



## TAX LITIGATION ISSUES

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### *When Can Feds Charge Tax, Nontax Crimes Together?*

Federal criminal cases frequently are brought against multiple defendants facing multiple charges, some of which are common to all defendants and some of which are not. Federal Rule of Criminal Procedure 8 dictates the proper joinder of offenses and defendants in an indictment. The U.S. Court of Appeals for the Second Circuit has recently clarified the application of this rule to indictments charging both tax and nontax crimes.

Rule 8(a) provides that multiple offenses may be joined in one indictment where they are: i) of the same or similar character; ii) based on the same act or transaction; or iii) connected with or constitute parts of a common scheme or plan.<sup>1</sup> Rule 8(b) goes on to state that two or more defendants may be joined in the same case if they are alleged to have participated in the same act or transaction, or in the same series of acts or transactions.<sup>2</sup> Thus, under Rule 8, joinder of defendants is only allowed when the defendants have participated in the same act or transaction. It is not sufficient that the alleged crimes are “of the same or similar character,” as permitted for joinder of offenses.

#### **‘United States v. Shellef’**

The application of Rule 8 recently was addressed by the Second Circuit in *United States v. Shellef*.<sup>3</sup> The case against Dov Shellef and his codefendant, William Rubenstein, grew out of a joint investigation by the Environmental Protection Agency and Drug Enforcement Administration into the supply of an ozone-depleting chemical called CFC-113 (CFC) to “meth” labs in California. In the course of that investigation, the government discovered that the individuals illegally manufacturing methamphetamine received CFC from a company



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called All Discount Lab Supplies, which received its CFC supply from Mr. Shellef, Mr. Rubenstein, and companies that they owned or operated.<sup>4</sup>

Mr. Shellef and Mr. Rubenstein were not alleged to have engaged in any drug-related activities. Rather, they were charged with conspiring to evade excise taxes due on sales of CFC. As part of its compliance with an international treaty regarding substances that deplete the ozone layer, the U.S. government imposes an excise tax on the sale or use of CFC by a manufacturer. The excise tax is designed to reduce the use of such substances, but where certain federal statutory and regulatory requirements are met, the sale of CFC is exempt from excise taxes. The government alleged that Mr. Shellef and Mr. Rubenstein did not comply with federal requirements when buying and selling CFC and, therefore, improperly claimed exemption from excise taxes on the CFC.<sup>5</sup>

Mr. Shellef and Mr. Rubenstein were charged jointly with conspiracy to defraud the Internal Revenue Service (IRS) by impeding its collection of excise taxes. Both defendants also were charged with multiple counts of wire fraud based on their conduct in connection with the sale of CFC. Specifically, the government argued that the defendants misrepresented to their suppliers that they were buying CFC to be exported, thereby causing the suppliers not to charge excise taxes.<sup>6</sup> Mr. Shellef was also indicted on 41 counts of money laundering arising out of the underlying conspiracy and wire fraud counts.<sup>7</sup>

In addition to these charges, the government charged Mr. Shellef with three tax-related

offenses: tax evasion on his personal return for 1996; subscribing to a false corporate return for 1996; and corporate tax evasion for 1999. Mr. Rubenstein was not named in these counts.

Before trial, Mr. Shellef and Mr. Rubenstein unsuccessfully moved pursuant to Rule 8 to sever the tax counts in the indictment from the nontax counts. After a five-week trial, both defendants were convicted on all counts against them. Subsequently, Mr. Shellef was sentenced principally to 70 months in prison, and Mr. Rubenstein was sentenced principally to 18 months in prison.

