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

DAVID A. COHEN, et al,	:	CIVIL ACTION
	:	
	:	NO. 03-CV-3234
	:	
Petitioners,	:	
	:	
v.	:	
	:	
UNITED STATES,	:	
	:	
Respondent.	:	
	:	

PETITIONERS' SUR-REPLY BRIEF IN OPPOSITION TO RESPONDENT'S MOTION FOR SUMMARY ENFORCEMENT

Pursuant to this Court's Order of December 2, 2003, Petitioners submit this sur-reply brief to address the issues raised by this Court.

Additional SEI Statements will not show risk shifting and risk distribution.

The SEI statements do not reflect risk shifting and risk distribution. xélan and the Cohens assert that other documents provided to the IRS, and not in the possession of SEI, establish these elements. But it is undisputed that the SEI statements in no way reflect claims or forfeitures filed by other insureds under the group disability insurance policy. *Declaration of Leslie Buck*, ¶18.[1] The statements reflect the reserves of the Insurance Company, the amount of the insured's premium contribution, and the investment performance relating to the total premiums as allocated in proportion to the amount contributed by the insured. *Declaration of Leslie Buck,* ¶¶13, 15.

[1] All declarations referenced in this Sur-Reply are attached at Exhibit B to Petitioners' initial brief.

Respondent asserts that the IRS is entitled to review additional SEI statements to "better understand how xélan's disability insurance program works and determine whether it is, in fact, a program of insurance…" Respondent is less than candid. The IRS is fully aware of the information provided in the SEI statements, as Petitioner has produced and Respondent has received over 314 SEI statements in the audits of approximately 51 participants in the Disability Program. *Declaration of Michael R. Suverkrubbe*, ¶¶11, 12. All 314 SEI statements are identical, with the exception of the name of the insured, the insured's contribution, and the investment return. Additional SEI statements would not provide any different information other than the name of the insured. More importantly, they will not reflect risk shifting and risk distribution. Respondent has failed to show how several thousand additional SEI statements would shed any light on or provide a better understanding of how the Disability Program works.

Respondent asserts that Petitioners' concession is nothing more than a "self-serving" statement. The admission and concession by Petitioners that the SEI statements do not demonstrate the hallmarks of valid insurance is an admission against their interests. To further support Petitioners' concession, attached as Exhibit A is an Admission and Concession made on behalf of Drs. David and Margaret Cohen that none of the SEI statements reflects claims and forfeiture experience of the entire pool of the Disability Program.

Respondent is in possession of reliable documentation that demonstrates risk shifting and risk distribution.

Respondent is again less than candid. It asserts that the IRS "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," and asserts it needs to receive this information from an unrelated third party. However, Respondent was provided, in connection with the Cohen examination (months before the filing of their Reply Brief), reliable and accurate third-party information that specifically addresses and supports the elements of risk shifting and risk distribution. Such information includes, but is not limited to, copies of insurance policies, certificates of insurance, documentation of claims filed and paid, documentation of claims filed and denied, documentation of forfeitures, and five independent actuarial studies conducted by reputable actuarial firms during the time periods of 1996 through 2003. For this Court's review, Petitioner attaches, as Exhibit B, a copy of each of the five actuarial studies, one of which (James Gordon of GPWA, formerly of Watson Wyatt) includes the actuarial material prepared at the time that the disability program was first established in 1996. Again, Respondent has failed to address why the documentation that is currently in Respondent's possession does not support risk shifting and risk distribution, and why several thousand additional SEI statements will show something more than the 314 statements already in Respondent's possession.

Respondent has not made a prima facie case for enforcing the summonses.

The four criteria that the IRS must establish in order to have a summons enforced are: 1) the information sought is not already in the IRS' possession; 2) the investigation is conducted pursuant to a legitimate purpose; 3) the inquiry is relevant to

the purpose; and 4) the administrative steps required by the Code have been followed. *United States v. Powell, 379 U.S. 48 (1964).*

The first criterion (already in their possession) has been addressed above.

As to the second criterion (legitimate purpose), the IRS merely makes conclusory statements and fails to provide any supporting affidavits (as suggested by this Court) or legal arguments in support of a legitimate purpose for obtaining additional SEI statements. Respondent merely states, "It has proven that it is conducting a legitimate examination into the Cohens' correct income tax liabilities for the years under audit." Further, Respondent asserts that "good faith" and a "legitimate purpose" is all that is needed to enforce a summons. Specifically, it states, "If good faith and a legitimate purpose are found to exist, the summons should be enforced." Reply Brief, pg. 4.

Respondent's only purpose can be one of bad faith. It attempts to circumvent procedures adopted by Congress and abuse the powers of this Court to obtain a list of xélan participants in order to open additional examinations. Respondent's record in this matter shows a continuous pattern of bath faith on behalf of Respondent beginning with the theft of the xélan computer software and donor/participant list.

In regard to the third criterion (relevance), Respondent originally alleged that the summonsed material was relevant to the determination of risk shifting and risk distribution. *See Declaration of Marien*. The *sole* basis for Respondent's contention that the SEI statements contain relevant information was stated in Agent Marien's declaration as follows: After obtaining all of the statements, "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…" *Declaration of Marien*, ¶36. Neither Respondent in its initial brief, nor Marien in his declaration, made *any argument whatsoever* that the names of participants on the SEI statements had any relevance.

