10-583-cr (L)

10-585-cr(CON), 10-588-cr(CON), 10-593-cr(CON), 10-1716-cr (CON)

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Appellee,
v.

DAVID L. SMITH,
Defendant,
ROBERT COPLAN, MARTIN NISSENBAUM,
RICHARD SHAPIRO, BRIAN VAUGHN,
CHARLES BOLTON,
Defendants-Appellants.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF FOR APPELLANT MARTIN NISSENBAUM

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JURISDICTIONAL STATEMENT

The District Court's jurisdiction is based on 18 U.S.C. § 3231. This Court's jurisdiction is based on 28 U.S.C. § 1291. Mr. Nissenbaum's sentence was imposed on January 22, 2010, and entered on January 28, 2010. His Notice of Appeal was filed on January 27, 2010. The appeal is from a final judgment of conviction.

ISSUES PRESENTED

1. Whether the evidence against Mr. Nissenbaum on all counts of the indictment was sufficient to permit a reasonable juror to find him guilty.

2. Whether a criminal prosecution may be based on the allegation that attorneys have misrepresented the motivations and state of mind of their clients.

3. Whether the prosecution's evidence satisfied the elements of a *Klein* conspiracy in light of the Supreme Court's decision in *Skilling v. United States*, 130 S. Ct. 2896 (2010).

4. Whether the testimony of Graham Taylor was erroneously admitted.

5. Whether, in light of *Bourjaily v. United States*, 483 U.S. 171 (1987), hearsay declarations were erroneously admitted.

6. Whether the jury instructions erroneously defined "lacking economic substance" as "no reasonable possibility" of profit.

7. Whether a "theory of defense" jury instruction was erroneously denied.

8. Whether a "conscious avoidance" jury instruction was erroneously given.

This Brief discusses Issues 1, 2, and 6. Issues 3, 4, 5, 7, and 8 are discussed in the Briefs of other appellants and are adopted herein pursuant to Rule 28(i) of the Federal Rules of Appellate Procedure.

STATEMENT OF THE CASE

Mr. Nissenbaum was charged in Counts One, Two, Three, and Four of a seven-count superseding indictment returned against Robert Coplan, Martin Nissenbaum, Richard Shapiro, and Brian Vaughn. IA90-IA143[*]. Count One charged the four defendants with a conspiracy (a) to defraud the Internal Revenue Service ("IRS"), (b) to commit tax evasion, and (c) to make false statements in violation of 18 U.S.C. § 1001. Counts Two and Three charged the four defendants with tax evasion. Count Four charged Mr. Nissenbaum alone with obstructing and impeding the IRS by causing false and misleading statements to be submitted to the IRS.

The defendants were tried before United States District Judge Sidney A. Stein and a jury between March 3, 2009, and May 7, 2009. (IA440 – IVA66, VIA409-528). The jury found Mr. Nissenbaum guilty on Counts One, Two, Three,

[*] Pages of the multi-volume Appendix are designated by volume number and page as follows: [Volume]A[Page]. Government Exhibits are "GX" and Defendants' Exhibits are "DX." "SPA" refers to the Special Appendix filed by the Appellants.

and Four. (SPA 15) Mr. Nissenbaum was sentenced to concurrent terms of 30 months' imprisonment on each of the four counts, to be followed by three years of supervised release. He was fined $100,000 and a special assessment of $400, and held jointly and severally liable with his co-defendants for $22,720 costs of prosecution. (SPA 19-20). He was released on bail pending appeal. (SPA 16).

STATEMENT OF FACTS

1. Introduction

This appeal results from the criminal prosecution of three attorneys and an accountant who were assigned by Ernst & Young ("E&Y") to a team that, in 1998, entered the vigorous competition among major accounting firms for the clientele of individuals who were seeking tax shelters that would enable them to reduce the tax liability resulting from huge profits they made in a particular tax year. The Internal Revenue Service ("IRS") had long been well aware that highly respected accounting and law firms with impeccable integrity had, since the creation of the federal tax laws, been seeking and finding loopholes to lawfully reduce the tax burden of individual clients.

In late 1999 and early 2000, approximately two years *after* the E&Y team began its work, the IRS issued a series of notices, revenue rulings, and regulations aimed at "shutting down" popular tax shelters that had been promoted by lawyers and accountants who were engaged in the then-attractive "tax avoidance" practice

of advising clients who were seeking such tax breaks. In May 2000, the IRS established the Office of Tax Shelter Analysis, and in December 1999 and August 2000 it released Notices 99-59 and 2000-44 which were directed at "abusive" tax shelters known as "BOSS" and "Son of Boss." 1999-52 I.R.B. 761 ("Tax avoidance using distributions of encumbered property"); 2000-36 I.R.B. 255 ("Tax avoidance using artificially high basis").

In a press release dated July 1, 2004, the IRS announced that "more than 1,500" taxpayers who had utilized the "Son of Boss" tax shelter explicitly disapproved in August 2000 – including more than 300 who "were previously unknown" – had entered into civil settlements with the IRS. The IRS press release concluded: "Son of Boss was aggressively marketed in the late 1990's and 2000 to companies and wealthy individuals by a network of law firms, accounting firms and investment banks. In August 2000, the IRS issued Notice 2000-44 declaring the transactions abusive and requiring promoters to maintain a list of investors." IR-2004-87 (July 1, 2004).

The Government's evidence in this criminal prosecution established that in 1999, 2000, and 2001, the appellants evaluated and deliberated over various tax shelter proposals that were arguably permissible tax avoidance strategies even after the issuance of the "BOSS" and "Son of Boss" notices. A limited number were selected by top E&Y management to be marketed by the accounting firm through

its offices across the country after outside law firms indicated they would issue opinion letters concluding that the strategies more likely than not would qualify for tax losses. Since all who were professionally engaged in this field knew that a shelter would not pass muster with the IRS if it did not have a business purpose other than to obtain a tax benefit, law-abiding lawyers and accountants who dealt with tax shelters did not knowingly approve or recommend tax strategies that had no "profit potential." At the same time, the IRS was surely aware that "profit potential" was not the exclusive objective of complex investment strategies that generated substantial write-offs used to reduce large tax liabilities. Consequently, IRS audits of tax shelters weighed the chances of a taxpayer's realizing a profit from the investment strategy that resulted in the tax loss. In addition to evaluating whether there was an objective possibility of making money, the IRS also asked during its audits about the taxpayer's subjective motivation for making the investment. If a taxpayer was motivated by no business purpose other than securing a tax loss, the IRS might disallow the tax benefit on the ground that the transaction had no "business purpose" or "economic substance."

This case concerns four tax shelters that were marketed by E&Y and one in which eleven E&Y partners personally participated. Of the five shelters, the Government acknowledged that four "worked" – *i.e.*, satisfied the objective standards then in effect and could not be said to constitute an attempt to evade

taxes. IIIA564, 567. The fifth shelter, called "CDS Add-On," is the subject of the two tax-evasion counts (Counts Two and Three) with which the appellants were charged. Messrs. Nissenbaum and Shapiro learned in February 2003 (long after the relevant tax returns had been filed and marketing of the shelter had ceased) that the CDS Add-On shelter failed the "profit potential" test only because the fees a taxpayer-client would have to pay to E&Y, to the firm managing the investment, and to the law firm that wrote an opinion letter exceeded any possible profit that could be realized by a taxpayer who used that tax strategy alone (without previous use of the "CDS" tax shelter).

The Government alleged that in marketing the shelters and defending them during IRS audits the appellants "lied" in order to "defraud" the IRS. (The word "lied" was invoked, in one form or another, 50 times during the Government's opening statement and 149 times during the prosecutors' summations.) Putting to one side the charges in Counts Five, Six, and Seven that concern only appellants Coplan and Vaughn, the "lies" alleged in the indictment and proved at trial consisted overwhelmingly of instructions and warnings by one or more of the appellants that marketing descriptions of the tax shelters not detail features that would be helpful to the IRS in challenging the "business purpose" of the shelters (*see*, *e.g.*, Indictment paras. 40(g), 40(h), 40(i), 40(j), 40(k), 40(o), 40(ll), 40(tt); IA111, 112, 116, 117), directions that documents that might be advantageous to the

IRS but were not then subject to any legal process not be left where IRS agents could gain access to them (*see*, *e.g.*, Indictment paras. 40(h), 40(s), 40(w), 40(ii); IA111, 113, 114, 115), or representations made to the IRS regarding the subjective motivations of taxpayers in utilizing the tax shelter strategies (*see*, *e.g.*, Indictment paras. 27, 28, IA107, 108).

The indictment and prosecution of these appellants failed to take account of the realities of tax-shelter practice in the 1999-2002 period. It retroactively applied to attorneys and accountants, in the context of a criminal prosecution that threatens to imprison them for 2-3 years, aspirational standards for practice by professionals in the tax field that the IRS was developing during the period covered by their indictment. As attorneys and accountants, the appellants had a duty to zealously represent and prudently advise their taxpayer-clients. Instructing E&Y personnel that descriptive documents not highlight potential vulnerabilities of the tax-shelter strategy was not criminal; it was prudent legal advice. The same was true of directions that neither the clients nor E&Y personnel should, in the absence of formal legal process, make accessible to the IRS documents that could be utilized to challenge the tax shelters. *Cf. Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005). And proposing to the individual taxpayers that they emphasize in their own statements a profit potential of the investment strategies proposed by E&Y and de-emphasize the tax losses was not fraud. It was what law-abiding counsel do

routinely when they defend their clients' position before courts and administrative agencies.

