos. 03-CV-3238 and 03-CV-3239)

BRIEF OF XÉLAN PETITIONERS IN OPPOSITION
TO RESPONDENT'S MOTION FOR SUMMARY ENFORCEMENT

This brief in opposition to Respondent's Motion for Summary Enforcement is submitted by Petitioners élan, Inc., xélan Foundation, Inc., xélan Administrative Services, Inc., xélan Investment Services, Inc., xélan Annuity Co., *x*élan, The Economic Association Of Health Professionals, Inc., Pyramidal Funding Systems, Inc., dba xélan Insurance Services, and Jaye and Junck Consulting, Inc. (collectively and severally, "Petitioners").

INTRODUCTION

Respondent has failed to establish its entitlement to summary enforcement for the following reasons:

1. The summonses request only those documents related to the Cohens and other xélan Disability Program participants' investments with SEI. Neither has investments with SEI. Monies invested with SEI are owned by an insurance company and a charitable foundation, and therefore no documents should be produced. In any

event, enforcement of the summonses should be denied because they fail to describe with reasonable certainty the documents to be produced.

2. To the extent Respondent seeks documents relating to and identifying other participants in the Disability Program, the summonses were issued for an improper purpose and in bad faith. The IRS' true purpose in seeking these documents is not to shed light upon the correctness of the Cohens' tax returns, but to obtain the identities of other participants in the Disability Program and examine those participants' tax returns, in violation of well-established procedures of the I.R.C.

3. Documents, and/or portions thereof, disclosing the identities of other participants in the Disability Program are irrelevant to the audit of the Cohens' tax returns.

4. Documents pertaining to one year not under examination in the Cohens' audit are irrelevant. The IRS' request for such documents is for the purpose of obtaining the identity of additional participants in the Disability Program and to initiate examinations of those participants' tax returns, in violation of well-established procedures of the I.R.C.

5. Respondent has failed to show that documents and information sought are not already in the possession of the IRS.

RELIEF SOUGHT

Respondent's Motion for Summary Enforcement should be denied in its entirety. Alternatively, this Court should order Respondent to answer Petitioners' interrogatories and hold an evidentiary hearing with respect to the issues raised in this Response. In any event, this Court should direct that the names, addresses, social security numbers

and any other information which could provide the indemnity of participants in xélan programs, other than the Cohens, be redacted from any documents produced by SEI.

FACTS

In 1974, xélan, Inc. was founded by Dr. L. Donald Guess to provide financial education and investment advice to doctors. Through its related entities, xélan, Inc. provides a range of financial services to doctors, including investment advice, disability, life and long-term care insurance, pension plans, and annuities. The goal of the organization is to assist doctors in structuring their practices to provide financial security to them and their families during their professional careers, and upon retirement. xélan, Inc. has retained independent tax and financial experts to assist it and its members in accomplishing its goal. Declaration of L. Donald Guess ("Guess Dec."), pgs. 1-2, ¶3.[1]

The summonses at issue were served upon SEI in April 2003. They purport to request information pertaining only to the examination of the federal income tax returns of the Cohens.[2] Previously, other summonses were served upon the Cohens, xélan, Inc., and the Cohens' financial counselor, Jaye & Junck Consulting, Inc. ("Jaye & Junck"). Thousands of pages of documents were produced as a result, and days of testimony were provided by the Cohens, Dr. Guess, and Richard Jaye. Declaration of Michael R. Suverkrubbe ("Suverkrubbe Dec."), pg. 2, ¶¶5,6; Declaration of Richard Jaye

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1 The declarations submitted in support of this brief are attached at Exhibit B. They are referenced in this brief as "Dec.," preceded by the name of the declarant and followed by the page and paragraph of the declaration.

2 The summonses request documents pertaining to David A. and Margaret L. Cohen, Ameripath, and David Andrew Cohen, DMD, MS, PA. Doctors David A. and Margaret L. Cohen both participate in xélan programs, including the Disability Program. Dr. David A. Cohen is an employee and the sole owner of his professional corporation, David Andrew Cohen, DMD, MS, PA. Dr. Margaret L. Cohen is employed by Ameripath. The individual Cohens' corporate employers also participate in xélan programs. For

("Jaye Dec."), pg. 2, ¶¶8,9; Declaration of David C. Jacquot ("Jacquot Dec."), pgs. 8-9, ¶¶29-34. Moreover, examinations of at least 102 participants in xélan programs, including the Supplemental Disability Insurance Program ("Disability Program") have been initiated by the IRS. In connection with these examinations, many more documents were obtained by the IRS. Suverkrubbe Dec., pg. 2, ¶5, pg. 4, ¶¶11,12.

