IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

XÉLAN, INC. et al.	:	CIVIL ACTION
v.	:	
UNITED STATES	:	NO. 04-2289

MEMORANDUM

Dalzell, J. November 3, 2004

Before us is the Internal Revenue Service's motion seeking summary enforcement of ten summonses served on SEI Investments Company ("SEI") and The Vanguard Group ("Vanguard"). The Service is investigating xélan, Inc., a California-based organization that has marketed tax-reduction programs to over 70,000 physicians.[1] Pursuant to its investigation, the Service has issued ten summonses directing SEI and Vanguard to produce documents concerning five xélan programs.

In 2003, Jay Higgins, a seasoned agent in the Service's Abusive Tax Avoidance Transactions Group, began investigating xélan's potential tax liability. Agent Higgins is investigating whether xélan's representatives made fraudulent statements when they marketed programs and whether any programs qualify as tax shelters. On May 6, 2004, the IRS served summonses on SEI

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1. Xélan is a veritable family of corporations and affiliated financial advisors, the following of which are petitioners in this action: xélan, Inc.; xélan Administrative Services, Inc.; xélan Investment Services, Inc.; xélan Annuity Co.; xélan, The Economic Association of Health Professionals, Inc.; Pyramidal Funding Systems, Inc., d/b/a xélan Insurance Services; and xélan Pension Services, Inc. The IRS's investigation targets xélan, Inc., and so, for simplicity's sake, we use the shorthand, "xélan."

because it was xélan's recordkeeper and client investment adviser until September 2003; it served summonses on Vanguard on May 7 because it served the same purpose after September of 2003. The petitioners responded by filing a motion to quash the summonses, and the Government has filed a motion for summary enforcement.

This action came to us because it is factually related to Cohen v. United States, 306 F.Supp.2d 495 (E.D.Pa. 2004) and Xélan, Inc. v. United States, No. 03-6433, 2004 WL 1047721, at *1 (E.D.Pa. May 6, 2004), which are cases involving summonses that the Service issued to SEI pursuant to investigations into the tax liability of the Cohen and Baughman families, both xélan clients. In Cohen and Xélan, we denied the petitions to quash and granted the Government's motion for summary enforcement. After independently reviewing the record in this case, and for the reasons set forth at greater length in Cohen and Xélan, we will also dismiss the petitions now before us and grant the Government's motion for summary enforcement.

A. Discussion

The Internal Revenue Code grants the IRS expansive authority to issue administrative summonses for the production of "books, papers, records, or other data" to determine the correctness of any return or the tax liability of any person. I.R.C. § 7602(a)(1).[2] Emphasizing the breadth of this power, the

2. This Court has jurisdiction under I.R.C. §§ 7402(b) and 7604(a) to enforce IRS summonses.

Supreme Court has analogized it to that of a grand jury, "which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." United States v. Powell, 379 U.S. 48, 57 (1964).

To determine whether the summonses are enforceable, we apply Powell's burden-shifting regime. First, the Government must make a prima facie showing that (1) the investigation will be conducted pursuant to a legitimate purpose, (2) the inquiry may be relevant to that purpose, (3) the information sought is not already within the Service's possession, and (4) the administrative steps that the Code requires have been followed. Powell, 379 U.S. at 57-58. Once the Government makes a prima facie showing, the burden then shifts to the petitioner either to disprove one of the four Powell elements or otherwise demonstrate that enforcement of the summons will result in an abuse of the court's process. Id. at 57-58; United States v. Rockwell Int'l, 897 F.2d 1255, 1262 (3d Cir. 1990).

1. The Government's Prima Facie Case

In support of its prima facie case, the Government offers the declaration of IRS Agent Jay Higgins. Upon carefully reviewing Agent Higgins's declaration, we conclude that the Government has carried its prima facie burden.

To prove the first element under Powell -- that it has a legitimate purpose -- "means nothing more than that the

government's summons must be issued in good faith pursuant to one of the powers granted under 26 U.S.C. § 7602." Rockwell, 897 F.2d 1262. Here, as Agent Higgins explains, the IRS is investigating xélan for a legitimate purpose, i.e., to determine whether to penalize it for violating the Internal Revenue Code:

> I am investigating whether, in the course of marketing any of the following xélan-developed programs, representatives of xélan, Inc. made any false or fraudulent statements about the tax benefits that doctors might expect to receive from participating in these programs. I am also investigating whether any of the following xélan-developed and marketed programs qualify as tax shelters subject to the registration, disclosure and reporting requirements of the Internal Revenue Code.

Higgins Decl. ¶ 29. In other words, Agent Higgins is investigating whether xélan violated I.R.C. § 6700 by making false statements about tax benefits and should be enjoined, under I.R.C. § 7408, from committing further violations. Higgins Decl. ¶¶ 3, 6, 16, 25, 29, 36.B. He is also investigating whether xélan's tax-reduction programs violate Code provisions regulating tax shelters, particularly I.R.C. §§ 6677, 6701, 6707, and 6708. Id. ¶ 3. Thus, the IRS has a legitimate purpose.

