

## TAX LITIGATION ISSUES

BY JOHN J. TIGUE JR. AND JEREMY H. TEMKIN

### *The Wesley Snipes Trial*

In Wesley Snipes' famous role as a basketball hustler in the movie "White Men Can't Jump," his character tries to teach Woody Harrelson's character a life lesson about getting conned, saying "You either smoke, or you get smoked."

In the recent courtroom battle between Mr. Snipes and the U.S. government, it was initially difficult to decide which side "got smoked." Both claimed victory—the government for three misdemeanor tax convictions and Mr. Snipes for two felony and three misdemeanor acquittals. At the end of April, however, Mr. Snipes was sentenced to three years in prison, thus giving greater credence to the government's assertion that it "won" the case.

However, the Snipes case demonstrates that tax protestor cases, often based on seemingly inane defenses, may prove more difficult for the government than expected.

#### The Case Against Snipes

On Oct. 17, 2006, Mr. Snipes, Eddie Ray Kahn, the founder and leader of two tax protestor organizations, and Douglas Rosile, an accountant who worked for those organizations, were indicted on federal tax fraud charges. The indictment alleged that Mr. Kahn's organizations were "for-profit, commercial enterprises that promoted and sold fraudulent tax schemes."<sup>1</sup>

The government asserted in Count One that Mr. Snipes conspired with Mr. Kahn and Mr. Rosile to defraud the United States by "impeding, impairing, obstructing and defeating the lawful government functions of the Internal Revenue Service" in the collection of income taxes. Specifically, the indictment detailed efforts by Mr. Snipes and the others to make it appear as if Mr. Snipes had no tax liability by relying on a common tax protestor argument that U.S. residents are not subject to taxes on wages and income derived within the country. This assertion, referred to as the "861 argument" because it relies on language contained in §861 of the Internal Revenue Code, is among



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the positions listed in the IRS's publication "The Truth About Frivolous Tax Arguments."

In furtherance of the conspiracy, the indictment alleged that Mr. Snipes willfully failed to file federal income tax returns beginning in 1999, and that Mr. Snipes and the others knew that the 861 argument was "false" and had been repeatedly rejected by courts. The indictment also alleged that Mr. Snipes had filed an amended tax return that fraudulently sought a refund of more than \$7 million for the tax year 1997. The amended 1997 return formed the basis for Count Two of the indictment, which charged that Mr. Snipes had filed a false, fictitious or fraudulent claim in violation of §287 of Title 18.<sup>2</sup> Finally, the indictment also charged Mr. Snipes with six misdemeanor counts of willfully failing to file income tax returns for the years 1999 through and including 2004.<sup>3</sup>

#### Pretrial Jostling

At the time of Mr. Snipes' arraignment, his attorney asserted that "the evidence in the case will show [Mr. Snipes] has been the victim of unscrupulous tax advice. And this trial will help vindicate him."<sup>4</sup> Mr. Snipes' defense began to take form. In June 2007, Mr. Snipes moved to dismiss the charges against him, arguing in part that the indictment was "impermissibly brought on the basis of Mr. Snipes' race" and should be "dismissed based on selective prosecution" grounds.

Specifically, Mr. Snipes objected to the fact that his two white codefendants had only been charged in the first two counts, and that Mr. Kahn had not been charged with failure to file even though he too had not filed his federal income tax returns between 1997 and 2002. In the memorandum supporting his motion, Mr. Snipes again claimed that he had been "a victim of unscrupulous tax advice" given by [Mr.] Rosile and [Mr.] Kahn.<sup>5</sup>

Commentators said that Mr. Snipes was "grasping at straws" in arguing selective prosecution. Some noted that selective prosecution requires a showing that similarly situated individuals were not prosecuted for violating the same statute as well as proof that the prosecution was due to an "arbitrary classification."<sup>6</sup> One observer wrote "[Mr.] Rosile and [Mr.] Kahn are being prosecuted as the promoters of the tax evasion scheme—charges likely to lead to longer sentences—while Mr. Snipes is being prosecuted for using it. And considering how Mr. Kahn [who has been denied bail] remains in custody...while Mr. Snipes is free on bond, it's not clear how the white guy is getting favored treatment."<sup>7</sup>