In the Cohens' examination, the IRS raised issues with respect to the tax aspects of the Cohens' participation in three xélan programs: 1) the Health and Welfare Benefit Program ("419 Program"); 2) the Disability Program; and 3) the Cohens' contributions to xélan Foundation, Inc. ("Foundation"). Suverkrubbe Dec., pg. 3, ¶9. In Respondent's Memorandum and attached declarations, Respondent alludes to programs other than the Disability Program only to bolster its general allegations that the Cohens' "diverted income" to these programs. Memorandum in Support of Respondent's Motion for Summary Enforcement ("Memorandum"), pgs. 12, 16, and 30. Respondent does not argue that SEI has documents relevant to programs other than the Disability Program. Memorandum, pgs., 4, 7, 24-25, and 34. In fact, with regard to the Cohens, investments with SEI pertain only to the Disability Program and the Foundation.[3]

Respondent attacks the merits of the Disability Program, calling it a "disguised" and "tax free savings program for doctors." Respondent alleges the Cohens "diverted over $1 million dollars to xélan programs," comparing these programs to tax evasion schemes. The merits of the programs are irrelevant to this proceeding. Nevertheless,

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convenience, the individual doctors and their employers hereinafter will be collectively referred to as ("the Cohens").

3 The Foundation has been examined and it has received a final IRS determination that it is a qualified, tax-exempt foundation. Guess Dec., pg. 2, ¶4.

the following information is provided to this Court to place Respondent's allegations in context.

xélan, Inc. encourages doctors to incorporate their practices and to cause their personal service corporations to pay premiums for health and disability insurance coverage for the doctors and other qualified employees. The premiums are tax deductible and not taxable income to the doctors individually, despite the personal benefit of the coverage. While this certainly saves taxes, it is no different than any professional incorporating his/her practice and obtaining immediate tax benefits from doing so, such as those provided by pension and health insurance plans.

The Disability Program provides benefits in the event of a participant's complete or partial disability. Additionally, after seven years of participation, or upon reaching a specified age, the program provides a potential for the participant to obtain a retrospectively rated refund. The IRS' fundamental opposition to the Disability Program relates to this potential refund. The refund is dependant upon the amount of premiums paid on behalf of the participant, the investment experience of the Insurance Company's reserves, any forfeitures of other participants' past contributions, and claims filed by other participants. Declaration of Leslie S. Buck ("Buck Dec."), pg. 3, ¶11. Superficially, the Disability Program has certain features of a "savings program." It provides an immediate tax deduction and defers income recognition to the insured until such time as the participant is disabled or a refund is obtained. This does not mean, however, that the Disability Program fails to qualify as "insurance" for tax purposes. Large, independent insurance companies, such as Pan American Insurance Company, offer

primary disability insurance policies, and their coverage is offered to xélan members. Most of these policies contain a refund feature. Buck Dec. pgs. 2-3, ¶¶9-10.

Twenty years ago, the IRS ruled favorably for the taxpayer with respect to a program that provided medical malpractice liability coverage, where the policy involved provided for a refund of premium after five years of participation. *Rev. Rul. 83-66, 1983-1 C.B. 43*. There, as here, doctors were members of a medical association which purchased group insurance for the doctors' benefit. The doctors could obtain a refund of a portion of the premiums paid on their behalf dependent upon the loss experience of the covered group as a whole. There, as here, premiums paid became part of the insurance company's reserves, although separate records were maintained for each insured for purposes of determining their *pro rata* share of any refund. The IRS ruled that, despite the refund feature, the premiums paid qualified as ordinary and necessary business expenses under §162 of the Internal Revenue Code ("I.R.C.") of 1986. The refund feature, and the separate accounting for each insured's *pro rata* share of any refund, did not disqualify the program from being deductible "insurance." IRS revenue rulings are binding upon the IRS and, may be relied on as precedent by other taxpayers. *Rauenhorst v. Commissioner,* 119 T.C. 157, 173 (2002).[4]