On appeal, the defendants argued that the 1996 tax fraud charges against Mr. Shellef improperly were joined with the other counts in the indictment.<sup>8</sup> The 1996 tax counts focused on undisclosed business and personal receipts. During 1996, one of Mr. Shellef's businesses, PolyTuff USA, allegedly deposited almost \$2 million into an account that Mr. Shellef did not disclose to PolyTuff's accountant and the income did not appear on the company's tax return. Similarly, Mr. Shellef allegedly failed to report almost \$1 million additional income that he received in 1996, which he had deposited into undisclosed accounts. In 1999, Mr. Shellef also allegedly failed to report approximately \$780,000 that another of his companies, Poly Systems, received from the sale of CFC. These funds had been deposited into accounts at North Fork Bank and Commercial Bank of New York, which Mr. Shellef did not disclose to the accountant preparing Poly Systems' 1999 return. Mr. Shellef also failed to disclose personal income in 1999.<sup>9</sup>

#### **Application of Rule 8**

As a threshold matter, the Second Circuit addressed whether Rule 8(a), governing the joinder of offenses, or Rule 8(b), governing the joinder of defendants, applies when a defendant in a multidefendant, multicount prosecution challenges the joinder of a count in which he is the only defendant charged.<sup>10</sup>

While noting that the answer to this question is not well-settled, the court found it unnecessary to resolve the issue. Rather, the government had

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asserted that the joinder was proper under either subsection, arguing that the 1996 tax charges were “based on the same act or transaction” as the other charges the jury was to consider,” and that all of the charges, including the 1996 tax charges, shared a common nucleus in that they arose from the sale of CFC.<sup>11</sup> Describing the government’s failure to defend the joinder of the offenses under Rule 8(a)’s “same or similar character” clause as “critical,” the Second Circuit observed that the government’s position meant that if it were to find that the 1996 tax charges against Mr. Shellef were not “based on the same act or transaction” as the other charges brought against Mr. Shellef and Mr. Rubenstein, then both the joinder of the charges and the joinder of defendants were improper.<sup>12</sup>

## Joinder of Offenses

• **Under Rule 8(a).** Initially, the court focused on the joinder of the charges against Mr. Shellef and the defendants’ argument that the 1996 tax charges should not have been joined with the remaining counts in the indictment, including the 1999 tax charge. The court noted that it applies a “commonsense rule” to decide whether the joinder of charges is proper; “whether, in light of the factual overlap among charges, joint proceedings would produce sufficient efficiencies such that joinder is proper notwithstanding the possibility of prejudice to either or both of the defendants resulting from the joinder.”<sup>13</sup>

It is well-established that tax counts may be joined with nontax counts where the funds derived from the nontax violation “either are or produce the unreported income.”<sup>14</sup> For this reason, the conspiracy and wire fraud charges against Mr. Shellef and Mr. Rubenstein properly could have been joined with the 1999 tax count against Mr. Shellef, which related to unreported income generated through the conduct underlying the fraud and conspiracy charges. Further, the court noted that because common facts existed between the 1996 tax counts and the 1999 tax count, the two sets of tax counts properly could have been joined as well.

The court, however, found that the fact that the 1996 tax counts properly could be joined with the 1999 tax count, and that the 1999 tax count properly could be joined with the nontax counts, was not sufficient to justify the joinder of the 1996 tax counts to the nontax counts.

Rather, the court observed that the necessary connection between the 1996 tax counts and the nontax counts could not be established. “Indeed, the alleged 1996 tax violations took place before the conspiracy and wire fraud allegedly began. The government’s contention that all the charges ‘share a common nucleus, the sale of CFC-113,’ paints the allegations with too broad a brush.”<sup>15</sup> Thus, “the fact that the businesses that produced the 1996 unreported income were subsequently used to perpetrate the alleged conspiracy and wire fraud does not justify a conclusion that the

offenses are based on the same act or transaction, or are connected with or constitute parts of a common scheme or plan.”<sup>16</sup>

Finally, the court concluded that requiring the 1996 tax counts to be tried separately from the other crimes would not require the government to prove the same set of facts more than once. “Because [c]ommission of [the alleged wire fraud and conspiracy] neither depended upon nor necessarily led to the commission of’ the alleged 1996 tax misconduct and ‘proof of the one act neither constituted or depended upon proof of the other,’ joinder was improper.”<sup>17</sup>

Having determined that there was a misjoinder of offenses, the court analyzed whether the misjoinder was harmless. Reversal would be required “only if the misjoinder results in actual prejudice because it had substantial and injurious effect or influence in determining the jury’s verdict.”<sup>18</sup> Relevant to this inquiry is whether the evidence required to prove the wrongfully joined offense would have been admissible at a separate trial of the other counts.