In this Brief we focus on the conduct of Mr. Nissenbaum, a highly respected attorney and accountant who was the primary author of the E&Y Tax Guide (IIA594) and whose expertise in personal income-tax law led E&Y management to assign him to the tax-shelter group. We demonstrate that Mr. Nissenbaum participated far less in the evaluation, promotion, marketing, and defense of the E&Y tax shelters than any other appellant. That conclusion emerges from an analysis of the record in this case and particularly of the Government's summation to the jury. Mr. Nissenbaum's participation in the alleged conspiracy was insufficient to make him responsible for any "fraud" allegedly perpetrated against the IRS in the marketing or defense of the shelters.

In fact, the Government effectively acknowledged during the trial that Mr. Nissenbaum could be held criminally liable on Counts Two and Three only if the jury invoked the vicarious liability doctrine of *Pinkerton v. United States*, 328 U.S. 640 (1946). That doctrine is inapplicable to Mr. Nissenbaum because even if it be assumed, *arguendo*, that some E&Y personnel were parties to an agreement to "defraud" the IRS as alleged in Count One, it was not reasonably foreseeable to Mr. Nissenbaum that anyone at E&Y would commit tax evasion in defending an E&Y shelter.

A tax shelter in which eleven E&Y partners participated and to which Mr. Nissenbaum did give personal attention was Tradehill, which followed the model of COBRA, a tax strategy marketed by E&Y. Tradehill's participants included lawyers whose reputations for integrity were among the finest at E&Y, including Ron Friedman, the chief of E&Y's Tax Quality and Standards Office, a former IRS employee who was regularly consulted on ethical issues. Count Four of the Superseding Indictment charges Mr. Nissenbaum alone with defrauding the IRS by causing the submission of "false and misleading" statements regarding the motivations, understandings, and expectations of the E&Y partners who participated in that shelter. In fact, the evidence in the record, including the testimony of two E&Y partners who joined in the Tradehill shelter, established that the allegedly false statements regarding the state of mind of Tradehill participants were probably true and could surely not be found, beyond a reasonable doubt, "false and misleading."

Details regarding the four E&Y shelters other than Tradehill are presented at pages 9-16 of the Brief for Appellant Shapiro, and we adopt those descriptions for purposes of this Brief. In this Statement of Facts we focus on the record evidence as it relates to Mr. Nissenbaum.

2. The Ernst & Young Team Is Assembled.

In January 1998 E&Y hired Brian Vaughn and Belle Six from Deloitte & Touche, where they had been marketing tax shelters. IIA356-60. Clients of E&Y had requested that the accounting firm provide for them the kind of tax avoidance, deferral and minimization vehicles that were being offered to clients by the other major accounting firms. E&Y then assigned Vaughn and Six to a newly formed group called "VIPER" and later "SISG." The other members of the VIPER/SISG group were appellants Robert Coplan, Richard Shapiro, and Martin Nissenbaum, all of whom were attorneys who had been with E&Y for many years and were highly respected for their specialized knowledge. Each was appointed to the VIPER/SISG group because of a particular expertise he had developed. IIA361.

For several months the group met regularly, sometimes daily, in New York as a "think tank" and "brainstormed" ideas for tax shelters. IIA360-61. It considered many ideas, and more were rejected than were accepted. IIA379. The group was introduced to E&Y field offices in late 1998 or early 1999 as a unit that would develop tax deferral and minimization techniques for taxpayers who had 20 million dollars or more in a year's income. IIA88. E&Y personnel were told that if they had clients whose income qualified and who were interested in a tax shelter "strategy," they should contact Mr. Coplan. IIA88.

3. Mr. Nissenbaum Is an Occasional Participant.

Mr. Nissenbaum was appointed to the VIPER/SISG group because of his expertise in retirement and income-tax planning. IIA361. His colleagues at Ernst & Young held him in high esteem and considered him the "go-to-guy." IIA563-64. The VIPER/SISG group met frequently and also conferred by telephone even more often. IIA385. Ms. Six testified that while other members of the group "almost always" attended meetings and participated in conference calls, Mr. Nissenbaum was a "frequent" attender, but was not always there. IIA385-86.

4. Ernst & Young Offers the CDS Tax Shelter.

The first challenged tax shelter offered by E&Y was known as "CDS" ("Contingent Deferred Swap"), which enabled a taxpayer to convert ordinary income into a long-term capital gain and defer recognition of the gain to the following year. The taxpayer became a partner in a trading partnership which borrowed from a foreign bank and traded in "swap contracts," which were agreements between counterparties to exchange a series of cash flows based on the performance of indices such as the Standard & Poor Index.GX 402, IVA361. The IRS acknowledged that the CDS shelter "worked" and did not contend that its use constituted tax evasion. IIIA567.

After the CDS shelter was introduced to the VIPER/SISG group, appellant Vaughn and his assistant Belle Six studied its complicated details and reported

back to the group. IIA363. Members were then assigned to research different parts of it. IIA364. Review of the CDS proposal took months, and many E&Y personnel, including the firm's highest levels, participated in the meetings and telephone conferences considering the CDS tax shelter proposal. IIA364-65.

Sometime in mid-1999, E&Y management decided to market the CDS shelter. IIA366. Approximately 17 such shelters were "sold" to E&Y clients in 1999. IIA377. An opinion letter from the law firm Locke Liddell & Sapp declared that the CDS shelter proposal "should" pass muster, meaning that in the firm's view a taxpayer was more than 80 percent likely to prevail in litigation with the IRS. GX 934, VA103; IIA286, 289. Many of the CDS arrangements were registered as tax shelters on the partnership returns. IIA403.

5. Mr. Nissenbaum Has Limited Involvement in the CDS Shelters.

After the meetings that culminated with E&Y management's approval of the marketing of the CDS shelters, Mr. Nissenbaum's involvement in that shelter was substantially diminished. Ms. Six testified: "After the committee, I don't really remember Marty involved with CDS. I remember him being involved a little bit, but not really that much." IIA366. When asked what Mr. Nissenbaum's role was to be with regard to CDS, she replied: "I think it was . . . to tell the client or Ernst & Young professional how much the legal opinion would be." IIA374. Jason Rydberg, a prosecution witness who marketed CDS and CDS Add-on tax shelters

for Ernst & Young and made between 50 and 100 sales calls, did not speak with Mr. Nissenbaum about any of these calls or about the allegedly false IDR responses that he submitted and that were the subjects of substantial testimony by him. IIIA396-97.

At trial, the prosecutor's summary to the jury of the CDS tax shelter covered 26 pages of transcript. IIIA538-45. The prosecutor began by reviewing purportedly incriminatory email traffic relating to false statements made by the appellants with regard to CDS. GX 795, IVA551 (IIIA539), GX 88, IVA94 (IIIA539), GX 281 (IIIA540), GX 1003 (IIIA540), GX 248 (IIIA540-41), . None of these exhibits was sent by or to Mr. Nissenbaum. Nor was he sent a copy of any of them. Mr. Nissenbaum's name was not mentioned during the first 15 pages of the prosecutor's discussion of the CDS shelter. At that point, the prosecutor referred to Government Exhibit 232, an email from Ms. Six to Messrs. Vaughn and Coplan which was forwarded to Messrs. Shapiro and Nissenbaum – the first of the allegedly incriminatory emails on which Mr. Nissenbaum even received a copy. After referring to Government Exhibit 1219 (not sent by or to Mr. Nissenbaum or on which he received a copy), the prosecutor referred to an email sent by Mr. Coplan to "one of those big distribution lists" that included Mr. Nissenbaum. GX 493 (IIIA543).

Not until near the end of his summation on CDS did the prosecutor describe any conduct by Mr. Nissenbaum that, in his view, demonstrated personal participation in the alleged fraud on the IRS. Government Exhibit 312 begins with an email dated November 12, 2001, from Mr. Coplan to Messrs. Shapiro and Nissenbaum inquiring whether Mr. Coplan should "intercede" with a CDS shelter that was to terminate after 13.5 months to "suggest running another year out with the trading account?" Mr. Nissenbaum's reply on the following day was, "Yes. They sound way too anxious to get out." The prosecutor then argued to the jury that Mr. Nissenbaum's cryptic reply was designed "to bulk up this false cover story." IIIA544. But see p. 47, *infra*. And in closing his discussion of CDS, the prosecutor cited to the jury Government Exhibit 303, which is an email from Ms. Six to Mr. Coplan (not copied to Mr. Nissenbaum) and Mr. Coplan's email of September 14, 2001, copied to Messrs. Shapiro and Nissenbaum, that suggests attributing termination of a CDS shelter to the 9/11 disaster. IIIA544-45.

