Court Reverses Convictions of 2 Former E&Y Shelter Promoters

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The Second Circuit has overturned the conspiracy and tax evasion convictions of two attorneys accused of promoting abusive tax shelters while in the employ of Ernst & Young LLP.

The November 29 decision establishes boundaries for what the Second Circuit considers criminal conduct on the part of defendants charged in promoter and evasion conspiracies and is seen as offering some relief to practitioners engaged in structuring transactions that may push legal limits. (For *United States v. Coplan*, No. 10-583-cr (2d Cir. 2012), see *Doc 2012-24490* or *2012 TNT 231-17*.)

The attorneys, Martin Nissenbaum and Richard Shapiro, were found guilty in May 2009 following a 10-week jury trial in the District Court for the Southern District of New York. Also convicted were Robert Coplan, an attorney, and Brian Vaughn, an accountant, all of whom were part of E&Y's Strategic Individual Solutions Group. A fifth defendant, Charles Bolton, an independent investment adviser, pleaded guilty to a single conspiracy charge. (For prior coverage, see *Tax Notes*, May 11, 2009, p. 685, *Doc 2009-10398*, or *2009 TNT 87-4*.)

More than one year after hearing arguments on November 14, 2011, the Second Circuit, in a lengthy decision by Judge José A. Cabranes, reversed the convictions of Shapiro and Nissenbaum on counts of conspiracy and tax evasion. Nissenbaum also had a conviction of obstructing the IRS in violation of section 7212 reversed. The convictions of Coplan and Vaughn were upheld. Bolton, whose plea agreement allowed for a limited appeal waiver, had his $3 million fine vacated and remanded.

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Nissenbaum and Shapiro argued that the government's *Klein* conspiracy theory (that is, intent to defraud the government by impairing IRS functions, which originated in *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957) was invalid and that there was insufficient evidence to support their convictions on count one, which related to conspiracy. Count one had three objectives: the *Klein* conspiracy, conspiracy to commit tax evasion in connection with one of the promoted shelters in violation of section 7201 (the so-called Add-On shelter), and conspiracy to make false statements to the IRS.

They also argued that there was insufficient evidence to support convictions on two counts of tax evasion related to the Add-On shelter and, for Nissenbaum, that there was insufficient evidence to support an obstruction conviction.

Klein Skepticism

Cabranes did not criticize the government's *Klein* conspiracy theory of liability under 18 U.S.C. section 371. He took issue with the government's ''*stare decisis* defense of the *Klein* doctrine,'' saying that it lent support to the defense's view that the theory was textually unfounded.

Cabranes explored the differences in defrauding the government as opposed to a private person but ultimately relied on *Dennis v. United States*, 384 U.S. 855 (1966), stating that 18 U.S.C. section 371 ''is not confined to fraud as that term has been defined in the common law,'' but rather that it reaches ''any conspiracy for the purpose of impairing . . . the lawful function of any department of Government.'' He declined to follow *Skilling v. United States*, 130 S. Ct. 2896 (2010), and ultimately rejected the defendants' argument, holding that ''because the *Klein* doctrine derives from and falls within the scope of the law of the Circuit . . . we reject the defendant's challenge to the validity of that theory of criminal liability.''

Conspiracy

Although the court rejected the defendants' argument that the government's theory for the *Klein* conspiracy was textually flawed, it held that there was insufficient evidence regarding the intent of Shapiro and Nissenbaum to support their convictions for conspiracy.

Sufficiency challenges place a heavy burden on the defendant bringing the challenge, because the standard of review is ''exceedingly deferential'' to the government, Cabranes wrote. A person charged with conspiracy must have known of the existence of the scheme alleged and ''knowingly joined and participated in it,'' he continued, citing *United States*

v. Rodriguez, 392 F.3d 539 (2d Cir. 2004). The conspiracy must be judged on the whole of its parts rather than viewed separately, he wrote. The court held that while the government can prove its conspiracy charges based on circumstantial evidence, the tie goes to the defendant.

In this case, Shapiro had no specific intent to violate the law, the court held. Cabranes cited conference calls and discussions involving Shapiro and others that showed that the government's assertions that he had coached a fellow E&Y practitioner, Thomas Dougherty, to lie to the IRS were ''slim at best.'' The government's arguments that Shapiro was deceptive ''in the context of this case'' were also unpersuasive, Cabranes wrote.

Shapiro's participation by providing comments to an ''amnesty template'' were also insufficient in the court's eyes. The scope of the comments was not reflected in the record, nor was Shapiro's receipt of an instant message from Vaughn suggesting that the shelter's business purpose was false. Rather, it was during conferences and meetings Shapiro did not participate in that a cover story was developed, Cabranes wrote.