Now, after this Court's order caused Respondent to focus upon this issue, Respondent asserts, for the first time in its Reply Brief, three new spurious arguments for relevancy:[2] 1) "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." The IRS has already contacted and opened examinations on more than 50 additional participants from the stolen list of participants' names. Marien also states in his declaration that he has obtained audio and video tapes, as well as "all the documents and testimony," including that of Dr. Guess, that reflect what the participants (not just the Cohens) were told about the program and how it works. Respondent has failed to demonstrate how contacting more individuals will shed light on these matters; 2) "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 participants have any effect on the premiums and benefits under the program." Again, as discussed above, Respondent has failed to demonstrate how contacting more

[2] Notably, no declaration of Marien, nor of any other fact witness, was submitted with Respondent's Reply Brief to support Respondent's new arguments.

individuals (above the 50-plus already contacted) or reviewing additional SEI statements will shed light on "risk factors" and premiums, particularly in light of the fact that the IRS has been supplied with five actuarial studies that deal with these matters in detail; and 3) "The Service may wish to audit the tax returns of other participants…" This is Respondent's true and sole purpose. As discussed above, its purpose is one of bad faith, and as discussed below, Respondent does not have the authority to do so.

***Tiffany* does not support Respondent's position.**

Respondent argues that *Tiffany Fine Arts, Inc. v. United States,* 469 U.S. 310 (1985), provides the IRS with virtually unlimited authority to obtain information in connection with the examination of a taxpayer with the intent of using that information to identify and examine other taxpayers. *Tiffany* does not provide such *carte blanche* authority to the IRS. Respondent overlooks the Supreme Court's conclusion that the "government argues persuasively that contact with the licensees might be necessary to verify the transactions reported by Tiffany actually occurred. In fact, Tiffany itself acknowledged the relevance of the requested information, as it offered the IRS names of certain licensees…" *Id.* at 323. Here, Respondent has not provided any "persuasive" argument as to how the identity of other xélan participants is relevant to the examination of the Cohens' tax returns. xélan and the Cohens have never agreed, as did the taxpayer in *Tiffany,* that the identity of others is in any way relevant, or will even "shed light upon," the risk shifting and risk distribution issues raised by the IRS in the Cohens' examination.

If this Court orders production of SEI statements, which Petitioners contend it should not, redaction of other xélan participants' identifying information should be ordered.

Respondent argues, pg. 4 of its Reply Brief, citing *U.S. v. Barrett*, 837 F.2d 1341 (5th Cir. 1988), "There is no statutory authority or Supreme Court authority to permit a district court to conditionally enforce a summons." Respondent further argues, pg. 6 of its Reply Brief, "xélan has not and cannot provide authority for redaction of the names of other insureds." To the contrary, xélan has provided such authority.

In *Tedder v. U.S.*, 77 F.3d 1166 (9th Cir. 1996), a case acknowledged but misconstrued by Respondent in its Reply Brief, the Ninth Circuit affirmed the district court's order "enforcing the summons in part and quashing it with respect to the client-identifying information." *Id.* at 1168. The Ninth Circuit upheld the district court's order requiring production of law firm records with the redaction of client names because it concluded the IRS had not shown the clients' identities to be sufficiently relevant to the examination of the law firm's tax returns. Thus, *Tedder* could not be more in point both with respect to the authority of a court to order production of redacted records and the authority of a court to partially enforce a summons.

Respondent's reliance on *Barrett* is misplaced: *Barrett* provides no support for Respondent's mistaken notion that a court must take an "all or nothing" approach to enforce or deny a summons. In *Barrett,* the summonses at issue were issued to hospitals and sought to obtain patient records pertaining to a taxpayer/ physician. The IRS sought the records and identity of patients so that the IRS could contact the patients and determine from the patients and their records whether the

amounts they paid to the physician coincided with the amounts the physician reported as income on his returns. The relevance of the patient identities was clear and not disputed. Instead, the taxpayer, although not objecting to production of the patient identity information to the IRS, requested that the production be conditioned upon the IRS not using the information in a manner that would disclose to the patients that the taxpayer was under criminal investigation.

The taxpayer's argument was that such disclosure would violate I.R.C. §6103. A majority of the Fifth Circuit concluded that once the relevancy and other three *Powell* criteria had been satisfied, the district court lacked authority to condition the use of the information obtained as requested, even if its use would violate §6103.[3] The majority of the court in *Barrett* stated that "…the district court has broad discretion in protecting taxpayers only by determining whether the sought after information is relevant. The relevancy inquiry is one of the Powell inquiries, and it only pertains to whether the summons should be enforced in its entirety…" *Barrett*, *supra,* at 1350. The court further stated the taxpayer "attempts to rely on [a case] as support for his position…[that case] is one that deals with the scope of the enforcement order, i.e., what amount of information would the government be provided. This inquiry is also in the nature of asking whether the material is relevant." *Id.* at 1351. Nothing in *Barrett* suggests that this Court lacks the power to tailor enforcement of a summons to protect individuals whose identity is of no relevance to an IRS investigation of other taxpayers.

Here, Respondent has failed to show the relevance of the xélan

[3] Four judges joined in a dissenting opinion concluding that, even where the four *Powell* criteria are satisfied, the court has authority to condition the use of summons material.

participant identity information, and has therefore not satisfied one of the four fundamental *Powell* requirements with respect to the information sought. Accordingly, *Barrett* does not support Respondent's position that this Court lacks the authority to order the redaction of participants' names on the SEI statements (if this Court concludes that the SEI statements should be produced at all).

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Date: December 23, 2003

CERTIFICATE OF SERVICE

I, Karen Heenan, hereby certify that true and correct copies of the foregoing Petitioners' Sur-Reply Brief to Respondent's Reply Brief in Support of Motion for Summary Enforcement, Proposed Order, and the Certificate of Service were served by United States Certified Mail, return receipt requested, postage prepaid, upon the following:

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Dated: December 23, 2003