6. <u>COBRA Is Marketed Without Mr. Nissenbaum's Involvement.</u>

Thomas A. Dougherty, formerly a 34-year tax partner at the Minneapolis office of E&Y, testified that he had unsuccessfully offered a CDS tax shelter to clients who had realized profits of more than $20 million. The clients then asked whether E&Y could provide a shelter like one offered by the Heritage Group that would eliminate, rather than defer and minimize, taxes. IIA92. Dougherty called

Mr. Coplan and was told that E&Y leadership would soon be "signing off" on a tax elimination shelter. IIA93.

Several weeks later, Mr. Coplan called Dougherty and advised that E&Y would be offering a tax-elimination shelter named COBRA ("Currency Options Bring Reward Alternatives"). E&Y's decision was based on approval of the COBRA strategy by two national law firms – Jenkins & Gilchrist and Brown & Wood. IIA105.

The prosecutor's summation to the jury with regard to COBRA covers 26 pages of the trial transcript. IIIA545-49, 552-54. Other than when he incidentally discussed the Tradehill shelter (IIIA546), the prosecutor named Mr. Nissenbaum twice during this portion of his summation. Mr. Nissenbaum was named as having received a copy of an email (GX 535) in which Mr. Coplan notified Messrs. Shapiro, Vaughn, and Nissenbaum that, long after the COBRA transactions were marketed and implemented, Dougherty's COBRA client had received an audit notice. IIIA547. Mr. Nissenbaum did not participate in that audit; it was handled by Dennis Conlon and Dougherty. IIIA548. Nor was there evidence of any other COBRA audit involving Mr. Nissenbaum in any manner.

Towards the end of his summary of the evidence regarding COBRA the prosecutor cited Government Exhibit 976, which is an email sent by Mr. Shapiro to Messrs. Coplan and Nissenbaum forwarding a memo that describes "a foreign

exchange investment strategy." The prosecutor described this document to the jury as one in which Mr. Nissenbaum was "discussing" with the others "a variation of COBRA" – although there is no statement by Mr. Nissenbaum in the email exchange to support the inference that he participated in any "discussion." IIIA553.

In an email from Mr. Shapiro dated January 17, 2000 (DX 5, VIA30), Mr. Nissenbaum was told that the "short option" analysis on which COBRA was based had been approved by leading law firms such as Jenkins & Gilchrist, Brown & Wood, Proskauer, Curtis Mallet, Arnold & Porter, and Cadwalader.

7. Mr. Nissenbaum Reviews PICO Amnesty Templates.

With respect to PICO, Dougherty testified that Mr. Nissenbaum did not participate in his marketing of the shelter, neither in consultation nor in discussion with the clients. IIA232-33. Mr. Nissenbaum's only role was in reviewing drafts of templates of amnesty submissions made to the Office of Tax Shelter Analysis. IIA236. Dougherty testified that the content of the submissions tracked the legal opinion issued by Arnold & Porter. It was reviewed by him with the clients without Mr. Nissenbaum's participation, and he considered it truthful. IIA237-38. See pp. 47-48, *infra*.

The prosecutor's summation to the jury with regard to the PICO shelter covered 14 pages. IIIA563-66. The summation indicated that before he received a

request regarding an amnesty letter, Mr. Nissenbaum was sent no emails relating to PICO and was copied on some emails that asked for no action whatever from him. GXs 799 (IIIA564), 602, IVA437 (IIIA564), 846 (IIIA564), 794 (IIIA564-65). The amnesty draft contains, according to the prosecutor, two true introductory sentences (IIIA565) and then sentences that have nothing "to do with what the client had in their [sic] head, with what they intended." IIIA566.

8. Mr. Nissenbaum Organizes Tradehill.

In May 2000 E&Y divested itself of a consulting business and received in exchange shares of a French corporation called Cap Gemini. Sale of the shares of the foreign corporation, which were distributed to E&Y partners, was restricted for approximately five years. IIA565. The result for the individual partners was a substantial tax obligation for 2000 with no immediate realization of the cash value of the Cap Gemini stock. IIA595, IIA617, IIIA31.

E&Y provided to the partners funds with which to pay their additional 2000 tax obligation for receipt of the Cap Gemini stock. Nonetheless, following discussions in which Mr. Nissenbaum was an active participant, eleven partners of E&Y, including Ron Friedman, who was the chief of E&Y's Tax Quality and Standards Office and was viewed as the E&Y expert on ethics (IIIA27), joined in October and November 2000 in a tax shelter involving Tradehill Investments, LLC ("Tradehill"). Through other entities, Tradehill traded in foreign exchange options

as a member of AD International FX Fund, LLC ("ADFX"). IIA573, IIIA21, IIIA22. Mr. Nissenbaum distributed to the Tradehill participants valuation sheets for their Tradehill investment on thirteen dates between November 10 and December 20, 2000. IIA601, IIIA36, DX 5002, VIA142. On December 19, 2000, Tradehill withdrew from ADFX and received euros and various stocks for the fair market value of its investment in ADFX. IIA579.

Before they took the tax deduction on their 2000 tax returns in April 2001, the Tradehill participants were provided by Mr. Nissenbaum with a draft of a tax opinion letter written by the Proskauer Rose law firm. IIA571, 575. The opinion discussed the IRS' issuance of the "Son of Boss" Notice in December 2000, and the IRS Notice was a subject of particular interest to E&Y partner Jacob Blank and to E&Y partner Martin Flashner, both of whom testified as prosecution witnesses. IIA603, IIIA30.

In May 2003, after providing oral notification that the Tradehill shelter would be audited, IRS initiated a formal audit and sent an Information Document Request ("IDR") to the participants in the shelter. IIIA24. IDR #1 mostly sought copies of documents. IIA605, 607. Abraham Gutwein, an attorney at Proskauer Rose, was retained by the E&Y partners to represent them with regard to the IRS audit and the E&Y partners executed powers of attorney appointing Gutwein as their representative before the IRS on all matters relating to their 2000 tax return.

IIA606; *e.g.*, DX566. Blank and Flashner testified that their understanding was that Proskauer was retained as counsel at the time of the audit because Ira Akselrad, a Proskauer partner, was a friend of Lester Marks, one of the E&Y partners who participated in the Tradehill shelter. IIA606, IIIA32. Neither had any conversation with Marks about retaining Proskauer. IIIA32.

Gutwein submitted responses to IDR #1 on behalf of Blank and Flashner, as their attorney. IIA590, IIIA24. Although neither one read the responses before they were submitted, both accepted the responses as truthful. IIA607, IIIA39.

In August 2003, the Tradehill participants received IDR #2. Once again Gutwein had the responsibility to respond as the attorney for the E&Y partners. Mr. Nissenbaum sent Gutwein an email with the IDR and his proposed responses. GX 949. Gutwein substantially modified Mr. Nissenbaum's answers and replied on behalf of Blank, Flashner, and the other E&Y partners. GXs 4018, 4025, IIA609-610, IIIA24. Three of the responses submitted to IDR #2 were alleged in paragraph 34 of the Redacted Superseding Indictment to be "false and misleading" and were the basis of the charge in Count Four that Mr. Nissenbaum had obstructed and impeded the due administration of the Internal Revenue Code.

9. Mr. Nissenbaum Does Not Participate in CDS Add-On.

In the 20 transcript pages of the prosecutor's summation regarding CDS Add-On (IIA554-559), Mr. Nissenbaum's name is mentioned only once because Mr. Nissenbaum did not participate at all in the design or marketing of the Add-On shelter. The emails concerning CDS Add-On are not sent by him or to him. GXs 115, IVA120 (IIIA555), 792, IVA548 (IIIA555), 633 (IIIA556), 149, IVA173 (IIIA556), 216, IVA191 (IIIA556), 182, IVA177 (IIIA556), 879, VA44 (IIIA557).

On March 5, 2002, at 9:16 a.m., a draft template amnesty letter for "Generic Add-On" was sent by Mr. Coplan to Mr. Nissenbaum with the request that Mr. Nissenbaum look it over "to avoid unnecessary facts or to make it easier to complete accurately." GX 491, IVA400. Mr. Nissenbaum replied with a less-than-three-line email on the same day at 8:36 a.m. (the clock on one of the two computers may have been off by one hour) that "[t]he disclosure looks fine to me except that I don't believe that it's necessary to put the specifics of each option trade in the letter. If we do it here, presumably we'd have to include the hundreds of trades that are done in PICO." GX 491, IVA400, IIIA557.

Nothing in the draft amnesty letter related to whether there was profit potential in the CDS Add-On tax strategy. The prosecutor summarized the evidence relating to the tax evasion charges in Counts Two and Three at pages 5548-5582 (IIIA567-76) of the trial transcript and cited GX 836 (VA20), an email

dated February 13, 2003, from Mr. Coplan to Messrs. Shapiro and Nissenbaum as the critical evidence that Messrs. Shapiro and Nissenbaum knew that CDS Add-On "is not a money-maker." IIIA569. In fact, there is absolutely no evidence that either recipient of the February 13, 2003, email from Mr. Coplan had any idea before that date that there was no profit potential in the CDS Add-On shelter.

The prosecutor then summarized the evidence that supported the Government's theory that an "affirmative act of evasion" was committed to mislead the IRS either before or after the CDS Add-On tax returns were filed. Apart from the almost immediate response to Mr. Coplan's inquiry concerning the form of the amnesty template, the name of Mr. Nissenbaum was not mentioned during this summary. IIIA574-76.