Respondent argues that *Neonatology Associates, P.A. v. Commissioner,* 299 F.3d 221 (3d Cir. 2002), involved "an improper scheme for avoiding income taxes on the 'premiums' similar to the xélan Disability Insurance Program." Memorandum, pg. 31. *Neonatology* involved a Voluntary Employee's Beneficiary Association plan with a

4 The National Treasury Employee Union offers a long-term care plan to IRS employees that provides for potential return of premium. Depending upon the length of enrollment in the plan, up to 100% of the premiums can be returned to the insured. Suverkrubbe Dec., pgs. 5, ¶17.

conversion option. The employee could access funds paid by the employer for a group whole life policy (the cost of this policy substantially exceeded the costs of ordinary term insurance), could borrow against the policy, and the loan could be repaid out of tax-free death benefits. The Court held that payments for premiums were not ordinary or necessary business expenses under I.R.C. §162, and constituted dividends to covered employees.

The Disability Program has no parallels to the program involved in *Neonatology*. It provides disability, not life insurance coverage, at costs actuarially determined. It is not funded by whole life insurance policies. There is no ability for the participant to borrow against his/her potential benefits. Disability payments or refunds paid under the terms of the policy are to be reported as taxable income to the recipient in the year paid.

Respondent's contention that *Neonatology* is authority for the notion that xélan, Inc. claims invalid tax benefits reflects upon the purpose for which the summonses were served upon SEI. While Respondent argues it is seeking documents to determine "the extent to which the xélan program is similar to the program struck down in *Neonatology*" (Memorandum, pg. 31), the IRS already has the information to show that the Disability Program is completely unlike the program in *Neonatology*. Respondent has copies of the policies, claims, forfeitures, actuarial studies, and information about fees, costs, and commissions. The true purpose of the IRS' request for information from SEI is to obtain names of other xélan participants for purposes of examining their tax returns, in violation of well-established procedures of the I.R.C. Respondent wrongly seeks to obtain their identities by circumventing the John Doe Summons requirements of I.R.C. §7609(f).

ARGUMENT

A. The summonses only call for the production of documents relating to the Cohens' and other participants' investments with SEI. Neither has their own monies invested with SEI. Monies invested with SEI are owned by and are the investments of the Insurance Company and the Foundation. Therefore, SEI has no documents to produce pursuant to the summonses. At a minimum, the summonses are ambiguous as to what documents are sought, and enforcement should be denied for their failure to describe the documents with reasonable certainty.

The summons issued to SEI in connection with the Cohens' tax returns states, "provide the following documents relating to Ameripath and Ameripath's employees investments with SEI…" and "provide the following documents relating to Mrs. Cohen's and Mr. Cohen's investments with SEI…" Declaration of Catherine Johns ("Johns Dec."), Ex. A, pg. 3, ¶1, pg. 6, ¶2. The summons issued in connection with Dr. Andrew Cohen's professional corporation likewise requests all "documents relating to Cohen's and Cohen's employees investments with SEI …." Johns Dec., Ex. B, pg. 3, ¶1. Both summonses also request documents pertaining to investments received or held by SEI "for the benefit of other employees or their respective employers." Johns Dec., Ex. A, pgs. 4-5, ¶¶1 (u), (w), (x), (y), (cc), (hh), (ii); Ex. B, pgs. 5-6,¶¶1 (u), (w), (x), (y), (cc), (hh), (ii).

SEI does not have documents pertaining to the Cohens' or their employers' investments, because neither the Cohens nor their employers have any investments with SEI. The investments with SEI, which pertain to xélan programs and the Cohens' participation in these programs, are those held for and owned by Doctors Benefit Insurance Co., Ltd., formerly xélan Insurance Company, Ltd. ("Insurance Company"), and the Foundation. Buck Dec., pgs. 4-5, ¶¶13-19; Declaration of Paul Dunn ("Dunn Dec."), pgs. 2-3, ¶¶7-11. The same situation exists with respect to other doctors and

their employees' participation. Documents relating to the Foundation's and the Insurance Company's investments are not within the scope of the summonses, and therefore should not be produced.

