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Expert Analysis

TAX LITIGATION ISSUES

Dual Prosecution for Tax Offenses: Closing the 'Helmsley Loophole'

By
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Because state individual income tax returns reflect income and deductions reported on federal returns, a taxpayer engaged in fraud in connection with his federal taxes likely will also be subject to state prosecution. For more than 20 years, the ability of New York state prosecutors to pursue charges against defendants previously convicted in federal court was restricted by the Appellate Division's decision precluding the dual prosecution of hotelier Leona Helmsley. On June 21, 2011, however, the New York State Legislature closed the so-called "Helmsley loophole" by excluding tax offenses from coverage under the state's double jeopardy statute.[1]

When the amendment becomes effective on Oct. 18, 2011, practitioners may be forced to rely on discretionary arguments to defeat dual prosecutions. However, while there may be egregious cases in which both federal and state authorities will be warranted in pursuing the same defendant, given the limited governmental resources, as well as the ability of federal prosecutions to vindicate state interests, there is reason to be hopeful that such dual prosecutions will continue tobe rare.

Double Jeopardy Statute

While both the U.S. and the New York State Constitutions protect defendants against double jeopardy, under the "dual sovereignties" doctrine, the constitutional provisions do not bar federal and state governments from pursuing successive prosecutions, and imposing separate punishments, for the same conduct.[2] Through Section 40.20 of the Criminal Procedure Law, however, New York has provided broader protection against double jeopardy than is otherwise available under either the federal or state constitutions.[3]

Section 40.20 provides that "a person may not be separately prosecuted for two offenses based upon the same act or criminal transaction" unless the case falls within an enumerated exception. Thus, where a defendant has been "prosecuted"—i.e., when an accusatory instrument has been filed and either (1) the defendant has pleaded guilty or (2) jeopardy has attached through the swearing-in of a jury or of the first witness in the case of a non-jury trial[4]—Section 40.20 mandates a two-stage analysis. First, the court will examine whether the offenses forming the basis for each prosecution are "so closely related in purpose or objective" as to form parts of the same criminal transaction.[5] And second, the court will consider whether any of the exceptions to the broad prohibition against dual prosecution apply.

The 'Helmsley' Decision

On March 31, 1988, Leona Helmsley was charged in a 188-count state indictment alleging that she charged personal home renovation expenses to entities she controlled and filed false personal and corporate state income tax returns that treated the renovations as business expenses rather than income to Helmsley and her husband. Two weeks later, Helmsley was charged in a federal indictment covering the same conduct and time period as the state charges. The federal indictment alleged that Helmsley engaged in a conspiracy to defraud the Internal Revenue Service and falsified federal individual and corporate income tax returns, premised on the same fraudulent business deductions and unreported income as the state charges. Helmsley was also charged with mail fraud based on the submission of false income tax returns to the New York State Department of Taxation and Finance.

> Under the amended double jeopardy statute, the vast majority of federal tax offenders are subject to the possibility of dual prosecution.

The federal charges were tried first. Helmsley was convicted of 33 of 47 counts, sentenced to 18 months in prison, and ordered to pay $7 million in fines and approximately $1.7 million in restitution for federal and state taxes owed.[6] Thereafter, Helmsley moved to dismiss the state indictment pursuant to Section 40.20.

Affirming the trial court's dismissal of the state charges, the Appellate Division, First Department, first found that the acts described in the federal and state indictments reflected the same criminal purpose—to renovate the Helmsleys' homes at the taxpayers' expense by falsely claiming deductions for business expenses—and the acts constituted integral parts of a single criminal venture.[7] Looking to the charging documents, the court determined that the conduct alleged in the state indictment either was or could have been charged in the federal prosecution, and therefore constituted the same criminal transaction.

In the second stage of the analysis, state prosecutors argued that their prosecution fell within three separate statutory exceptions to Section 40.20. First, the People relied on Section 40.20(2)(a), which requires that the offenses have substantially different elements and the acts establishing one offense be clearly distinguishable from those establishing the other. In rejecting this exception, the court acknowledged some small differences in the elements of the federal and state offenses charged, but found that these differences were not substantial. Rather, the court found that, "strikingly," the acts establishing the state conspiracy, false instrument, and fraud offenses were "for the most part identical" to the acts establishing the federal conspiracy, fraud, and tax offenses.[8]

The court likewise rejected the People's reliance on Section 40.20(2)(b), which requires that each of the offenses charged in the two indictments contains an element that is not an element of the other, and that the statutes are designed to prevent very different kinds of harm or evil. The court again acknowledged that the state and federal crimes with which Helmsley was charged included different elements. However, the court found "nothing different *in kind*" between the evils the state and federal governments sought to prevent through their respective fraud and tax statutes.[9]

Finally, while Section 40.20(2)(e) allows separate prosecutions where each offense involves loss or injury to a different victim, the court held that this exception requires that all of the "victims" of the charged offenses be uniquely identifiable individuals. By contrast, the victims in the *Helmsley* prosecution were collective or sovereign entities.[10] Because no statutory exceptions prevented application of the broad double jeopardy prohibition in Section 40.20, the state charges against Helmsley were dismissed in their entirety.