SUMMARY OF ARGUMENT

This highly unusual prosecution is an effort by the IRS and federal prosecutors to punish with imprisonment conduct that was considered at the time to be lawful and permissible advocacy by lawyers and accountants defending tax shelters against the IRS, their clients' litigation adversary. It is an even more extreme and excessive invocation of the criminal law against professionals who contended in good faith with the IRS in 2000-2001 than the prosecution that this Court described in *United States v. Stein*, 541 F.3d 130, 157 (2d Cir. 2008), as "based on a fairly novel theory of criminal liability." A recent decision by this

Court in that case held that the operators and marketers of a tax shelter that allegedly had no "economic substance" could be convicted of tax evasion. This case goes one giant step farther; it imposes criminal sanctions not for the management and marketing of an "abusive" tax shelter, but for alleged improper behavior in defending and advocating on behalf of such a shelter. And it treats as "liars" all advocates who represent in one form or another that their clients have motives or states of mind that explain or justify their conduct.

The case concerns four tax shelters that "worked" – *i.e.*, that the Government could not, and did not, claim constituted tax evasion. A fifth tax shelter that is the basis for two tax-evasion counts did not "work" only because it was belatedly discovered that the investment provided no real possibility of a profit since the total out-of-pocket costs and fees of utilizing the shelter exceeded any profit that could be realized by the taxpayer.

On behalf of Mr. Nissenbaum, one of four appellants in this case, we join and adopt the challenges to the validity of this prosecution made by the other appellants and by *amici*. This brief is principally directed, however, to legal issues personal to Mr. Nissenbaum. Even if, *arguendo*, the fundamental legal underpinnings of the over-all prosecution are accepted as valid, the convictions of Mr. Nissenbaum on all four counts must be reversed because of the legal insufficiency of evidence of his own guilt.

1. We begin with the invalidity of his conviction on the count that charges him alone – Count Four. It alleges that Mr. Nissenbaum "caused" certain "false and misleading" statements specified in Paragraph 34 of the Redacted Superseding Indictment "to be submitted to the IRS on behalf of himself and ten other E&Y partners." It is manifest, however, from the evidence presented at trial that a jury could not find beyond a reasonable doubt that *any* of the three statements that Paragraph 34 of the Indictment calls "false and misleading" were in fact, false.

The cross-examination of Messrs. Blank and Flashner, the two Tradehill participants who were prosecution witnesses, established the truth of the first statement in the Redacted Superseding Indictment that went to the jury – that the Tradehill transaction was intended, at least in part, to hedge against fluctuation in the euro. The second and third statements – that the Tradehill participants had no "unwritten understandings" and that the participants knew of no "expectation or referral of any future business to Proskauer Rose" – were not contradicted by the testimony of the Tradehill participants or by any other evidence. Although they testified on direct examination that their principal subjective motivation was to obtain a tax loss that could defer tax liability, both Tradehill participants acknowledged on cross-examination that the intention to hedge fluctuation in the euro was one objective that motivated them and, most probably, other Tradehill partners.

Moreover, the trial testimony established that the statements that were allegedly "false and misleading" in the IDR response were reviewed and submitted by the attorney who represented the individual Tradehill participants. With respect to the statement that allegedly concealed an "understanding" that the E&Y partners would "exit their option positions before the end of 2000," Mr. Nissenbaum's proposed draft – which Mr. Gutwein revised – identified as possible understandings "the sale of the assets that generated the losses." GX 949, VA128. It demonstrated an intent on Mr. Nissenbaum's part to be more candid in responding to the IRS than his attorney was ready to be.

2. Mr. Nissenbaum's convictions of tax evasion on Counts Two and Three are similarly invalid because the evidence, even if viewed "in the light most favorable to the prosecution," was insufficient to permit a jury to find Mr. Nissenbaum guilty of evasion beyond a reasonable doubt. The proof at trial failed to show any personal involvement by Mr. Nissenbaum in the design, development, or marketing of the CDS Add-On tax shelter. He was not present and did not participate in any manner in the meetings or email correspondence that introduced marketing of CDS Add-On in early 2000. Nor was he told that there were clients who used the CDS Add-On strategy without previously using CDS. And he did not know that the maximum potential profit to a client from the CDS Add-On tax shelter did not exceed the fees the client was obliged to pay – the Achilles heel of

the shelter – until February 2003, long after the tax returns had been filed and the allegedly false amnesty submissions had been made.

The absence of affirmative proof of Mr. Nissenbaum's guilt of tax evasion was graphically demonstrated by the reliance in the prosecution's response to Mr. Nissenbaum's Rule 29 motion, and in its rebuttal summation, on a *Pinkerton* theory to warrant a finding that Mr. Nissenbaum was guilty on these counts. IIIA517, IVA43. *Pinkerton* permits a jury to find a conspirator guilty of a substantive offense that he did not personally commit or plan only if the offense is "reasonably foreseeable." Given the enormous effort made by the E&Y personnel to find and promote only tax shelters that would be legally defensible and their knowledge that their conduct would be subject to searching scrutiny, it was highly improbable that the E&Y partners would have foreseen anyone committing tax evasion. It is not a foreseeable leap from joining other E&Y partners in an alleged conspiracy to mislead the IRS in defending tax shelters that "work" to committing tax evasion by marketing and defending, with representations that are alleged to be untruthful, a tax shelter that does not "work" and that crosses the line into criminal tax evasion.

Moreover, the record contains no evidence whatever that Mr. Nissenbaum committed any "affirmative act of evasion." He first learned that the CDS Add-On shelter had no "profit potential" on February 13, 2003 – long after the relevant tax

returns were filed and the shelter was no longer being marketed. He was interviewed by the IRS but never made any false statement to the IRS. He did not participate in any manner in any audit of CDS Add-On. Since tax evasion requires the performance of an "affirmative act," its absence also required the entry of a judgment of acquittal for Mr. Nissenbaum on Counts Two and Three.

3. The conspiracy count of the indictment is fundamentally defective as a matter of law. Its linchpin is the allegation that the appellants misrepresented to the IRS the true motivation of the clients who utilized their tax strategies. But it is impossible to prove beyond a reasonable doubt that a person's belief regarding another person's state of mind is false. Perjury and false statement cases may be brought when an individual lies about his own or someone else's *conduct* or about his *own state of mind*. (Circumstantial evidence or contradictory statements about one's own state of mind may be sufficient to meet the beyond-a-reasonable-doubt standard.) But a person's statement regarding his view of another's state of mind cannot be proved or disproved with the certainty required in a criminal case.

4. The charge that the appellants conspired to "defraud" the IRS did not satisfy the standard of *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), as that precedent must now be understood in light of *Skilling v. United States*, 130 S. Ct. 2896 (2010). There was also insufficient evidence to warrant finding Mr. Nissenbaum guilty of conspiracy.

5. A number of trial errors were committed. Prejudicial testimony of a fraudulent lawyer who had absolutely no relation to the appellants was presented to the jury. Hearsay was admitted without the precautionary procedures prescribed by *Bourjaily v. United States*, 483 U.S. 171 (1987). The jury instructions improperly defined "economic substance" by departing from the "no market risk" language approved by this Court in four criminal decisions. The jury instructions also failed to include the "theory of the defense" and improperly charged on "conscious avoidance."

ARGUMENT

I.

THE EVIDENCE WAS INSUFFICIENT TO FIND MR. NISSENBAUM GUILTY ON COUNT FOUR

A. The Standard of Review Is Whether a Reasonable Juror Could Have Found Guilt Beyond a Reasonable Doubt.

We recognize that in challenging the sufficiency of the evidence we bear "a heavy burden." *United States v. Heras*, 609 F.3d 101, 105 (2d Cir. 2010); *United States v. Aguilar*, 585 F.3d 652, 656 (2d Cir. 2009). The evidence is to be viewed "in the light most favorable to the government, crediting every inference that could have been drawn in the government's favor," and "the conviction must be upheld if '*any* rational trier of fact could have found the essential elements of the crime

beyond a reasonable doubt." *United States v. Chavez*, 549 F.3d 119, 124 (2d Cir. 2008), quoting *Jackson v. Virginia*, 443 U.S. 307, 319 (1979) (emphasis original). *See also United States v. Pfaff*, No. 09-1702-cr, slip op. at 2 (2d Cir. Aug. 27, 2010).

That formidable standard is satisfied in this case because the evidence failed to prove that any of the three allegedly "false and misleading statements" submitted for the jury's consideration on Count Four were actually false or misleading. In fact, the testimony of the participants in the Tradehill shelter who testified as prosecution witnesses refuted the allegation that the specified statements submitted in their responses to IDR #2 were "false and misleading." Hence reversal for insufficiency of evidence of guilt is warranted on this record. *See, e.g.*, *United States v. Torres*, 604 F.3d 58 (2d Cir. 2010); *United States v. Lorenzo*, 534 F.3d 153 (2d Cir. 2008).

B. After Mr. Nissenbaum's Rule 29 Argument, the Prosecution Withdrew from the Jury One Allegedly "False and Misleading" Statement.