Under the Disability Program, a member's employer makes contributions to a trust, which maintains a group policy providing benefits for the members. All members' contributions are used to pay premiums on the group policy, and are paid to Insurance Company accounts, including an account with SEI. The SEI account (and monies contained therein) is owned by the Insurance Company, and the investments maintained by SEI constitute a portion of its reserves. Buck Dec., pg. 4, ¶13; Dunn Dec., pg. 3, ¶11. Insured members have no ownership interest in the invested reserves. The member has no authority to add to or withdraw funds from the SEI account; only the Insurance Company has that authority. Dunn Dec., pg. 2, ¶8.

SEI does maintain, on behalf of the Insurance Company, a separate accounting of each member's potential disability benefit and refund, and it issues periodic statements to each showing their premium contributions and their *pro rata* share of investment performance. Just as was the case in Rev. Rul. 83-66, these separate accountings are maintained so the member can estimate his/her disability benefit, as well as his/her estimated *pro rata* share of any potential refund. These separate statements and accountings do not evidence ownership by the members of funds invested with SEI. Nor do they evidence separate accounts, as none exist. Indeed, the investment contract governing the funds held by SEI is between the Insurance Company and SEI, not the members and SEI. Dunn Dec., pg. 2, ¶7.

This Court must enforce, or decline to enforce, the summonses as drafted. It cannot order SEI to produce documents that are not described in the summonses, especially where the IRS indicates that it is seeking documents outside their scope. If this Court should conclude that it is unclear whether the documents sought are outside the scope of the summonses, it should nevertheless decline to enforce the summonses. If an ambiguity exists, the summons must fail. Section 7603(a) of the I.R.C. requires a summons to describe documents sought "with reasonable certainty." The "reasonable certainty" or "reasonable particularity" standard is imposed to give the summoned party "sufficient information to determine what records are to be produced." *United States v. Malnik*, 489 F.2d 682, 687 (5th Cir. 1974).

Petitioners contend that the facts show the investments are owned by the Insurance Company. At a minimum, SEI cannot conclude, with reasonable certainty, that the investments it holds are the Cohens', their employers', or other employees' or employers' investments, as opposed to investments of the Insurance Company. Since the documents described in the summonses pertain only to the Cohens, their employers, or other employees, this Court should decline to enforce the summonses in their entirety. At the very least, this Court should determine that Respondent has not made a *prima facie* case for enforcement of the summonses, and order an evidentiary hearing to determine these issues.

The Foundation also maintains investments with SEI. Its funds are held by SEI for the benefit of the Foundation, and are owned by the Foundation. Donors who make contributions to the Foundation have no interest in the Foundation funds. Although members may suggest to the Foundation's Board the charitable uses to be made of their

contributions, the ultimate dominion, control, and ownership of the funds remains with the Foundation. Guess Dec., pgs. 3-4, ¶¶8,9; Jaye Dec., pgs. 3-4, ¶12. Members are issued periodic statements by SEI reflecting their contributions and the investment performance of the Foundation's funds attributable to their contributions. These statements do not reflect the funds as investments of or owned by the donor/member. Declaration of David A. Cohen ("Cohen Dec."), pg. 2, ¶7. Accordingly, the Cohens have no investments with SEI with respect to their contributions to the Foundation. Hence, documents relating to the Foundation should not be produced.

B. To the extent the summonses request documents relating to participants in the Disability Program other than the Cohens, they were issued for an improper purpose and in bad faith.

The summonses request documents that will disclose the identity of participants in the Disability Program, other than the Cohens. In particular, periodic accounting statements identical to those attached as Exhibits 2 and 6 to the Declaration of John L. Marien ("Marien Dec.") are prepared by SEI and issued to all the insured xélan members. Buck Dec., pgs. 4-5, ¶¶15, 17, Ex. A. The name of the insured member appears at the top of the first page of the statements.

Nowhere in Respondent's Memorandum does it disclose the true purpose for which it seeks these documents. Respondent alleges that "the summonses at issue in this lawsuit were issued primarily—but not solely—to obtain information that could help verify or disprove factual assertions made by Cohen [sic] and xélan petitioners about the Disability Insurance Trust Program." (Emphasis supplied.) Similar statements are made throughout Respondent's Memorandum (pgs. 24-25, 33-34) and are made by Marien in his Declaration (pg. 5, ¶14).

