UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

DAVID A. COHEN, et. al.	)	
	)	
Petitioners,	)	
	)	
v.	)	Civil No. 03-cv-3234
	)	
UNITED STATES OF AMERICA	)	
	)	
Respondent.	)	

UNITED STATES' REPLY BRIEF IN SUPPORT OF MOTION FOR SUMMARY ENFORCEMENT

The United States submits this reply brief pursuant to the Court's December 2, 2003 Order to address the following two issues:

ISSUES PRESENTED

1. Xélan's "Concession" About the Nature of Its Disability Insurance Trust Program.

The Court asked the United States to address the purported concession by xélan that reviewing its participants' SEI account statements will not show the risk shifting and risk distribution elements of an insurance program because these, "statements are but an approximation of the insured's potential benefits . . . [that] do not take into account claims and forfeitures of other participants." In particular, the Court asked whether that "concession" affects the Internal Revenue Service's ("Service") entitlement to information sought in the summonses. The United States asserts that the Service is entitled to review records of other xélan participants' "segregated" SEI accounts so that it can better understand how xélan's disability insurance program works and determine whether it is, in fact, a program of insurance – all in order to determine the Cohens' correct tax liabilities. Must the Service rely upon xélan's self-serving statements, or may the Service obtain this information from independent source documents?

2. Redaction of Names of Other Xélan Participants.

Xélan suggested that if the Court did enforce the summonses, it should require SEI to redact the information which would identify other xélan participants. The Court asked whether the United States would agree. The United States does not agree, as this proposal would contravene well established law. The Supreme Court has held that once the United States has made a *prima facie* case for enforcement, the courts should avoid placing restrictions upon the Service's summons power. The Supreme Court has expressly upheld the power of the Service to issue dual purpose summonses similar to the ones at issue here. The Service made a *prima facie* showing to enforce these summonses. Should the Court require SEI to redact information which would identify other xélan participants?

ARGUMENT

I.

The Internal Revenue Service is entitled to obtain the information it seeks from disinterested third parties instead of having to rely upon xélan's and the Cohens' self-serving statements.

As described in our moving papers, the Service is trying to determine whether the xélan disability insurance trust program is a program of insurance funded with deductible premiums, or simply a disguised savings plan, which should be funded with taxable dollars. To do so, the Service needs to determine whether this is a program of insurance, possessing the elements of risk shifting and risk distribution. The Service has been unable to obtain accurate and reliable information from xélan or the Cohens about whether the xélan disability insurance trust program possesses these elements of risk shifting and risk distribution. Thus, the Service has turned to SEI, an unrelated third-party, for this information.

In conducting an audit, the Service need not rely on information provided by people who have a financial stake in the outcome of that audit. Here, the Service should not have to rely exclusively upon the petitioners' allegations, documents, or affidavits to learn how the disability insurance trust program works.[1] Indeed, xélan's argument that "[t]he SEI statements are but an approximation of the insured's potential benefits" is **xélan's** legal conclusion, and not a concession at all. In fact, it is one of the legal conclusions that the Service is attempting to verify or refute in this audit. The Service seeks to enforce these summonses to assist in that effort. Xélan merely submitted an affidavit from one of its officers, Leslie Buck, alleging that the account statements would not demonstrate the elements of risk sharing and risk distribution commonly found in a program of insurance.[2] But the Service need not rely upon those self-serving statements.[3] Indeed, Congress gave the Service independent power to obtain and review the summoned documents and testimony, so that it can draw its own conclusions about the xélan disability insurance trust program.

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[1]See, e.g., United States v. Administration Co., 1994 WL 240518, *3 (N.D. Ill. 1994) ("That the IRS may have already obtained copies of documents it seeks from other sources ... does not prevent its seeking original documents. . . . The IRS is entitled, and it is a legitimate purpose to summon, original documents so as to check their consistency and completeness with those obtained elsewhere."); United States v. Davey, 543 F.2d 996, 1000 (2d Cir. 1976) ("Service should not be required to rely on taxpayer's affidavit that a print-out accurately reproduces all information [requested on tapes as s]uch a holding would run contrary to the investigatorial purpose of the audit.").

[2] Ironically, although xélan was able to obtain an affidavit from Mr. Buck in this case, Dr. Guess could not even tell the Service how to locate Buck, so it could ask him questions about the disability insurance trust. As of December 15, 2003, Buck no longer appears as an officer on the xélan website.

[3]Buck's statements seem to contradict the information that xélan and Dr. Guess give to potential participants, about the right to place tax-deductible savings in a tax-deferred investment account owned by the participant.