As the indictment stood during the course of the trial, Paragraph 34 – incorporated by reference into Count Four – alleged that Mr. Nissenbaum was responsible for the submission to the IRS of the Tradehill participants' response to IDR #2, and that the response contained four "false and misleading statements." The first allegedly "false and misleading" statement was that "Ernst & Young

partners had entered into the Tradehill transaction in order to generate profits[.]" After Mr. Nissenbaum's counsel argued to the judge that a judgment of acquittal should be entered on Count Four (IIIA517-522), the Government advised that it would withdraw the allegation that the first of the four statements was "false and misleading" and would redact the indictment accordingly. IIIA533. This redaction was an acknowledgment by the Government of the force of the testimony given on direct and cross-examination by Messrs. Blank and Flashner.

Although they initially testified on direct examination that their motivation was "to obtain a tax loss" (Blank, IIA579) or "to reduce my overall capital gain" (Flashner, IIA671), Flashner added immediately that "the fact that there was a substantial opportunity for profit was also key." IIA671. Later in his direct testimony when asked about "how much profit you could make," Flashner replied, "I didn't have a specific number in mind, but I believed the amount could be quite substantial." IIIA21. Blank also testified on cross-examination that one objective of the Tradehill transaction was "to make money." IIA597. He agreed that the participants had three objectives: "to hedge against the currency . . . to make money, and the obvious, tax motive." IIA609. In light of this testimony from the only Tradehill partners who testified, it is not surprising that the Government abandoned the allegation in the indictment that submission of the first of the four

purportedly "false and misleading" statements amounted to an endeavor to obstruct and impede the IRS in violation of 26 U.S.C. § 7212.

C. The Testimony of Blank and Flashner Established That the Three Statements That Remained in the Redacted Superseding Indictment Were Not "False and Misleading."

(1) Hedging Against the Euro – The second of the four allegedly "false and misleading" statements that were the basis of the accusation made against Mr. Nissenbaum in Count Four of the Superseding Indictment before its redaction was that "the Tradehill transaction was intended fully to hedge the partners' exposure to fluctuation in the euro." The indictment alleged that this statement was false because "in reality, the transaction had no capacity to do so." Blank acknowledged on cross-examination that hedging against fluctuation of the euro was "a consideration." IIA596. He later was asked: "You believe that a purpose of this transaction was to manage your foreign exchange exposure, isn't that correct, sir?" He replied, "At the time I entered into this transaction, I did believe that, yes." IIA597.

Flashner testified on cross-examination that the E&Y partners discussed the "exchange rate risk" presented by the fact that the stock they were receiving was denominated in euros. IIIA32. He also admitted that he and Mr. Nissenbaum discussed forming a partnership "that would invest in trading or hedging of foreign

currency." IIIA33. And he agreed that "it would make sense" for him to protect his investment in the French company stock, which was dependent on the value of the euro, by "trying to make some money from this downward movement of the euro against the dollar." IIIA33. The testimony of these two prosecution witnesses not only established the truth of the statement that the Tradehill transaction was intended to hedge fully against exposure to fluctuation in the euro, but that it had the capacity to do so.

(2) Unwritten Understandings – The third allegedly "false and misleading" statement identified in Paragraph 34 of the Superseding Indictment was that "there were no unwritten understandings between the participants in the Tradehill transaction." The indictment alleges in Paragraph 34 that the parties had agreed that they "would exit their option positions before the end of 2000." Neither Blank nor Flashner testified about any "understandings" or agreements they had with other Tradehill members regarding any "exit" from the Tradehill LLC. In fact, both denied that they had engaged in any discussion with any other E&Y partner about exiting their option positions. IIA578, 579, 580, IIIA23. Hence this statement could not have been found "false and misleading" by any reasonable juror.

(3) Referral to Proskauer Rose – Both Blank and Flashner testified that they had no conversation with any other E&Y partner regarding the referral of clients to the Proskauer Rose law firm. Neither gave any testimony to support even

a speculation that there had been any "expectation or referral of any future business" to the Proskauer firm. Both surmised that Proskauer was selected to represent them and other E&Y partners during the IRS audit because Messrs. Akselrad (of Proskauer) and Marks (of E&Y) were good friends. IIA606, IIIA32. On this record, there was no evidence on which a reasonable juror could find beyond a reasonable doubt that the final allegedly "false and misleading" statement identified in paragraph 34 was false in any respect.

In his summation, the prosecutor argued that the jury should infer that there had been an agreement to refer PICO business, at customary rates, to the Proskauer firm from the fact that Proskauer did not charge the E&Y partners for the work it did on Tradehill. IIIA577. A far more likely explanation for Proskauer's benevolent attitude in the Tradehill matter is that it concerned the personal tax liability of Mr. Marks and other E&Y partners and, out of long friendship and professional courtesy, those services were provided *gratis* by Proskauer. Only the Government's assumption that everything done by the appellants must be viewed with suspicion supports the more nefarious speculation that there was an actual unspoken agreement to make a future referral to Proskauer and that the denial of such an agreement was a deliberate "lie" in the response to IDR #2.

D . Attorney Gutwein, and Not Mr. Nissenbaum, Was Responsible for the Contents of the Responses to IDR #2.

A final reason why Mr. Nissenbaum could not have been found guilty on Count Four by any reasonable juror is that the testimony of Messrs. Blank and Flashner conclusively established that they retained Mr. Gutwein to be their attorney in responding to the IDRs. Indeed, Blank and Flashner acknowledged that they continued to retain Gutwein to respond to IDR #3, and Blank gratuitously expressed his appreciation to Gutwein for "the good job he was doing." IIA611, IIIA40. Blank even retained Gutwein independently in June 2004. IIA611-12. Consequently, even if Gutwein sought Mr. Nissenbaum's input into drafts of responses to the IDRs, Mr. Nissenbaum could not be found to have "caused" the submission of the answers provided to IDR #2, particularly since it was Gutwein who had the signed powers of attorney from the E&Y partners.

Ironically, Gutwein revised the text of a response that Mr. Nissenbaum had proposed for one of the relevant questions in IDR #2. In a proposed draft response, Mr. Nissenbaum noted that the term "understandings" could refer to the conditions under which Tradehill would sell "the assets that generated the losses." GX 949, VA128. Gutwein chose to revise that response, thereby making it, according to the Government's allegations, *less* accurate and truthful than it would have been had Mr. Nissenbaum's proposed language been adopted. Accordingly, Mr. Nissenbaum

could not have been found guilty by a reasonable juror of causing the filing of any "false and misleading" statement in response to IDR #2.

II.

THE EVIDENCE WAS INSUFFICIENT TO FIND MR. NISSENBAUM GUILTY OF TAX EVASION

A. Criminal Liability for Tax Evasion Could Not Be Based on a *Pinkerton* Theory Because Criminal Tax Evasion Was Not Reasonably Foreseeable.

Because there was simply no evidence whatever that Mr. Nissenbaum had been involved with the development or marketing of the CDS Add-On shelter, a substantial Rule 29 argument was made by Mr. Nissenbaum's trial counsel with respect to Counts Two and Three. IIIA262. ("There is simply no evidence of any affirmative act of evasion that could be attributed to Mr. Nissenbaum.") Counsel cited the testimony by Ms. Six that Mr. Nissenbaum had not participated in telephone conferences relating to the CDS Add-On shelter. IIA419. There was no evidence that he had been involved in email traffic that would have led to knowledge regarding CDS Add-On. Nor did he have any reason to know, before receiving an email on February 13, 2003 (GX 836, VA20), that the CDS Add-On shelter had no profit potential. And he first learned in July 2003 (GX 963, VA169)

that there were E&Y clients who used the Add-On strategy without engaging the CDS shelter.

The prosecutor responded to the Rule 29 argument by acknowledging that Mr. Nissenbaum "[a]dmittedly doesn't have the same involvement that Mr. Coplan and Mr. Vaughn and Mr. Shapiro do." IIIA516. Judge Stein replied, "I'm with Ms. Kirshner [Nissenbaum's trial counsel] to the extent that the admitted evidence is weak, and the issue really is what inferences are permissible for a jury." IIIA516-17. When the prosecutor replied that what Mr. Nissenbaum learned regarding the CDS Add-On shelter in 2003 might be considered by the jury in deciding whether he committed tax evasion in prior years, the following colloquy ensued (IIIA517):

> THE COURT: You're talking three years later.
>
> MS. GOLDBERG: Three years later that it has no profit potential. They are aware of the audits that are going on as evidenced by Government Exhibit 963. It's certainly reasonably foreseeable and certainly liability could attach under Pinkerton. He knows there are audits going on. Obviously, this is our theory. He's in a conspiracy with people who are engaged in defending those audits. And we think that when you combine that that there is enough evidence for a reasonable juror to conclude that he's guilty of Counts Two and Three.

Having identified *Pinkerton v. United States*, 328 U.S. 640 (1946), as "our theory" of Mr. Nissenbaum's liability, the prosecutor repeated her reliance on *Pinkerton* in her responsive argument: "[I]f you are just focusing on Pinkerton liability, it has nothing to do with speculation. The elements are clearly laid out in

your charge and at the minimum the government would take the position that a reasonable juror could reach that conclusion." IIIA517.