Notably absent is a candid statement to this Court that the IRS is seeking to obtain the identity of other participants so it can examine their returns. Respondent even refuses to answer Petitioners' interrogatories, which ask whether the IRS contemplates using information obtained from SEI to initiate audits of other participants. Ex. A, Petitioners' Interrogatories, pg. 3, ¶4. This lack of candor bears upon the issue as to whether the summonses were issued for a legitimate purpose and in good faith—both elements the government must prove to make a *prima facie* case. *United States v. Powell*, 379 U.S. 48, 57-58 (1964); *United States v. Harris*, 628 F.2d 875 (5th Cir. 1980) (holding a summons is issued in bad faith if issued for an improper purpose).

Respondent states "…the IRS seeks detailed financial records in SEI's possession concerning the accounts of every participant in the xélan Disability Insurance Trust Program so it can determine whether the program is, in fact, a program of insurance." Memorandum, pg. 37. Marien likewise states this in his declaration:

> When it obtains from SEI all account statements of all xélan members who participated in the xélan Disability Insurance Trust Program, the IRS can review them, and determine whether any individual participant's account was charged for providing disability insurance benefits in response to claims filed by other participants in the xélan Disability Insurance Program. If, for example, those statements show that the hypothetical Dr. Smith had a charge to his account to pay his share of the costs of paying the disability claim of hypothetical Dr. Jones, then there would be evidence of risk distribution that is essential to the insurance concept. If, on the other hand, the account statements do not show those types of charges, there would be no evidence of risk distribution, and the IRS might reasonably conclude that the xélan program was not insurance.

Marien Dec., pg. 23, ¶36.

Revenue Agent Johns states "none of the information sought from SEI in the summonses is in the possession of the IRS…The IRS does not posses any documents from SEI about other participants in the xélan Disability Program, as sought in the

summonses." Johns Dec., pg. 3, ¶7. Contrary to her assertions, the IRS already has in its possession hundreds of statements issued by SEI, none of which reflect that the statements provided to the insured by SEI are charged for claims filed by other participants. Neither xélan nor the Cohens maintain that is the case. Furthermore, Johns (as well as Marien and Respondent) fails to state why Respondent cannot determine the correctness of the Cohens' tax returns without the identity of the other participants.

The SEI statements are but an approximation of the insured's potential benefits, taking into account his/her contributions and *pro rata* share of investment performance. They do not take into account claims and forfeitures of other participants. When a claim is filed, the benefit of the insured is determined by adjusting the amount reflected on the most current statement by a factor, which is computed annually by the Insurance Company's actuary and takes into account investment performance, claims, and forfeitures.[5] Buck Dec., pg. 5, ¶18.

The Cohens provided the IRS with all account statements issued to them by SEI covering the periods 1998 through 2001. Suverkrubbe Dec., pg. 2, ¶5. In response to summonses, Jaye & Junck provided the IRS with their copies of all SEI statements issued to the Cohens. Jaye Dec., pg. 2, ¶8. Approximately 51 doctors who are under examination and are participants of the Disability Program represented by attorney Michael R. Suverkrubbe have provided SEI statements to the IRS, statements which are identical to the SEI statements issued to the Cohens. To date, approximately 314 SEI

5 The IRS was also provided information regarding claims and forfeitures by xélan, Inc. Jacquot Dec., pg.8, ¶30.

statements covering the years 1998 through 2001 have been provided to the IRS. Suverkrubbe Dec., pgs. 4, ¶12.

Thus, the arguments made by Respondent about the need to examine SEI statements of other participants in order to determine “risk distribution” and "risk pooling" are simply untrue. Whatever relevance to the issue of risk distribution or pooling is to be attributed to the fact the insureds’ account statements do not reflect claims of other participants, the IRS already has that evidence, many times over.

Respondent does not assert that the identity of other participants is relevant to the Cohens’ examination. It is not addressed because to do so would show the IRS’ true purpose in seeking account statements.

The history of the IRS’ examination of xélan, Inc. and its members further evidences the IRS’ bad faith. In 2001, after the IRS initiated an examination of the Cohens and questioned their participation in xélan programs, IRS Agent John Wong notified the Foundation that he was purportedly initiating an examination of the Foundation to verify its tax-exempt status. Thereafter, Wong illegally copied the Foundation’s computer software and database information, created a list of donors/members of the Foundation, and provided the list to an IRS Abusive Trust Coordinator in Florida. Jacquot Dec., pgs. 4-6, ¶¶15-23. The list was then used by the IRS to open approximately 170 examinations and challenge the taxpayers’ participation in xélan programs, including the Foundation, the Disability Program, and the 419 Program. Jacquot Dec., pg. 7, ¶24; Suverkrubbe Dec., pgs. 4-5¶¶14-16.6

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6 This conduct is the subject of a separate lawsuit brought by xélan, Inc. and other xélan entities seeking an injunction and damages. xélan, Inc., et al. v. United States, et al., Cause No. 03-6025, MMM SHSX, United States District Court for the Central District of California.