Turning to the second Powell element, relevance, the Government must show that the summonsed information "might throw light upon" the matter under investigation. United States v. Rockwell Int'l, 897 F.2d 1255, 1263 (3d Cir. 1990). In his declaration, Agent Higgins explains -- in painstaking detail -- why the IRS seeks to serve summonses on SEI and Vanguard. First,

he explains that because the Service is investigating whether xélan representatives made false statements about the tax benefits doctors could obtain by participating in its programs, the Service needs to interview these doctors:

> Individual xélan doctors can tell the IRS precisely what information they received from xélan and its representatives, and what tax benefits were touted to them. In this respect, individual xélan doctors can shed light on the IRS's investigation of xélan, Inc. as a tax shelter promoter.

Higgins Decl. ¶ 36.B. Hence, the records in SEI's and Vanguard's possession may enable the Service to determine whether xélan's representatives touted false tax benefits.

Second, the IRS seeks to learn whether xélan's programs are legitimate insurance plans or instead fronts devised to enable doctors to evade income taxes. The Service can investigate the legitimacy of xélan's programs only by delving into the accounts of its participants. Consequently, examining the SEI and Vanguard records may enable the Service to confirm whether xélan trusts are legitimate insurance programs or unlawful tax shelters.[3]

Turning to the third and fourth prongs of the Powell test, we conclude that the Government has carried its

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3. On June 30, 2004, xélan, Inc. and three other xélan entities filed voluntary petitions, under Chapter 11 of the Bankruptcy Code, in the United States Bankruptcy Court for the Southern District of California. The IRS also hopes that the "information sought by these summonses may shed light on, and help to determine the amount of, the IRS's claims against the debtors in bankruptcy, for their liabilities for taxes imposed upon tax shelter promoters . . . ." Higgins Decl. ¶ 36.C.

burden. Aside from the information SEI has already produced in response to the Orders this Court entered in the Cohen and Baughman income tax audits (which the Service emphasizes it "does not seek to obtain," Gov.'s Mot. at 23), the IRS does not already have the information it now seeks. Higgins Decl. ¶¶ 37, 38. Indeed, if it already had the information, the IRS would never have issued these summonses in the first place. As for the final Powell prong, Agent Higgins has declared that the Service followed all administrative steps required under the Code for issuing summonses. Higgins Decl. ¶ 39.

2. The Petitioner's Response to the Service's Prima Facie Case

Because the Service has established a prima facie case for the enforcement of these summonses, xélan "faces a heavy burden" that requires it either to highlight a serious weakness in the Government's case or to show that the IRS issued the summonses in bad faith. United States v. Muratore, 315 F.Supp.2d 305, 307 (W.D.N.Y. 2004) (quoting Miller v. United States, 150 F.3d 770, 772 (7th Cir. 1998)); see also United States v. Rockwell Int'l, 897 F.2d 1255, 1262 (3d Cir. 1990). We separately consider each of xélan's arguments.

First, xélan argues that the IRS failed to give notice to third parties identified in the summonses, an alleged violation of I.R.C. § 7609(a)(1). Section 7609(a)(1) provides that, if any summons requires the "giving of testimony on or relating to [or] the production of any portion of records made or

kept on or relating to . . . any person (other than the person summoned) who is identified in the summons," the IRS must give notice to that person. While the summonses in question never name any xélan participant, xélan argues that we should construe the word "identified" to encompass all participants.

As a preliminary matter, xélan contends that the IRS needed to give notice only to the about "100 participants . . . *who are* [already] *under audit*." Pet.'s Resp. at 6. After all (so the argument goes), it would be impossible for the IRS to notify any other participants because it does not yet know who they are.

Xélan's argument that the IRS had to give notice to the hundred participants already under audit misses the mark. First, absent an absurd result, when the express language of a statute is clear, a court will not adopt a different construction. Hay Group, Inc. v. E.B.S. Acquisition Corp., 360 F.3d 404, 406 (3d Cir. 2004). The plain meaning of Section 7609(a) requires that the IRS notify only those persons identified in the summons. Because here the summonses *identify* only xélan, Section 7609(a) never required the IRS to notify any xélan participants.

Two decades ago, the United States Court of Appeals for the Second Circuit confronted the issue we face and reached the same conclusion. United States v. First Bank, 737 F.2d 269, 271 (2d Cir. 1984). In First Bank, the Second Circuit emphasized that "strict adherence to Congress' chosen words" required that notice be given only to persons named as targets in the

summonses. Id. at 272. Furthermore, the court conducted an exhaustive legislative history analysis and ultimately concluded that "Congress intended the literal dictates of the statute to be controlling." Id.