In denying Mr. Snipes' motion to dismiss, Senior U.S. District Court Judge William Terrell Hodges rejected the argument that Mr. Snipes was the victim of a selective prosecution. Rather, Judge Hodges said that the goal of general deterrence was possibly served by the government prosecuting Mr. Snipes on additional charges: "Since the government lacks the means to investigate and prosecute every suspected violation of the tax laws, it makes good sense to prosecute those who will receive, or are likely to receive, the attention of the media."<sup>8</sup>

Mr. Snipes' pretrial motion also sought a change of venue from the federal courthouse in Ocala, Fla., to his district of "legal residence," the Southern District of New York and a severance from his codefendants on the grounds that the defenses would be "antagonistic to each other." The court denied both motions.<sup>9</sup>

#### Twists and Turns at Trial

At trial, Mr. Snipes' attorneys consistently characterized Mr. Snipes as the victim of his codefendants' nefarious scheme. During opening statements, Mr. Snipes' lawyer referred to his client as "the [local] boy who made good" and stated that "[h]e has never, ever been a tax protester." Contradicting the prosecution's assertion that Mr. Snipes fully understood the tax scheme promoted by Mr. Rosile and Mr. Kahn, Mr. Snipes' attorney asserted that Mr. Snipes had sought tax and investment advice from Mr. Kahn's tax group because he was dissatisfied with the New York firm that had handled his affairs up to that point, and not because he intended to join the protestor's movement.<sup>10</sup> Mr. Snipes' defense team further argued that Mr. Kahn and Mr. Rosile had "betrayed and exploited [Mr.] Snipes—confusing him with legal opinions that he owed no federal taxes and also was due a hefty refund for past overpayments."<sup>11</sup>

To prove Mr. Snipes' wrongful intent, the prosecution relied on the testimony of his former investment

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adviser who claimed that in 2000, after Mr. Snipes had started working with Mr. Kahn and Mr. Rosile, he had a lengthy telephone conversation with Mr. Snipes during which he tried to convince Mr. Snipes to pay his taxes. The former adviser claimed that “[Mr.] Snipes was adamant about the fact that he did not have that obligation. I said that was ridiculous; that everyone has that obligation. He said he had spoken to some people that said he didn’t have to.”<sup>12</sup>

The government also offered numerous letters that Mr. Snipes had sent to the IRS claiming that the government had failed to demonstrate that he was required to pay taxes. The government characterized these letters as frivolous correspondence used to dodge taxes. The defense countered that Mr. Snipes was merely asking for information: “He simply asked the IRS whether this innovative way to file returns was allowed. He did what every other American is entitled to. Asking questions is not a crime, even if the IRS would like it to be.”<sup>13</sup>

Issues surrounding Mr. Snipes’ intent were of primary importance in the case. “Willfulness,” for purposes of criminal tax laws, requires the government to prove that the law imposed a duty on the defendant, that the defendant knew of the duty, and that he voluntarily and intentionally violated that duty. Where a defendant can demonstrate that he had a good faith belief that he was not under a duty to pay taxes, the government has failed to meet this burden. Moreover, in *United States v. Cheek*, the Supreme Court held that a good-faith belief need not be objectively reasonable in order for it to negate evidence of the defendant’s awareness of his duties under the tax laws. In other words, “it is not contrary to common sense, let alone impossible, for a defendant to be ignorant of his duty based on an irrational belief that he has no duty, and forbidding the jury to consider evidence that might negate willfulness would raise a serious question under the Sixth Amendment’s jury trial provision.”<sup>14</sup>

After the prosecution’s case in chief, the defense unexpectedly rested without calling any witnesses. Given the decision to rely on a “reasonable doubt” defense, it was not surprising that Mr. Snipes’ attorney claimed that the defense “could have put on a big show” by calling a number of celebrity witnesses to testify on Mr. Snipes’ behalf, but to do so would have been a waste of the jury’s time given the prosecution’s failure to make their case.<sup>15</sup>