The same theme was sounded in the Government's rebuttal summation. Exploiting the opportunity she had to provide the last word, the prosecutor claimed that the argument of Mr. Nissenbaum's counsel that he could be found guilty of tax evasion only if there was an "affirmative act of evasion" was trumped by the *Pinkerton* theory of criminal liability. The prosecutor urged the jurors to decide "whether it was reasonably foreseeable that one of their co-conspirators might commit the affirmative act of evasion." IVA43.

But this Court unequivocally rejected such an open-ended *Pinkerton* theory of vicarious criminal liability in *United States v. Jordan*, 927 F.2d 53, 56 (2d Cir. 1991), when it cautioned that *Pinkerton* did not create "a broad principle of vicarious liability that imposes criminal responsibility upon every co-conspirator for whatever substantive offenses any of their confederates commit." This caution was applied to reverse convictions of substantive offenses that were not foreseeable in *United States v. Bruno*, 383 F.3d 65, 89-91 (2d Cir. 2004).

Similarly, in *United States v. Graziano*, 616 F. Supp. 2d 350 (E.D.N.Y. 2008), a District Judge set aside a jury's verdict that had held a defendant guilty on a *Pinkerton* theory of the substantive offense of using a destructive device because he was found to have been a party to a conspiracy to commit arson. Review in the

evidence, the District Court held that "no rational jury could conclude that it was reasonably foreseeable to [the defendant] that his co-conspirator would use a destructive device . . . to set this small fire at an adjacent store." 616 F. Supp. 2d at 375.

On the record in this case, no reasonable juror could have found that Mr. Nissenbaum – whose participation in the conspiracy alleged in Count One was peripheral at best – could have foreseen that alleged co-conspirators would commit tax evasion. In these circumstances, the *Pinkerton* decision does not create criminal liability. Hence his conviction on Counts Two and Three must be reversed.

B. Mr. Nissenbaum Was Not Guilty of Tax Evasion Because He Committed No Affirmative Act of Evasion.

The jury instructions correctly told the jury that it could return a verdict of guilty against any of the defendants only if the proof satisfied the jury beyond a reasonable doubt that the particular defendant had committed "one or more affirmative acts of evasion." VIA425. *See Spies v. United States*, 317 U.S. 492, 499 (1943); *United States v. Josephberg*, 562 F.3d 478, 493 (2d Cir. 2009). This instruction conflicted, of course, with the instruction that permitted a guilty verdict under *Pinkerton* if evasion was foreseeable, even if the defendant committed no affirmative act at all.

In any event, Mr. Nissenbaum committed no "affirmative act" of evasion either before or after February 2003. He was interviewed by the IRS and no response of his has ever been alleged to have been false. He did not participate in the IRS audit of CDS Add-On, where false statements were allegedly made. In short, he took no personal steps of the kind contemplated by the "affirmative act" element of the crime of tax evasion. Hence he was entitled to a judgment of acquittal on Counts Two and Three.

III.

ALLEGED MISREPRESENTATION OF ANOTHER PERSON'S MOTIVES OR STATE OF MIND CANNOT BE PROVED BY THE CONSTITUTIONAL STANDARD REQUIRED IN CRIMINAL CASES

There is a fundamental defect in the Government's theory of prosecution in this case, and it affects the alleged guilt of all the appellants on Count One, the conspiracy count. At the heart of the Government's case is the proposition that was often repeated by the prosecutors in the indictment and during the trial – *i.e.*, that the defendants "lied" to the IRS and misrepresented the intentions and state of mind of the investors in E&Y's tax strategies. In order to find any of the defendants guilty, the jury had to conclude beyond a reasonable doubt that representations made by defendants to the IRS regarding the motivations of taxpayer-clients were false.

The four appellants were charged in Count One with conspiring to defraud the IRS by "using means and methods intended to deceive the IRS about the bona fides of those [tax] shelters, and about the circumstances under which the shelters were marketed and implemented." IA95, para. 13. Paragraph 14 of the Redacted Superseding Indictment then specifies that in order to prevent the IRS from "aggressively challeng[ing] the claimed tax benefits" and "seek[ing] to collect the unpaid taxes plus interest" and "seek[ing] to impose substantial penalties upon the clients," the defendants "undertook to prevent the IRS from (a) detecting the shelters, (b) understanding them, (c) learning that they were "marketed as cookie-cutter products," (d) learning that the clients had not undertaken them as "profit-making investment opportunities" but to obtain "huge tax benefits," and (e) learning that the clients "intended to complete a pre-planned series of steps that had been designed by the conspirators to lead to the specific tax benefits sought by the clients." IA95-96.

The first and second of these five enumerated means of implementing the alleged conspiratorial objective – *i.e.*, concealing from the IRS the existence of the tax shelters or how they worked – were not seriously pursued at trial. Obviously, the existence of the E&Y shelters was no secret; they were all either formally registered as tax shelters or subject to tax shelter voluntary-disclosure amnesty applications. As to each of the tax shelters that were subjects of the indictment,

there were lengthy opinions of nationally reputed tax counsel detailing and explaining the basis on which deductions were taken and the rationale on which E&Y's clients relied.

The third fact that the defendants allegedly tried to prevent the IRS from discovering – *i.e.*, that the shelters "were marketed as cookie-cutter products" – is not immediately comprehensible and, in any event, appears to be irrelevant to any legitimate IRS determination of the validity of the shelters. Moreover, it is hard to credit the implication that the IRS was unaware, on account of the defendants' conduct, that E&Y – along with virtually every other nationally recognized accounting firm – offered its clients carefully planned tax shelter strategies that could be characterized as "cookie-cutter" products.

This leaves the two final subjects on which the defendants allegedly sought to defraud the IRS with the conduct and submissions specified in the indictment and in the trial evidence: *First*, that the clients' subjective motives for undertaking the transactions were not to secure "profit-making investment opportunities" but to obtain "huge tax benefits." *Second*, that clients subjectively "intended to complete a pre-planned series of steps" such as early withdrawal from a partnership or early termination of an 18-month swap arrangement. The prosecution's evidence on both of these subjects consisted of alleged conduct and statements made to the IRS by or at the instance of the defendants misrepresenting or withholding evidence

relating to the subjective intention of the taxpayer clients of E&Y with regard to their motives (1) in utilizing the tax shelter and (2) in taking action such as "early termination" that qualified the transaction for beneficial tax treatment. *See* Superseding Indictment paras. 39(i), 39(j), 39(k).

The prosecution's theory is that the defendants lied or misled the IRS about the state of mind of the taxpayers: Did the taxpayers intend to engage in a venture with a profit potential? Did they have a business purpose? Did they intend to terminate their investment early? On each of these questions, the defendants are accused of misrepresenting *another person's intentions or state of mind* to the IRS. The allegedly "false and misleading" statements relate to the subjective intention *of the clients*. The defendants could be found guilty only if the prosecution proved beyond a reasonable doubt that the defendants lied when they represented to the IRS the state of mind of their taxpayer clients. (When taxpayers such as the E&Y partners who participated in the Tradehill shelter actually testified, they corroborated the representation that had been made by Mr. Nissenbaum regarding their subjective motivation in utilizing the tax-shelter strategy. *See, e.g.*, IIA597, 609, 671, IIIA21, 32.)

It is a well-established principle of federal law that an individual cannot be criminally prosecuted for providing a "literally true" answer to a question that he is legally obliged to answer. *Bronston v. United States*, 409 U.S. 352 (1973); *United*

States v. Earp, 812 F.2d 917 (4th Cir. 1987); *United States v. Lighte*, 782 F.2d 367, 372-74 (2d Cir. 1986); *United States v. Tonelli*, 577 F.2d 194, 198 (3d Cir. 1978). The prosecution has the obligation to satisfy the trier of fact beyond a reasonable doubt that the statement made by the declarant is false and was known by him to be false. *United States v. Shotts*, 145 F.3d 1289, 1297-1299 (11th Cir. 1998). We know of no federal criminal prosecution in which a defendant has been prosecuted for perjury or for submitting a false statement regarding another person's motive or state of mind.

It is, we submit, not possible to prove beyond a reasonable doubt that a defendant is lying if he represents what he believes to be the subjective motivation of a client's acceptance of a tax strategy. Indeed, the fact that the attorneys' opinion letters were sent to the clients, as well as drafts of the IDR responses that the clients had to sign and notarize, supports the veracity of the defendants' belief that the clients' motivation included "investment opportunities" and the potential for profit. Even assuming, *arguendo*, that the jury believed from the testimony of a client taxpayer who was a prosecution witness such as Kathryn Munro (IIIA51, 59, 60-61) that the client was motivated by the prospect of a large tax saving and not by any profit potential (IIIA57, 59, 60-61), that did not necessarily mean that the defendants were "lying" to the IRS when they presented their view that profit potentials were among the motives that led the clients to accept the tax strategies

proposed by the E&Y shelters. And since the evidence established that many clients – Ms. Munro among them – never met or spoke with any of the defendants (IIIA52), there was no proof to rebut the defendants' good-faith belief that what was recited in the attorneys' opinion letters and in the clients' signed representations to the IRS were truthful subjective motivations of at least *some* of those who used Ernst & Young's tax shelter strategies.