The government asserted that Nissenbaum reviewed documents concerning the Add-On shelter, which it argued was evidence of his participation in the *Klein* conspiracy. But his review, a three-line e-mail, did not equate to a ''stamp of approval'' of the document, Cabranes wrote.

> ***The government argued that Nissenbaum was liable under* Pinkerton *because it was reasonably foreseeable that one of his co-conspirators would commit tax evasion.***

The government's principal argument that Nissenbaum was liable for tax evasion was based on *Pinkerton v. United States*, 328 U.S. 640 (1946). Under *Pinkerton*, ''once a conspiracy has been established, the criminal liability of its members extends to all acts of wrongdoing occurring during the course of and in furtherance of the conspiracy.'' The government argued that Nissenbaum was liable under *Pinkerton* because it was reasonably foreseeable that one of his co-conspirators would commit tax evasion.

In his opinion, however, Cabranes emphasized that for *Pinkerton* liability to attach, intent is critical. The government's identification of an affirmative act by Nissenbaum, the three-line e-mail, was ''simply not enough,'' Cabranes wrote.

Tax Evasion Counts

Counts two and three of the indictment charged all the trial defendants with tax evasion in violation of section 7201. Under *United States v. Romano*, 938 F.2d 1569 (2d Cir. 1991), to prove a violation of section 7201, the government must prove beyond a reasonable doubt that there was a substantial tax deficiency, willfulness, and an affirmative act ''with the intent to evade or defeat a tax or payment of it,'' Cabranes wrote.

Yet it was the court's holding against conspiracy that saved both Shapiro and Nissenbaum from affirmed guilty verdicts for counts two and three — notably that they lacked the requisite mental state. ''For substantially the reasons that compel reversal as to Count One, we conclude that the convictions of Shapiro and Nissenbaum on Counts Two and Three must be reversed,'' Cabranes wrote.

Pleasantly Surprised

Members of the defense bar said they were pleasantly surprised by the court's decision. Bryan C. Skarlatos of Kostelanetz & Fink LLP said it ''shows that the government cannot rely on the fact that somebody simply reviewed some e-mails or documents — in this case templates of some letters or some [information document request] responses — and therefore must necessarily have been involved in a conspiracy to defraud the government.''

The decision bodes well for practitioners who are often involved only in parts of transactions or who are part of e-mail chains or meetings, Skarlatos said. Those individuals, who had no plan to defraud the government, may sometimes be pulled into a conspiracy based on such tangential involvement, he said, adding, ''The government needs to prove some more active participation in the wrongdoing.''

Skarlatos said it is not enough to use *Pinkerton* to convict practitioners of conspiracy ''just because they were on an e-mail exchange or just because they were in the room when someone talked about something that could potentially be perceived as part of a larger scheme to defraud, but in and of itself isn't clearly a bad, bad thing.''

Not every conversation or statement implies a malicious purpose to defraud the government, said Mark D. Allison of Caplin & Drysdale. But while ''there may very well have been inappropriate purpose behind these statements, at least in isolation, it's hard to see how you can pool [them] together to create a motivation that wasn't present on its face,'' he said.

Peter D. Hardy of Post & Schell PC said he ''was struck by how willing — because it's unusual — the court of appeals was to really parse through, in painful detail, the evidence.'' Generally, appellate

courts are apt to defer to the jury's decision, especially given how high the standard for reversal is, he said.

But Hardy warned how easy it is for a practitioner in the same situation to be convicted. In this case, the fate of Shapiro and Nissenbaum turned on the phrasing of language in an opinion letter, specifically that ''the clients had a substantial nontax business purpose, which apparently was sufficiently OK for the court of appeals, but not the jury, as opposed to whether or not the clients had a principal investment purpose.''

That slight difference was important, and the Second Circuit took pains to parse it, Hardy said. ''At the same time, I find it alarming as a professional to think that whether or not you're going to be charged and convicted can turn on really, just a turn of phrase,'' he said. ''Let's not lose sight of the fact that [they] were actually convicted.''

Josh O. Ungerman of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP agreed. ''It is distressing to think that with insufficient evidence, the government was able to convince the jury at trial that Shapiro engaged in a conspiracy by 'coaching' other E&Y partners on the nontax reasons for the transaction that the government had advocated was not true,'' he said.

And despite the reversals, the ''government has accomplished much of what it set out to do, namely punish high-functioning tax professionals who participated in both planning and defending the same transactions the government deemed to be tax shelters,'' Ungerman said. Practitioners may think twice about planning and defending the same transactions, he said.

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Edward M. Robbins Jr. of Hochman, Salkin, Rettig, Toscher & Perez PC warned that practitioners should probably temper their enthusiasm. ''I would not get too excited about this case until we see whether the Second Circuit grants the government's request for *en banc* review,'' he said. Robbins said he thought the request is ''inevitable in a 2-1 decision of this importance.'' ■