In their closing argument, Mr. Snipes’ lawyers portrayed him as a “well-intended victim of bad advice by his codefendants. They called his tax theories ‘kooky,’ ‘crazy’ and ‘dead wrong,’ but said acting on these views did not make him a criminal because he disclosed his actions.”<sup>16</sup> In accordance with *Cheek*, Judge Hodges instructed the jury that “good faith is a complete defense to the charges in the indictment since good faith on the part of the Defendant is inconsistent with intent to defraud or willfulness which is an essential part of the charge,” and that “one who expresses an honestly held opinion, or an honestly formed belief, is not chargeable with fraudulent intent even though the opinion is erroneous or the belief is mistaken; and, similarly, evidence which establishes only that a person made a mistake in judgment or an error in management, or was careless, does not establish fraudulent intent.”<sup>17</sup>

On Feb. 2, 2008, the jury returned a verdict acquitting Mr. Snipes on the felony conspiracy and fraudulent claim for refund charges in Counts One and

Two of the indictment. In addition, Mr. Snipes was acquitted of three of the misdemeanor charges of failing to file tax returns. However, Mr. Snipes was convicted of the misdemeanor charges with respect to the years 1999, 2000 and 2001.<sup>18</sup> Mr. Snipes’ codefendants, Mr. Rosile and Mr. Kahn, were convicted of the two felony counts.<sup>19</sup>

Both sides claimed victory. The government asserted that “[t]he jury’s conviction of Wesley Snipes today represents the latest in a long string of criminal convictions by the Justice Department and the IRS against tax protestors. Those who unlawfully dodge their tax obligations should know that they face long prison terms and stiff financial penalties.”<sup>20</sup> By contrast, Mr. Snipes’ lawyer viewed the verdict as vindication of the defense position that Mr. Snipes had not committed fraud.<sup>21</sup>

### Post-Trial Commentary

After trial, the IRS made it clear that it still intends to pursue the taxes owed by Mr. Snipes on roughly \$38 million in income. For this reason alone, many viewed Mr. Snipes’ so-called “victory” as hollow. One commentator noted that Snipes will “have to pay the back taxes due, with considerable penalties and interest, and he faces up to three years in jail. He probably has a substantial defense attorney bill to pay as well, and could still face civil tax fraud charges. That’s not exactly the rosy result the promoters of the tax protest movement promise their followers.”<sup>22</sup>

Commentators also assert that the government’s claim of victory was similarly disputable, going so far as to suggest that Congress should revise the tax laws to negate the subjective analysis required by *Cheek*. Thus, one commentator has recommended that Congress define the concept of willfulness “so that people who ignore the advice of competent tax professionals in favor of what scam artists tell them cannot claim they seriously believe that the tax laws do not apply to their income.”<sup>23</sup>

### On the Day of Sentencing

Mr. Snipes’ sentence on April 24, 2008, adds an interesting post-script to the case. Facing up to one year imprisonment on each of the misdemeanor charges of failing to file income tax returns, Mr. Snipes apparently attempted to deposit three envelopes containing \$5 million in checks with the judge during the day-long sentencing hearing. Mr. Snipes’ offer, meant to demonstrate his intent to accept responsibility and pay his taxes, was rejected by both Judge Hodges and prosecutors who claimed they were not authorized to accept the money. The payment later was accepted by an IRS agent as a “down payment” on monies owed, alleged to be more than \$15 million.<sup>24</sup>

During the hearing, the defense submitted letters from celebrities including Woody Harrelson and Denzel Washington urging the court to impose a probationary sentence on Mr. Snipes. Mr. Snipes referred to himself as an “idealistic, naïve, passionate, truth-seeking, spiritually motivated artist, unschooled in the science of finance” and claimed that his wealth and celebrity attracted “wolves and jackals like flies are attracted to meat.” Ultimately, however, Judge Hodges sentenced Mr. Snipes to the three-year maximum term of imprisonment, finding that Mr. Snipes exhibited a

“history of contempt over a period of time” for tax laws. Judge Hodges stated, “In my mind these are serious crimes, albeit misdemeanors.”<sup>25</sup> Nonetheless, Mr. Snipes could consider himself fortunate. Consistent with the notion that Mr. Snipes’ race-based selective prosecution motion lacked merit, Judge Hodges treated the promoters of the evasion scheme more harshly, sentencing Mr. Kahn to 10 years imprisonment and Mr. Rosile to 54 months.