This proceeding will not determine the Cohen's correct income tax liabilities. To the contrary, here the Service simply seeks to obtain information from a disinterested third party, in order to determine the Cohen's tax liabilities. Xélan's filing of an affidavit from one of its officers does not diminish or negate the Service's right to obtain that information from SEI.

The United States asks the Court to determine that the Service is entitled to examine the summoned information, irrespective of xélan's views about the design and operation of its disability insurance trust program. After all, if the Service is entitled to summons original documents or other information to ensure the accuracy of what it does possess, a fortiori, it may summons information that it does not possess.

II.

The Supreme Court has ruled that the Internal Revenue Service is entitled to obtain the identities of other participants.

The Supreme Court has specifically held that once the Service proves a *prima facie* case for enforcing a summons, "restrictions upon the IRS's summons power should be avoided 'absent unambiguous directions from Congress.'"[4] There is no statutory authority nor Supreme Court authority to permit a district court to conditionally enforce a summons.[5] "If good faith and a legitimate purpose are found to exist, the summons should be enforced."[6] The Supreme Court has

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[4]United States v. Arthur Young & Co., 465 U.S. 805, 816 (1984) (quoting United States v. Bisceglia, 420 U.S. at 150).

[5]See United States v. Barrett, 837 F.2d 1341, 1350 (5th Cir. 1988). See also United States v. Jose, 131 F.3d 1325, 1329 (9th Cir. 1997) (citing to Barrett and holding that the district court is "**strictly** limited to enforcing or denying IRS summonses") (emphasis added).

[6]Barrett, 837 F.2d at 1350.

also made clear that the Service is empowered to issue a dual purpose summons – to investigate both the tax liability of a known taxpayer and the tax liabilities of unnamed parties.[7]

Here the Service has met its burden. It has proven that it is conducting a legitimate examination into the Cohens' correct income tax liabilities for the years under audit, and that the summoned information sought may be relevant to that determination. The other people whose information the Service has summoned also participate in the xélan disability insurance trust program. Their information may clearly be relevant to the Cohens' taxes, because it will shed light on how they and xélan treated their contributions and earnings. Moreover, the Service may need to contact other participants to determine what they understood and were told about the program and how it works – this will help determine the accuracy of information provided by the Cohens and xélan, and in turn help the Service determine the Cohens' tax liabilities.[8] The Service may also need to follow up with other participants to determine matters relevant to the insurance issues, including whether common risk factors such as the age, occupation and health of the participant have any effect on the premiums and benefits under the program. Finally, the Service may wish to audit the tax returns of other participants – the Supreme Court has held this is permissible.

The Tedder case cited by petitioners is inapposite.[9] There the court found that the Service did not prove that the identities of a law firm's clients were relevant or material to an audit of the firm's income taxes. Nor did the Service demonstrate how specific client identities "might throw

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[7]Tiffany Fine Arts, Inc. v. United States, 469 U.S. 310, 324 (1985).

[8]Id., at 323 ("contact with licensees [of taxpayer under investigation] might be necessary to verify that the transactions reported by [taxpayer] actually occurred" and that it is IRS's – not taxpayer's – decision as to how many and which licensees to contact).

[9]David H. Tedder & Associates, Inc. v. United States, 77 F.3d 1166 (9th Cir. 1996),

light upon the correctness" of the firm's tax returns. Here, to the contrary, the Service has demonstrated that obtaining from an independent third-party the identities of participants in an alleged insurance scheme may be relevant to determining the income tax liabilities of the Cohens, who participate in the same scheme. As noted above, the Service may also decide to audit the other participants – as the Supreme Court has held it may.

Finally, xélan has not and cannot provide authority for redacting the names of other insureds. Neither the Internal Revenue Code, other federal statutory law, nor any other law of privilege provides a privilege for the identity of participants in an alleged program of insurance. In fact, earlier this year the Seventh Circuit Court of Appeals held that clients of an accounting firm may not prevent the Service from obtaining their identities through a summons issued to the accounting firm.[10] A fortiori, no privilege prevents the Service from obtaining the identities of insurance policy holders, especially those who have claimed large deductions on their federal income tax returns. Thus, it is not appropriate for the Court to permit xélan and SEI to redact the identities of other participants before producing the summoned information.

[10]United States v. BDO Seidman, 337 F.3d 802 (7th Cir. 2003).

CONCLUSION

The United States has proven a *prima facie* case to enforce these summonses. The petitioners have not met their "heavy" burden to establish that enforcing these summonses would constitute an abuse of the Court's power. Accordingly, the Court should dismiss the petitions and enter an order directing the summoned party to comply fully and promptly with these summonses.

Dated: December 16, 2003.

Respectfully submitted,

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