Of course, as Learned Hand once remarked, "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning." Cabell v. Markham, 148 F.2d 737, 739 (2d Cir. 1945), aff'd, 326 U.S. 404 (1945). Here, rather than contradicting our literal reading of Section 7609(a), however, Section 7609's purpose bolsters it. As our Court of Appeals explained, "The thrust of section 7609, taken as a whole, [is] to require that the target taxpayer be given notice, so that he [is] able to assert appropriate defenses." United States v. Pittsburgh Trade Exch., 644 F.2d 302, 305 (3d Cir. 1981). Agent Higgins's declaration and the summonses themselves demonstrate that the target taxpayer is xélan, not its participants. Xélan received notice and has had ample opportunity to "assert appropriate defenses." Id. at 305. Thus, xélan's first argument is without merit.

Xélan next reiterates the argument it made in Cohen that the Service is acting in bad faith for the sole purpose of obtaining participants' identities. This would allegedly violate the "John Doe" summons procedures of I.R.C. § 7609(f). This

claim also fails. The Service may serve a summons for the dual purpose of investigating both known and unknown taxpayers, provided the information sought will further its investigation of the named parties. Tiffany v. Fine Arts, Inc. v. United States, 469 U.S. 310, 323-24 (1985). When it serves this type of dual-purpose summons, the Service need not comply with Section 7609(f). Id. Based on Agent Higgins's declaration and the summonses themselves, it is hard to conclude that the Service is even partially motivated by a desire to discover the identities of future audit targets. In any event, even if that were the case, xélan's claim would still fail. See Tiffany, 469 U.S. at 323-24.

We now turn to xélan's third argument. Xélan claims that the Department of Justice is criminally investigating it and that I.R.C. § 7602(d)(1) therefore bars the Service from issuing civil summonses. Section 7602(d)(1) prevents the IRS from using its summons power to investigate a person to whom a Department of Justice referral is "in effect."

In his declaration, Agent Higgins avers that there is no Justice Department referral in effect regarding xélan. Higgins Decl. ¶ 40. In response, however, xélan attached copies of two subpoenas that a federal grand jury in San Diego, California issued to Vanguard. One subpoena seeks documents about various xélan-titled entities. Pet.'s Resp., Ex. D. On October 18, 2004, we ordered the Service to "address[] the apparent conflict between Agent Higgins's testimony and the

pending grand jury proceedings." Oct. 18, 2004 Order. The Service responded that day, with xélan replying shortly thereafter. Noting that the record still appeared "equivocal," we then directed the Service to submit in camera, "any and all writings that it may have sent to the Criminal Division of the United States Department of Justice pertaining or relating to a proposed criminal investigation of xélan . . . ." October 28, 2004 Order. The Service complied yesterday.

Carefully reviewing all relevant documents, we conclude that there is no Justice Department referral. First, Agent Higgins swore to this under oath. Absent compelling evidence contradicting his testimony, we give it great weight. Second, the Service's detailed in camera submission convinces us beyond any doubt that there is no referral. Thus, xélan's final argument is without merit.

Conclusion

The Government carried its prima facie burden, and the petitioners failed to rebut it. Furthermore, xélan failed to support its request for an evidentiary hearing by refuting material Government allegations or supporting an affirmative defense. See United States v. Garden State Nat'l Bank, 607 F.2d 61, 71 (3d Cir. 1979). Accordingly, we shall deny the request for an evidentiary hearing, deny the petition to quash, and grant the Government's motion for summary enforcement.

An appropriate Order follows.

/s/ Stewart Dalzell, J.

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ORDER

AND NOW, this 3rd day of November, 2004, upon consideration of the Government's motion for summary enforcement (docket entry # 5), petitioners' answer (docket entry # 8), the Government's reply (docket entry # 10), petitioners' counter-reply (docket entry # 11), and the Government's in camera submission (docket entry # 13), and for the reasons articulated in the accompanying Memorandum, it is hereby ORDERED that:

1. The petition to quash summonses issued to SEI Investments Company, Inc. and The Vanguard Group, Inc. is DENIED;

2. The Government's motion for summary enforcement of the summonses issued to SEI and Vanguard is GRANTED;

3. Except as to documents already produced by SEI in response to the previous orders of this Court enforcing IRS summonses concerning the Cohen and Baughman families, SEI and

Vanguard shall COMPLY with the challenged summonses no later than November 15, 2004 or at such other time as IRS Special Agent Jay Higgins, SEI, and Vanguard agree to in writing;

4. Petitioners' motion for permission to file a supplemental brief (docket entry # 11) is GRANTED; and

5. The Clerk of Court shall CLOSE this action statistically.

BY THE COURT:

/s/ Stewart Dalzell, J.