Post-'Helmsley' Prosecutions

Subsequent case law suggested that the double jeopardy statute did not absolutely bar successive prosecutions in tax-related cases. In *Sharpton v. Turner*,[11] decided six months after *Helmsley*, the Appellate Division, Third Department, allowed a state tax prosecution to go forward despite the

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defendant's prior acquittal in a different county on fraud charges stemming from the same conduct. The petitioner in *Sharpton* had been acquitted in Supreme Court, New York County, of charges of scheme to defraud, falsifying business records and grand larceny in connection with his alleged use of business accounts to conceal income and evade taxes. The petitioner then sought to bar a subsequent prosecution in Supreme Court, Albany County, on charges of offering a false instrument for filing, filing a false return, and failing to file a return on double jeopardy grounds.

The Albany charges were premised on the defendant's use of the same business accounts to conceal income during the period at issue in the New York indictment. After rejecting petitioner's federal constitutional claims, the court held that both sets of charges were part of the same criminal transaction, as part of petitioner's alleged purpose in committing both the New York and Albany offenses was to evade state taxes.

The *Sharpton* court, however, found that the Albany prosecution fell within the exception set forth in Section 40.20(2)(b) in that the statutes charged in each case were intended to prevent very different harms or evils. The scheme to defraud violations charged in the New York County case sought to prevent "the deceitful theft of property from consumers," and the business records offense sought to prevent "the defrauding of a business entity by falsification of its records."[12] Those statutes did not share the purpose of the statutes charged in the Albany prosecution: punishing tax evasion and defrauding the state of revenues. Thus, the court allowed the Albany prosecution to proceed.

Sharpton's reasoning would apply equally where state tax evasion charges are pursued first and fraud and falsification of business records charges are brought in a subsequent state prosecution. New York courts, however, were never asked to consider whether the double jeopardy statute permits a state prosecution for fraud or falsification of business records brought subsequent to a federal tax prosecution.

Since *Helmsley* and *Sharpton* were decided, state prosecutors have pursued successive prosecutions of federal tax defendants only in rare instances. In a few cases, state and federal prosecutors have cooperated to facilitate the dual prosecution. This occurred in several of the recent prosecutions for failure to report income from offshore bank accounts: As part of their federal plea agreements, taxpayer-defendants were required to waive statutory double jeopardy arguments, agree to plead guilty to New York State tax offenses, and agree to pay all state taxes due and owing. While the federal government's insistence on such waivers stripped the double jeopardy statute of the protections provided under *Helmsley*, the existence of the statutory rights gave defendants negotiating leverage with state prosecutors.

Double Jeopardy Amendment

In early June of this year, Attorney General Eric Schneiderman and Manhattan District Attorney Cyrus Vance Jr. drafted a bill to eliminate the "Helmsley loophole." As described by Mr. Schneiderman, the bill "unties the hands of state prosecutors so that all tax violations can be prosecuted to the fullest extent of the law."[13] By late June, the bill had passed the Legislature with overwhelming support.

The new statute eliminates *Helmsley's* applicability by adding an exception to Section 40.20(2). It provides that a person shall not be separately prosecuted for two offenses based upon the same act or criminal transaction unless one of the offenses is a violation of enumerated federal tax statutes[14] "where the purpose is to evade or defeat any federal income tax or the payment thereof" and the other offense is a violation of enumerated state statutes[15] "where the purpose is to evade or defeat any New York State or New York City income taxes."

Nearly every federal tax prosecution involves a violation of one of the enumerated federal statutes and evidence of the defendant's intent to evade taxes; and in most cases, the same conduct could also give rise to a violation of at least one of the enumerated state statutes. Thus, under the amended double jeopardy statute, the vast majority of federal tax offenders are subject to the possibility of dual prosecution. Public statements by Messrs. Schneiderman and Vance, and the legislative sponsors make clear that prosecutors are directed to, and intend to, use this new power broadly.[16]

Options for Defense Counsel

Although the double jeopardy amendment eliminated one legal argument against dual prosecutions in tax cases, defense counsel can still argue that such prosecutions should be rare given prosecutorial resource constraints and policy considerations. First, because the amendment substantially increases the number of potential cases state prosecutors will have the power to bring, counsel can and should argue that the state's limited resources are more appropriately spent on pursuing cases involving conduct that is both egregious and has not been punished separately.