1. Indictment, *United States v. Snipes, et al.*, 5:06-cr-22, 2006 WL 2985589, at ¶4.

2. Id. at Counts One and Two; see also Press Release, Department of Justice, “Wesley Snipes and Two Others Indicted on Tax Fraud Charges” (Oct. 17, 2006).

3. Id. at Counts Three through Eight.

4. The Associated Press, “Wesley Snipes Arrested for Tax Evasion” (Dec. 8, 2006) (quoting Mr. Snipes’ original attorney, Billy Martin).

5. Snipes Motion to Dismiss All Counts in the Indictment, *United States v. Snipes, et al.*, 5:06-cr-22, 2007 WL 1702746 (June 4, 2007).

6. Ellen S. Podgor, “Wesley Snipes Moves to Dismiss Tax Charges,” White Collar Crime Prof Blog (June 11, 2007).

7. Joe Kristan, “Will the O.J. Defense Work for Snipes?” Tax Update Blog (June 9, 2007).

8. Order on Motions, *United States v. Snipes*, 5:06-cr-22 (Sept. 5, 2007) (citing *United States v. Catlett*, 584 F.2d 864, 868 (8th Cir. 1978)) (available at [http://taxprof.typepad.com/taxprof\\_blog/files/snipes\\_order.pdf](http://taxprof.typepad.com/taxprof_blog/files/snipes_order.pdf)).

9. Order on Motions, *United States v. Snipes*, 5:06-cr-22 (Sept. 5, 2007).

10. Stephen Hudak, “Snipes’ Lawyer: Anti-Tax Group Exploited Actor,” Orlando Sentinel (Jan. 17, 2008).

11. Id.

12. Travis Reed, “Ex-Snipes Tax Adviser Testifies in Trial,” Associated Press (Jan. 18, 2007).

13. Id.; Hudak, “Snipes’ Lawyer: Anti-Tax Group Exploited Actor.”

14. 498 U.S. 192, 203 (1991).

15. Stephen Hudak, “Defense Lacks Star Power, Snipes’ Lawyers Rest Without Calling Witnesses,” Orlando Sentinel (Jan. 29, 2008).

16. Associated Press, “Tax Case vs. Snipes Ends,” Wall Street Journal (Feb. 2, 2008).

17. Court’s Instructions to the Jury, *United States v. Snipes*, 5:06-cr-22, 2008 WL 356868 (Feb. 1, 2008). Although a defendant is entitled to a jury instruction presenting the theory of his defense, the defendant usually is required to present some evidence supporting his proposed instruction. Given that none of the defendants testified, it is unclear how Mr. Snipes presented evidence sufficient to support the *Cheek* instruction, although such an instruction can be premised on testimony from other witnesses or documentary evidence.

18. Verdict, *United States v. Snipes*, 5:06-cr-22, 2008 WL 356869 (Feb. 1, 2008).

19. David Cay Johnston, “Wesley Snipes is Acquitted of Tax Felonies,” The New York Times (Feb. 1, 2008); Associated Press, “Tax Case vs. Snipes Ends.”

20. Press Release, Department of Justice, “Jury Finds Wesley Snipes Guilty on Three Misdemeanor Charges and Acquits Him of Two Felony Charges” (Feb. 1, 2008).

21. CNN, “Snipes Acquitted of Tax Fraud, Conspiracy,” CNN.com (Feb. 1, 2008).

22. Linda Beale, “It Doesn’t Pay Not to File Your Taxes: Wesley Snipes,” A Taxing Matter Blog (Feb. 2, 2008); see also, Neil H. Buchanan, “A Conviction Is a Conviction, and Wesley Snipes Was Convicted,” Dorf on Law Blog (Feb. 7, 2008).

23. David Cay Johnston, “Wesley Snipes Is Acquitted of Tax Felonies.”

24. Paul L. Caron, “Judge Gives Maximum Three Year Sentence to Wesley Snipes After Defense Hands Judge \$5M,” Tax Prof Blog (April 24, 2008).

25. Associated Press, “Judge Sentences Snipes to 3 Years for Tax Convictions” (April 24, 2008).