The same was true of testimony by witnesses that they, in the language of the Superseding Redacted Indictment, "intended to complete a pre-planned series of steps that had been designed by the conspirators to lead to the specific tax benefits sought by the clients." The IRS knew from the fact that these were shelters proposed by a leading accounting firm that they involved "a pre-planned series of steps." If the trial testimony of clients or those who advised them contradicted the written descriptions of the transaction in the attorneys' opinion letters and the signed representations to the IRS, the defendants were not "lying" when their submissions relied upon the written representations that the clients confirmed with their signatures. Hence the critical center-piece of the prosecution's conspiracy theory – that the defendants conspired to convey "false and misleading" representations to the IRS regarding the client-taxpayers' motivations and understandings – was not proved on this record and, indeed, *could not be proved without plumbing the defendants' own thought-processes.*

This Court held more than 60 years ago that a defendant cannot be found guilty of conspiring to submit a false statement merely on proof that the statement he submitted was false. *United States v. Ausmeier*, 152 F.2d 349 (2d Cir. 1945). In an opinion by Judge Jerome N. Frank, joined by Judge Learned Hand, this Court said: "[I]t was necessary for a [conspiracy] conviction of any defendant to prove that he gave an answer *which that defendant knew to be untruthful*." 152 F.2d at 357 (emphasis added). In the present case, the prosecution may have believed that the statements made to the IRS regarding the clients' motivations and understandings were untruthful, and the jury might even have concluded that the taxpayers were motivated solely by the tax consequences and had an understanding of the anticipated early terminations. But the evidence failed to establish beyond a reasonable doubt that the defendants unequivocally knew the clients' subjective motivations and understandings.

The prosecution of these appellants is, we submit, another instance in this Circuit of an effort to stretch conspiracy law beyond its tolerable limits in order to subject to criminal sanctions individuals who engaged in conduct that the Government disapproves but that has never been thought to be criminal. In *United States v. Bufalino*, 285 F.2d 408 (2d Cir. 1960), this Court barred an innovative recourse to conspiracy law that was invoked to carry out an objective that was in the public interest. 285 F.2d at 419. This Court said that the defendants could not

be found guilty of a conspiracy that "the government could not prove, on inferences no more valid than others equally supported by reason and experience." *Id. See also United States v. Schwarz*, 283 F.3d 76, 105-110 (2d Cir. 2002); *United States v. Mulheren*, 938 F.2d 364 (2d Cir. 1991).

IV.

THE EVIDENCE WAS INSUFFICIENT TO FIND MR. NISSENBAUM GUILTY ON THE CONSPIRACY COUNT

A. None of the Appellants Committed the Offense of Conspiring To Defraud the IRS.

The Government's theory of prosecution was that the appellants could be convicted of conspiring to defraud the IRS under 18 U.S.C. § 371 and this Court's opinion in *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957). We submit, however, that the "defraud" provision of federal conspiracy law, even after *Klein*, does not reach lawful conduct allegedly committed in order to cheat the IRS. The statutory language must be narrowly construed in light of the decision and rationale of *Skilling v. United States*, 130 S. Ct. 2896 (2010). We adopt the argument made on this subject in the Brief for Robert Coplan, pp. 19-51.

B. There Was Insufficient Evidence That Mr. Nissenbaum Had the Specific Intent of Defrauding the IRS, Submitting False Statements, or Committing Tax Evasion.

The mere fact that Mr. Nissenbaum was appointed by E&Y to be a member of its VIPER/SISG group was plainly insufficient to make him guilty of conspiracy. The Government did not claim that all personnel of E&Y who participated in the accounting firm's competitive effort to market high-end tax shelters and approved the particular shelters identified in the Superseding Indictment were guilty conspirators. Only those who knew of the alleged efforts to defraud the IRS, submit false statements, or commit tax evasion were, on the prosecution's theory, guilty of conspiracy.

A conspiracy conviction can be sustained only on "some evidence from which it can reasonably be inferred that the person charged with conspiracy knew of the existence of the scheme alleged in the indictment and knowingly joined and participated in it." *United States v. Rodriguez*, 392 F.3d 539, 545 (2d Cir. 2004), quoting from *United States v. Gaviria*, 740 F.2d 174, 183 (2d Cir. 1984). In *United States v. Ogando*, 547 F.3d 102, 107 (2d Cir. 2008), this Court held that proof of specific intent is essential to sustain such a conspiracy charge. And in *United States v. Glenn*, 312 F.3d 58, 70 (2d Cir. 2002), the Court noted that "if the evidence viewed in the light most favorable to the prosecution gives 'equal or

nearly equal circumstantial support to a theory of guilt and a theory of innocence,' then 'a reasonable jury must necessarily entertain a reasonable doubt.'" If these governing principles are applied to the prosecution's evidence supporting its claim that Mr. Nissenbaum was guilty of conspiracy, the evidence must be held insufficient to support his conviction on Count One.

(1) **Extension of the CDS Trading Account** --The prosecution took a most jaundiced view of a perfectly innocent response that Mr. Nissenbaum gave to an inquiry by Mr. Coplan and relied on it to prove that Mr. Nissenbaum joined a conspiracy to defraud the IRS with regard to the CDS tax shelter. *See* p. 14, *supra*. In fact, Mr. Nissenbaum was responding in Government Exhibit 312 that Charles Bolton, the trader for the CDS partnership, was "way too anxious" to close down the partnership after 13.5 months for his own interest. Mr. Nissenbaum's cryptic statement was not part of a "false cover story," as the prosecutor claimed. It was a fair and neutral expression of opinion regarding what appeared to Mr. Nissenbaum to be a too-hasty exit from an investment vehicle.

(2) **Review of Templates for Amnesty Submissions** -- To prove that he was a conspirator the prosecution also relied on Mr. Nissenbaum's responses to emails that asked him to review amnesty submission templates drafted for the PICO and CDS Add-On shelters. *See* pp.16-17, 20, *supra*; Tr. 1641 (IIA236), 5507 (IIIA557), GX 491 (IVA400). This advice did not prove specific intent to join any

conspiracy to defraud the IRS. Mr. Nissenbaum was being called on in these instances for his expertise in drafting and reviewing such letters, not for participation in an illegal conspiracy. There is no suggestion in the templates that he reviewed – that tracked the attorneys' descriptions of the transactions in their opinion letters – that they were means of defrauding the IRS. Indeed, the fact that they were "templates" – *i.e.*, outlines that were to be completed with the details of a particular transaction – meant that they were not being used to mislead the IRS in a particular case. Hence Mr. Nissenbaum's conduct in reviewing templates for amnesty submissions could not be used by the prosecution to establish that he was a member of the alleged conspiracy.

(3) **Receipt of Copies or Forwarded Emails** -- The Government introduced emails sent by alleged conspirators to each other or to others that allegedly proved the effort to defraud the IRS, submit false statements, or commit tax evasion. Occasionally these emails were forwarded by a recipient to Mr. Nissenbaum. Sometimes the author of the email sent Mr. Nissenbaum a copy of an email addressed to someone else..

Mr. Nissenbaum's receipt of emails that might incriminate the sender is not evidence of his personal culpability. Mere receipt of a copy of an email is equivalent to mere presence at the scene of a crime. This Court said in *United States v. Jones*, 30 F.3d 276, 282 (2d Cir. 1994): "[A] defendant who is simply

present at the scene of a crime or who knew only of the existence and goals of a narcotics conspiracy is not thereby guilty of being a conspirator; the government must prove more than that." *See also Swartz v. Presidio Advisory Group*, 2008 WL 254054 (W.D. Wash. 2008) (receipt of email is not evidence of guilt).

This Court has reversed conspiracy convictions on records that contained substantially more incriminating evidence of participation in a conspiracy than appears in this record with regard to Mr. Nissenbaum. *United States v. Lorenzo*, 534 F.3d 153, 159-162 (2d Cir. 2008); *United States v. Wexler*, 522 F.3d 194, 207-9 (2d Cir. 2008); *United States v. Samaria*, 239 F.3d 228, 235-242 (2d Cir. 2001). Close scrutiny of the evidence against Mr. Nissenbaum must, we submit, result in reversal of the judgment of conviction against him on Count One.

V.

A NEW TRIAL MUST BE HELD BECAUSE OF TRIAL ERRORS

A. The Inflammatory and Prejudicial Testimony of Graham Taylor Was Improperly Admitted.

The highly prejudicial and inflammatory testimony of Graham Taylor, an attorney who admitted to composing deliberately fraudulent legal opinions, was admitted over the objections of the defendants made pretrial and during trial. That testimony was exploited by the prosecution in its summations (IIIA539-43/5438,

5439, 5445, 5448, 5450, 5452) and, for the reasons stated at pp. 55-66 of the Brief for Robert Coplan, was plainly inadmissible.

B. Hearsay Declarations Were Improperly Admitted.

The District Judge admitted many hearsay declarations during the course of the trial in violation of the standards and procedures prescribed in *Bourjaily v. United States*, 483 U.S. 171 (1987). We join the Brief for Brian Vaughn at pp. 16-31, that presents the reasons why these rulings resulted in an unfair trial that must be reversed.

C. The Jury in This Criminal Prosecution Was Erroneously Instructed that CDS Add-On Had "Economic Substance" Only If There Was a "Reasonable Possibility" of Profit.