## The Nontax Counts

The court concluded that the misjoinder was not harmless with respect to the nontax counts. Although evidence regarding the 1996 tax counts may have been relevant on the issue of Mr. Shellef’s state of mind with respect to the 1999 tax count, the court said that it would have been subject to exclusion during a separate trial of the 1999 tax and nontax counts under Federal Rule of Evidence 403 and 404(b).

First, the jury may have improperly applied the other acts evidence beyond the 1999 tax counts to the nontax counts. Second, the jury might have interpreted the 1996 tax counts evidence as an indication of Mr. Shellef’s criminal tendencies. The court noted that an instruction limiting the jury’s use of evidence relating to the 1996 tax count may have cured any potential prejudice. However, since no instruction was given in this case, the misjoinder of the 1996 tax counts with the nontax counts was not harmless and mandated reversal.<sup>19</sup>

## The 1996 Tax Counts

The court then noted that the prejudicial misjoinder of the 1996 tax counts and the nontax counts was a “two-way street.” Thus, just as the inclusion of the 1996 tax counts was prejudicial to jury’s consideration of the nontax counts, the inclusion of the nontax counts was similarly prejudicial to the jury’s consideration of the nontax counts.

## The 1999 Tax Count

Finally, the court also concluded that the misjoinder also mandated reversal of Mr. Shellef’s conviction on the 1999 tax count. Although evidence regarding the 1996 tax counts may have been relevant to the trial of the 1999 tax count,

“a limiting instruction was required to prevent the jury from improperly considering such evidence as demonstrating Shellef’s propensity to commit crimes of deceit.”<sup>20</sup> Because the district court’s instruction in his regard was limited to uncharged conduct (as opposed to conduct that was, in fact, charged), the court found it was not adequate to avoid this prejudice.

## Joinder of Defendants

After thorough analysis of the appropriateness of the joinder of offenses, the court only briefly addressed Mr. Rubenstein’s convictions, finding that the potential for jury bias by inclusion of evidence related to the 1996 tax counts was even greater in Mr. Rubenstein’s case than in that of Mr. Shellef. This was so “because [Rubenstein] had no connection at all with the 1996 Tax Count, but also because he chose not to testify yet may have suffered from any adverse credibility determinations made by the jury regarding Shellef’s testimony.” Accordingly, Mr. Rubenstein’s convictions for conspiracy and wire fraud also were vacated.<sup>21</sup>

## Conclusion

The court’s decision in *Shellef* is an important reminder of the careful analysis necessary to evaluate the joinder of tax and nontax counts. While the government commonly tries to expand indictments, *Shellef* demonstrates the limits of joinder, even where the misjoined counts share certain commonalities.



1. Fed. R. Crim. P. 8(a).
2. Fed. R. Crim. P. 8(b).
3. \_\_\_F.3d\_\_\_, 2007 WL 3286908 (2d Cir. Nov. 8, 2007).
4. Department of Justice, Press Release, “Businessmen Convicted in Scheme to Evade \$1.9 Million in Taxes on Sales of Ozone-Depleting Chemical” (Aug. 4, 2005).
5. 2007 WL 3286908, \*3.
6. Id. at \*8.
7. Id.
8. In its opinion, the Second Circuit noted the distinction between Mr. Shellef’s pretrial argument, seeking severance of all the tax claims from the case, and his appellate argument, positing that only the 1996 tax claims should have been severed. The court noted that since the government did not contend that Mr. Shellef’s argument on appeal was waived, it would consider the issue as briefed. Id. at \*8 n.11.
9. Id. at \*9.
10. The Circuit Court noted that the answer to the question was not well-settled in the Second Circuit. Id. at \*10, n. 12.
11. Id. at \*10.
12. Id.
13. Id. at \*11.
14. See *United States v. Turoff*, 853 F.2d 1037, 1043 (2d Cir. 1988).
15. 2007 WL 3286908 at \*12.
16. Id.
17. Id.
18. Id. at \*13 (citing *United States v. Lane*, 474 U.S. 438, 449 (1986)).
19. Id. at \*14.
20. Id. at \*15.
21. Id. at \*16.