Approximately ten percent of xélan members are donors to the Foundation. In an effort to obtain an expanded list of participants in xélan programs, on June 10, 2002, the IRS served a summons on xélan, Inc. This summons was purportedly issued in connection with the examination of the Cohens' tax returns. Included in the voluminous requests was a request for all documents identifying participants of the Disability Program. In response, xélan, Inc. produced thousands of pages of documents, including marketing and promotional materials the IRS now relies upon to attempt to discredit xélan programs, as well as copies of the insurance policies, trust agreements, and documents relating to commissions, fees, investments, forfeitures, and claims. Jacquot Dec., pg. 8, ¶¶29-31. Some of this information would show risk distribution and risk pooling. The only materials withheld from production were those portions of documents that disclosed the identity of other participants. Jacquot Dec., pg. 8, ¶32.

The IRS then served summonses on Jaye & Junck, the Cohens' financial advisor, again asking for documents disclosing the identity of other participants. Again, over 400 pages of documents were produced, and the testimony of Richard Jaye was taken for most of one day. Jaye & Junck withheld only the identity of other participants. Jaye Dec. pg. 2, ¶8. That led to the IRS' service of the summonses on SEI.

The IRS could have sought the identity of other participants in xélan programs through legitimate means, but it chose not to do so. Section 7609(f) of the I.R.C. permits the IRS to serve a John Doe summons, provided it demonstrates, in an *ex parte* court proceeding, three minimal requirements.[7] Instead, the IRS chose to attempt to

7 Those statutory requirements are: 1) the summons relates to the investigation of a particular person or ascertainable group or class of persons; 2) there is a reasonable basis for believing that there may have been a failure to comply with any provisions of the Code; and 3) the information sought to be obtained from the examination of the records is not readily available from other sources.

obtain the identity of other participants first from the Foundation through blatantly illegal means, then through summonses issued to third parties under the guise of the examination of the Cohens. This is not good faith.

Respondent argues that "it is irrelevant that the summonses might also provide information to the IRS that might enable it to identify and audit other taxpayers whose identities may or may not now be known to the IRS." Memorandum, pg. 37.[8] Respondent relies upon *Tiffany Fine Arts, Inc. v. United States*, 469 U.S. 310 (1985). *Tiffany* does not support Respondent's sweeping conclusion. Tiffany promoted tax shelters, including one involving the licensing of medical devices. The Revenue Agent stated in a declaration that he issued a summons to Tiffany requesting names and identification information of Tiffany's licensees, so he could determine whether Tiffany properly reported notes issued to it by the licensees, and could not perform a proper investigation of Tiffany without the identity of those who issued the notes. The Supreme Court stated:

> The government argues persuasively that contact with the licensees might be necessary to verify the transactions reported by Tiffany actually occurred…On the record before us, we agree with the government that the names of the licensees 'may be relevant' to the legitimate investigation of Tiffany.

Tiffany Fine Arts, Inc., 469 U.S. at 323.

Such is not the case here. The IRS does not allege that there are any transactions between the Cohens and other xélan participants whose identity it seeks to obtain that may be relevant to the issues raised with respect to the Cohens' tax returns.

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8 Notably, even here Respondent does not acknowledge that the summonses, if enforced in their entirety, will identify other participants (through the account statements) and that the IRS will use that information to initiate other audits.

Respondent does not even allege that the identities of other participants are relevant to the Cohens' examination. It only alleges that accounting information contained in the participants' statements is relevant (failing to disclose that the IRS already has hundreds of statements proving the fact it says it is seeking to establish).