The tax-evasion charges turned on whether the prosecution's evidence established that the CDS Add-On transaction lacked "economic substance." Only if the Government's proof established that element beyond a reasonable doubt could the jury find the defendants guilty on Counts Two and Three. One component of the "economic substance" element is the likelihood of the taxpayers' realizing a profit from the transaction.

Prior to trial, the defendants asked the District Judge to instruct the jury, in accordance with the established precedent in this Circuit, that a transaction lacks "economic substance" if there is no profit or loss potential. The defendants

explicitly noted that Judge Lewis Kaplan had varied from this formulation in the *Stein* case and had instructed the jury in that case that "no reasonable probability" of profit was the correct standard. *See* Memorandum of Law in Support of Defendants' Joint Motion Requesting Pre-Trial Ruling on Issues of Economic Substance, Business Purpose, and Profit Potential (February 2, 2009). IA411-416. The District Judge ruled at the time that he would follow Judge Kaplan's formulation.

When this issue was raised during the charging conference and defense counsel stated that "it is our position that there need not to [sic] be a reasonable possibility of profit," Judge Stein replied, "We have been through this. You can submit whatever you want. I have made my ruling. As a matter of fact, I gave the jury initial charges on it." Tr. 5192 (IIIA477).

The instruction given by Judge Stein to the jury over defense objection was the following (Tr. 6176, VIA424):

> The first element is that there was no reasonable possibility that the transaction would result in a profit.

The importance of this definition of "economic substance" is proved by the number of times it was emphasized in the Government's summation. The prosecutor drummed home to the jury the standard that Judge Stein invoked – "reasonable possibility of profit" – by stating those words at least eight times during the Government's summation. IIIA567, 568, 570, 574.

In this Court's recently issued unpublished opinion and summary order in *United States v. Pfaff*, No. 09-1702, 2010 WL 3374102 (2d Cir. Aug. 27, 2010), in which a petition for rehearing *en banc* is pending, the Court approved the "no reasonable possibility" language in a criminal-prosecution jury instruction, citing *Goldstein v. Commissioner*, 364 F.2d 734, 740 (2d Cir. 1966) – a civil tax case. The validity of that standard in the context of a civil tax dispute is, of course, very different from its permissibility in a criminal tax-evasion prosecution which requires specific intent – the voluntary intentional violation of the known legal duty to pay a tax. *Cheek v. United States*, 498 U.S. 192, 199-201 (1991).

In the four criminal cases decided by this Court before *Pfaff* that concerned this issue, the Court consistently stated that the prosecution satisfies its burden of proving that the transaction lacks "economic substance" only if there is "no market risk" (*United States v. Manko*, 979 F.2d 900, 910 (2d Cir. 1992); *United States v. Regan*, 937 F.2d 823, 828 (2d Cir. 1991); *United States v. Atkins*, 869 F.2d 135, 140 (2d Cir. 1989)) or, in terms used in an even earlier decision of this Court, if it has "no risk of loss or chance for gain." *United States v. Ingredient Tech. Corp.*, 698 F.2d 88, 97 n.9 (2d Cir. 1983). That standard differs substantially from the "no reasonable possibility" standard that the District Judge directed the jury to apply in this case.

In its recent *Pfaff* summary order this Court minimized the difference between the two formulations. Addressing the "no market risk" language that had been approved in the four earlier Second Circuit decisions reviewing criminal convictions, the Court said in *Pfaff*, "But we have not held that those instructions state the outer limits of the economic substance doctrine." Summary Order, p. 1. An individual charged with a crime who faces imprisonment surely had a right to rely on the precise standard that this Court had repeatedly articulated. In order to provide the fair warning required for criminal prosecutions, the "outer limits" of the doctrine that separates lawful advocacy from criminal obstruction cannot be so indistinct and so elastic.

The Supreme Court has observed that some federal statutes, tax laws among them, are "highly technical" and therefore "present . . . the danger of ensnaring individuals engaged in apparently innocent conduct." *Bryan v. United States*, 524 U.S. 184, 194 (1998). *See also United States v. Regan*, 937 F.2d 823, 827 (2d Cir. 1991) ("One of the most esoteric areas of the law is that of federal taxation. It is replete with 'full-grown intricacies,' and it is rare that a 'simple, direct statement of the law can be made without caveat.'" (Citation omitted.)); *United States v. Pirro*, 212 F.3d 86, 90-91 (2d Cir. 2000); *United States v. Mallas*, 762 F.2d 361 (4th Cir. 1985).

Since "no market risk" was repeatedly approved by this Court as the governing "economic substance" criterion in a number of criminal cases between 1983 and 1992, the E&Y personnel, including these defendants, were entitled to rely on it. They could be confident that, regardless of the outcome of any civil litigation with the IRS, they were not committing a criminal offense if the tax strategy proposed to clients had *any* "risk of loss or chance of gain."

Indeed, even with respect to civil tax liability this Court's articulation of the governing standard provided substantial grounds to believe that *any* economic consequence apart from the tax benefit would qualify. *Jacobson v. Commissioner*, 915 F.2d 832, 837 (2d Cir. 1990) ("whether the transaction has any practicable effects other than the creation of income tax losses"); *Rosenfeld v. Commissioner*, 706 F.2d 1277, 1282 (2d Cir. 1983) ("whether there has been a change in the economic interests of the relevant parties"). And this conclusion is buttressed by the Supreme Court's opinion in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), in which a purchase-and-leaseback transaction that essentially eliminated any true economic risk was held by the Court "not a simple sham to be ignored" (435 U.S. at 580) because the taxpayer retained "significant and genuine attributes of the traditional lessor status." 435 U.S. at 584.

This Court followed the teaching of the *Frank Lyon* decision and rejected the IRS' position that a transaction lacked "economic substance" in *Newman v.*

Commissioner, 902 F.2d 159 (2d Cir. 1990). Other Circuits have applied a similar "no risk" standard. *See Sochin v. Commissioner*, 843 F.2d 351, 354 (9th Cir. 1988) ("any practical economic effects other than the creation of income tax losses"); *James v. Commissioner*, 899 F.2d 905, 908-09 (10th Cir. 1990); *Bryant v. Commissioner*, 928 F.2d 745 (6th Cir. 1991).

Finally, Congress recently enacted a statutory definition of "economic substance" to be included in the Internal Revenue Code. Pub. L. No. 111-152, Title I, § 1409(a), (124 Stat.) 1068, 26 U.S.C. § 7701(o). The House report noted the prior "lack of uniformity" in court decisions on this subject. The House report stated that "in assessing whether a reasonable possibility of profit exists, it may be sufficient if there is a nominal amount of pre-tax profit as measured against expected tax benefits." H.R. Rep. No. 111-443, pt. 1, at 294 (2010). Reliance on a "nominal amount of pre-tax profit" was sufficient to qualify for "economic substance" under the tax laws, particularly in a criminal prosecution. But under the formulation used in Judge Stein's jury instruction, the jury was prevented from considering it in the appellants' favor.

D. The District Judge Refused to Give the "Theory of Defense" Instruction to the Jury.

The defendants sought throughout the trial to demonstrate to the jury that their conduct and the advice they gave to clients of E&Y who used the E&Y

shelters was what any lawyer or accountant is required to do by the applicable ethical canon. That position was the essence of the appellants' defense, and they proffered a jury instruction in that regard. Judge Stein refused to give such an instruction. We adopt the arguments made at pp. 65-75 of the Brief for Richard Shapiro on this point.

E. The Jury Should Not Have Been Instructed on "Conscious Avoidance."

Over defense objection, Judge Stein instructed the jury that in determining whether the appellants acted "knowingly" with respect to CDS Add-On, the jury could infer a defendant's guilt if that defendant "acted with a conscious purpose to avoid learning the truth about whether or not the shelter had a reasonable possibility of a profit." VIA425. This "conscious avoidance" instruction was wholly inappropriate in the factual context of this case and seriously prejudiced appellants Nissenbaum and Shapiro – who had absolutely no reason to know of the fatal flaw in the profit potential of CDS Add-On before February 13, 2003 – long after the relevant tax returns were filed. We join and adopt the legal argument presented on this issue in the brief for appellant Richard Shapiro, pp. 75-80. The statements made in that brief with respect to appellant Shapiro apply equally, on the record of this case, to Mr. Nissenbaum.

CONCLUSION

For the foregoing reasons, Mr. Nissenbaum's judgments of conviction on Counts One, Two, Three, and Four should be vacated with instructions to enter a judgment of acquittal on all Counts. Alternatively, the case should be remanded for a new trial.

Respectfully submitted,

Dated: September 30, 2010

By /s/ *Nathan Lewin*

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(c) of the Federal Rules of Appellate Procedure, I hereby certify that, by the word count of the word-processing system used to prepare this Brief, it contains 13,265 words exclusive of those portions that are excluded under Rule 32(a)(7)(B)(iii).

By /s/ *Nathan Lewin*

Dated: September 30, 2010

CERTIFICATE OF SERVICE

I hereby certify that on September 30, 2010, the foregoing ***Brief for the Appellant Martin Nissenbaum*** was served on all counsel of record by CM/ECF and Federal Express at the addresses listed below:

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