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Second, counsel can urge state prosecutors to look to the Department of Justice's Petite Policy[17] for guidance as to when a successive prosecution is appropriate. Under Justice Department guidelines, federal prosecutors are precluded from pursuing a defendant based on substantially the same acts or transactions involved in a prior state or federal proceeding unless three prerequisites are met: (1) the matter involves a substantial federal interest, which (2) was left demonstrably unvindicated by the initial prosecution,[18] and (3) the government believes that the defendant's conduct constitutes a federal offense and the admissible evidence is likely to sustain a conviction. Because state tax loss is frequently considered in connection with sentencing of federal tax defendants,[19] and because defendants who amend their federal income tax returns as a condition of federal plea agreements will also be required to amend their New York State returns,[20] a federal tax prosecution will generally vindicate the state's interests without the incremental allocation of limited resources.

Finally, counsel unable to dissuade state prosecutors from pursuing dual charges should consider moving to dismiss a successive state prosecution in the interests of justice and fairness.[21] *Clayton* motions are premised solely on the justice to be served by dismissal, and may be brought where there is no legal basis for dismissal and regardless of the guilt or innocence of the defendant. While *Clayton* motions are rarely granted, a convincing argument for dismissal can be made, particularly where the federal case resulted in a significant sentence, the defendant has agreed to pay taxes and interest owed to the state, and the state seeks a minimal incremental punishment.

Conclusion

The recent amendment to New York's double jeopardy statute strips tax defendants of one significant protection against successive prosecutions by federal and state authorities. It remains to be seen whether this will result in a sharp increase in the number of dual prosecutions, or whether prosecutors will exercise restraint as a discretionary matter. Clearly, the burden will fall on defense counsel to advocate against "double-teaming" their clients based on virtually identical conduct.

1. This bill, Assembly Bill A8247A, was signed into law on July 20, 2011. It becomes effective on the 90th day following that date, and applies only to offenses committed on or after the effective date.
2. *People v. Rivera*, 60 N.Y.2d 110, 114 (1983).
3. *Polito v. Walsh*, 8 N.Y.3d 683, 690 (2007).
4. Crim. Proc. L. §40.30(1).
5. See Crim. Proc. L. §40.10(2), defining "criminal transaction."
6. See *United States v. Helmsley*, 941 F.2d 71, 86 (2d Cir. 1991).
7. *People v. Helmsley*, 170 A.D.2d 209, 211 (1st Dept. 1991).
8. *People v. Helmsley*, 170 A.D.2d at 211.
9. *People v. Helmsley*, 170 A.D.2d at 212 (emphasis in original).
10. *People v. Helmsley*, 170 A.D.2d at 212 (citing *Matter of Kaplan v. Ritter*, 71 N.Y.2d 222 (1991)).
11. 170 A.D.2d 43 (3d Dept. 1991).
12. *Sharpton v. Turner*, 170 A.D.2d at 48-49.
13. "Legislature Passes Schneiderman Bill to Crack Down on Tax Cheats," Press Release, N.Y. Attorney General (June 21, 2011) at http://www.ag.ny.gov/media_center/2011/jun/jun21a_11.html ("AG Press Release").
14. The enumerated federal violations are: 18 U.S.C. §371, 26 U.S.C. §7201, 26 U.S.C. §7202, 26 U.S.C. §7203, 26 U.S.C. §7204, 26 U.S.C. §7205, 26 U.S.C. §7206, and 26 U.S.C. §7212(A).
15. The enumerated state violations are: Penal L. Art. 155 (larceny), Penal L. Art. 170 (forgery), Penal L. Art. 175 (false statements/records), Tax L. Art. 37 (state tax fraud and other tax offenses), and Admin. Code N.Y. City Tit. 11 Ch. 40 (city tax fraud and other tax offenses).
16. See AG Press Release (Bill sponsor Sen. Martin J. Golden: "Tax cheats who violate our state laws should be held accountable by state authorities—period"); S5776-2011(became A8247A) Senate Bill Memo, at http://open.nysenate.gov/legislation/bill/S5776-2011. ("It makes no sense to give an individual a free pass for tax crimes committed against the people of the State of New York owing to a concurrent investigation and prosecution at the federal level for violations of federal tax laws").
17. 7 Dept. of Justice U.S. Attorney's Manual Tit. 9, Pt. 1, Sec. 9-2.031 (July 2009), at http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/2mcrm.htm#9-2.031.
18. A demonstrably unvindicated federal interest includes, for example: acquittals due to intimidation, the improper exclusion of significant evidence, a sentence that is "manifestly inadequate" in light of the federal interest at stake, or charges in the initial prosecution that trivialized the seriousness of the offense. U.S. Attorney's Manual §9-2.031(D).
19. See *United States v. Fitzgerald*, 232 F.3d 315, 318 (2d Cir. 2000) (affirming the inclusion of amounts of state and local taxes evaded as relevant conduct in computing the total tax loss for purposes of sentencing).
20. See N.Y. Comp. Codes R. & Regs. tit. 20, §159.3.
21. *People v. Clayton*, 41 A.D.2d 204 (2d Dept. 1973); N.Y. Crim. Proc. L. §210.40.