The facts here are similar to those in *United States v. Gertner*, 65 F.3d 963 (1st Cir. 1995). There, the IRS summonsed a law firm whose tax returns were purportedly under examination, requesting records showing the identity of clients making large cash payments to the firm. The firm contended that the IRS already had the information showing its reporting of the cash payments, but was seeking the identity of clients in order to examine their tax returns. The Court concluded that the IRS did not have a legitimate purpose for the client identity information in connection with an examination of the law firm, and that the IRS should have sought the information through the John Doe Summons procedure of I.R.C. § 7609.

In *Riesman v. Kaplan*, 375 U.S. 440, 449 (1964), the Court held an IRS summons may be challenged on "any appropriate ground." Later, in *Powell v. United States*, *supra*, 379 U.S. at 58, the Supreme Court stated "it is the Court's process which is invoked to enforce the administrative summons and the Court may not permit its process to be abused." In light of the circumstances discussed above, it would indeed be an abuse of this Court's process to enforce the SEI summonses in their entirety, particularly requiring production of unredacted copies of account statements or other documents disclosing identities of other xélan program participants.

C. The identity of other participants in the Disability Program is irrelevant to the examination of the Cohens' tax returns.

While cases do hold that I.R.C. § 7602 establishes a broad relevancy standard as a general rule, the IRS' authority is not unlimited. As the Court held in *United States v. Caltex Petroleum Corp.,* 12 F. Supp.2d 545, 554, (N.D. Tex. 1998):

> On the other hand, the IRS is not permitted to conduct a rambling and unfocused 'fishing expedition' through a party's records. *United States v. Richards*, 631 F.2d 341, 345 (4th Cir. 1980); *United States v. Dauphin Deposit Trust Company*, 385 F.2d 129, 131 (3d Cir. 1967), *cert denied* 390 U.S. 921, 88 S.Ct. 854, 19 L.Ed.2d 981 (1968); the relevancy inquiry should be especially searching when the summons is directed to third party. *Venn v. United States*, 400 F.2d 207, 211 (5th Cir. 1968); *United States v. Harrington*, 388 F.2d 520, 524 (2d Cir. 1968). In such cited cases, the government must show 'a realistic expectation' rather than an idle hope that something may be discovered" *United States v. Wyatt*, 637 F.2d 293, 300-01 (5th Cir. 1981); *Harrington*, 388 F.2d at 524, see also *United States v. Arthur Young & Company,* 465 U.S. 805, 104 S.Ct. 1495, 1501 & n.11 (1984); *United States v. Matras*, 487 F.2d 1271, 1274 (8th Cir. 1973). [Emphasis supplied].

Respondent attempts to establish relevancy on pages 32 through 34 of its Memorandum. First, it argues "the IRS has been singularly unsuccessful in getting accurate and complete information about the Disability Insurance Trust Program from the Cohens, xélan, or others associated with the xélan program." Petitioners dispute this, as set forth in declarations filed contemporaneously herewith. But more to the point in this summons enforcement proceeding, Respondent gives only one underlying reason why documents it seeks from SEI regarding other participants will provide it with "accurate and complete information:" the account statements of other participants will disclose whether there is "risk distribution" and "risk pooling," or whether the Disability Program is a "disguised savings/investment plan." Memorandum, pg. 34. It asserts that the account statements regarding other participants need to be examined in order to

determine whether account statements reflect charges for claims filed, i.e., showing risk pooling/distribution.

Again, the IRS already has in its possession hundreds of account statements that show what information is, and is not, contained in the statements, and, specifically, show that the statements do not reflect claims filed. In any event, the IRS doesn't need the identity of other participants as disclosed on those statements to determine whether the statements reflect claims filed. Respondent does not assert that the participants' name, address and social security number or other identifying information is relevant, or will in any way shed light on the correctness of the Cohens' tax returns.

At the very least, Respondent has failed to make a *prima facie* case for the relevance of participants' identities. Furthermore, it has failed to show that the identity information is not easily redactable from the account statements it seeks (an examination of sample statements proves that this is the case). If this Court determines that third party account statements should be provided, it should, as the Court did in *David H. Tedder & Associates, Inc. v. United States*, 77 F.3d 1166, (9th Cir. 1996), require that names of participants other than the Cohens be redacted from the documents produced. In *Tedder*, the Court upheld redacting names from the documents sought by the IRS because:

> [C]lient names *per se*, are not potentially relevant or material to the audit of Tedder's 1989 tax return and, accordingly, the IRS has not made the showing required by section 7602(a)(1)….the IRS has not demonstrated that the specific client identities 'might throw light upon the correctness' of Tedder's return.[9]

9 In *Tedder*, the taxpayer under examination produced documents requested with client names redacted. Since third party (SEI) documents are summonsed here, Petitioners recognize SEI could incur some costs in making the redactions. xélan, Inc. will reimburse SEI for those costs. Guess Dec., pg 5, ¶13. If the IRS questions whether redacted copies of SEI documents sought will provide it with the information it seeks

77 F.3d at 1169.

That is the same situation here.[10]

D. Respondent has failed to show the relevance of documents pertaining to 2002, a year not under examination in the Cohens' audit. These documents are sought for an improper purpose.

Respondent asserts that the Cohens' tax returns for the years 1998-2001 are under audit. The summonses seek documents for periods through December 31, 2002. Respondent's argument for the relevance of documents pertaining to those beyond the years under examination is stated as follows:

> As discussed above, the IRS is examining whether, as organized and operated, the program is a program of insurance. In considering that issue, the IRS intends to review how individually segregated accounts are maintained and treated, including whether the funds from the account of one doctor are used to pay claims filed by any other doctor. By necessity, the records that might bear on this determination are not limited to the documents for 1998-2001.

Memorandum, pg. 39. The IRS' examination of more statements for more periods would not "shed any light" on whether the Disability Program constitutes insurance. It would, however, provide the IRS with even more participant identity information, which is the real reason the documents are sought.

Petitioners do not argue that the IRS cannot in any case summons documents beyond the audit period. But neither is there a rule that the IRS can do so or have a

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(other than participant identities), this Court could, as did the District Court in *Tedder*, examine the redacted and unredacted copies *in camera*.

10 Respondent makes no argument that account statements issued by SEI to donors/members of the Foundation are relevant, nor do the summonses specifically request copies of those statements. Petitioners request, however, that if it is determined these documents are within the scope of the summonses and should be produced, then the names of the donors/members should be redacted from

court enforce a summons for such documents by merely asserting that the documents "might help." Here, Respondent has failed to show the relevance of 2002 information to the examination of the Cohens' tax returns. It has also failed to show that the request for those documents is made for a legitimate purpose and in good faith.

E. Respondent has failed to show that documents and information sought are not already in the IRS' possession.

Respondent acknowledges that one of the *Powell* requirements is that the information sought is not already in the possession of the IRS. Memorandum, pg. 34. Respondent asserts "the Declarations of [Marien] and [Johns] prove that it is not." Memorandum, pg. 34.

Respondent is seeking copies of all SEI account statements issued to the Cohens and all other participants, yet it already has over 300. Suverkrubbe Dec., pg. 4, ¶12. The information it says it seeks from those accounts—whether a particular participant's SEI statement reflects claims filed by other participants—is a proven fact. The declarations filed contemporaneously herewith show that over thousands of pages of documents have already been produced to the IRS in connection with examination of the Cohens by xélan, Inc., Jaye & Junck, the Cohens, and by other participants in connection with their examinations. Respondent simply chooses to ignore that fact, and states in conclusory terms that it seeks documents not in the IRS' possession. Respondent has failed to make a *prima facie* case that this fundamental requirement for enforcement of a summons has been satisfied, particularly where it is not the taxpayer, but a third party, whose records and testimony are being summonsed, and where the

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the statements.

summonses are extremely broad and inclusive in their description of documents sought, and cover a five year period.

At a minimum, the IRS should be required to state what documents it already has in its possession that need not be produced by SEI. Respondent should also be required to answer Petitioners' interrogatories asking what documents are already in the IRS' possession.

CONCLUSION

The IRS served summonses on SEI describing documents sought consistent with the IRS' view of the Disability Program: purely a savings and investment program for doctors, not insurance. Declarations filed contemporaneously with this Response establish that SEI holds investments for the Insurance Company, not the doctors. Documents relating to the Insurance Company's investments are not being sought by the summonses. Therefore, nothing should be produced. In any event, Respondent has failed to show that its request for the identities of participants' in xélan programs have any relevance to the Cohen's examination. The Declarations show that in fact this information is sought for an improper purpose and in bad faith. This Court's process should not be abused by furthering the IRS' pattern of seeking the identity of other

participants through illegal and circuitous means, rather than through the specific statutory procedures readily available to the IRS.

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