UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Case No. SI-4:06CR337CEJ(MLM)
	)	
GARY STEPHEN KAPLAN,	)	
	)	
Defendant.	)	

REPORT AND RECOMMENDATION
OF UNITED STATES MAGISTRATE JUDGE CONCERNING
GARY KAPLAN'S MOTION TO DISMISS COUNTS 14-22

Defendant Gary Kaplan filed a Motion to Dismiss Counts 14-22 of the Superseding Indictment. [Doc. 450] The government responded. [Doc. 528] Defendant replied. [Doc. 556]

Counts 14-22 of the Superseding Indictment deal with alleged violations of tax laws by defendant Gary Kaplan ("defendant" or "Kaplan"). Counts 14-16 allege that defendant wilfully attempted to evade and defeat the wagering excise tax in violation of 26 U.S.C. § 7201 which criminalizes attempting to "evade or defeat any tax. . . or the payment thereof." Counts 17-22 allege that defendant corruptly obstructed and impeded and endeavored to obstruct and impede the due administration of the revenue laws in violation of 26 U.S.C. § 7212(a).

I. COUNTS 14-16

A. Whether the Wagering Excise Tax was Owed by Defendant Gary Kaplan

1. Defendant argues he did not violate 26 U.S.C. § 7201 ("§ 7201") because no wagering excise tax was owed by him because the wagers either were not accepted in the United States or were not placed by a person who was in the United States

with a person who was a citizen or resident of the United States as required by 26 U.S.C. § 4404.

The parties agree that 26 U.S.C. § 4401(a) ("§ 4401") provides for a 0.2% excise tax on wagers which are authorized by state law and a 2% excise tax on unauthorized wagers. The parties further agree that the wagers at issue in this case were not authorized by state law.

There is a territorial limit on the excise tax on wagering pursuant to 26 U.S.C. § 4404. It states:

> The tax imposed by this sub chapter shall apply only to wagers
> (1) accepted in the United States, or
> (2) placed by a person who is in the United States
> (A) with a person who is a citizen or resident of the United States, or
> (B) in a wagering pool or lottery conducted by a person who is a citizen of the United States .

The government argues that defendant was subject to the wagering excise tax pursuant to § 4404 based on defendant's status as owner and operator of various specified gambling entities doing business in the United States.[1] Response (Doc. 528) at 2. Defendant argues that it is clear from the face of the Superseding Indictment that all of the wagers at issue were placed with foreign corporations and not with "a person who is a citizen or resident of the United States" and thus, no tax was due that could have been evaded. Counts 14-16 only allege that "entities doing business in the United States, had and received taxable wagers." Merely doing business in the United States does not overcome the specific territorial restriction of § 4404, which, in relevant part, requires that wagers be accepted in the United States. Section 4404 makes it clear that a wager can be "placed"

[1] The Superseding Indictment does not allege that wagers were placed in a wagering pool or lottery under 26 U.S.C. § 4404(2)(B). This sub-section is not at issue.

and "accepted" in two different places. Wagers that are accepted in the United States are covered by § 4404(1) but only certain wagers "placed" in the United States are covered by § 4404(2). Therefore, it is clear that the statute contemplates that wagers can be "placed" in the United States and "accepted" outside the United States.

Wagers placed by a person in one jurisdiction with an entity in another jurisdiction are "accepted" in the latter jurisdiction. See United States v. Truesdale, 152 F.3d 443 (5th Cir. 1998) (bets placed by persons in the United States by dialing phone numbers in the Carribean were not accepted in the United States regardless of the fact that financial transactions related to those bets were conducted in the United States); see also State v. Oldham, 98 S.W. 497, 500 (Mo. 1906) (wagers telephoned by person in Missouri to Kansas are accepted in Kansas).

Counts 14-16 deal with wagers that were placed in the United States with telephone numbers or internet servers in Antigua and Costa Rica and accordingly were accepted in Antigua or Costa Rica. Truesdale made clear that the existence of other related business activities in the United States has no effect on the location where wagers are accepted. Truesdale, 152 F.3d at 444-45, 448. All of the operations for receiving wagers described in the Superseding Indictment are alleged to have been located outside of the United States and that is where any alleged wagers were accepted for purposes of the excise tax statute. The wagers do not fall within the territorial limitation of 26 U.S.C. § 4404(1).

The territorial reach of § 4404(2)(A) is dependent on wagers being placed with a person who is a United States citizen or resident.[2] In its Response, the government

[2] "Person" as defined in 26 U.S.C. § 7701(a)(1) includes companies and corporations. "Foreign" as defined in 26 U.S.C. § 7701(a)(5) when applied to a corporation means a corporation not operated or organized under the laws of the United States or any state.

repeatedly acknowledges that the wagers alleged in Counts 14-16 were placed with foreign companies.[3] The government however argues that because defendant (who is a U.S. citizen) owned and operated these entities, the corporate veil should be pierced and that he should be held responsible for the wagering excise taxes by failing to make an excise tax return on or before the last day of the month following the month the wagers were accepted, by failing to pay the wagering excise tax and by "causing and directing that the wagering funds be sent outside the United States." Superseding Indictment ¶¶ 41-43.

However, the fact that defendant owned and operated the foreign corporations cannot be used to extend the clear limitations on the extraterritorial reach of the excise tax imposed by Congress. Congress could have said, as it has in other applications of the tax laws, that the tax applies to foreign persons or entities controlled by U.S. citizens or residents, but it did not. See, e.g., 26 U.S.C. § 951(a)(1)(A) dealing with the tax on the undistributed sub-part F income of controlled foreign corporations attributable by virtue of economic ownership or control to United States taxpayers. See also 26 U.S.C. § 1293(a)(1) which causes income of a foreign corporation that is a qualified electing fund to be taxed to a United States shareholder. See Reply (Doc. 556) at 2.

Absent similar congressional action regarding the excise tax on wagers, the reach of § 4404 cannot be extended to cover wagers placed with foreign entities owned or controlled by United States persons. In United States v. Chalmer , the court held that a statute that can only be violated by a "United States person" cannot be violated by a foreign corporation

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[3] The Superseding Indictment alleges that entities doing business in the United States, including BETonSports.COM, BetonSports (Antigua), Millennium, Jaguar, Infinity, Gibraltar, MVP, Bettorstrust, Rockisland and Wagermall had and received from 2001 to 2004 taxable wagers in the combined sum of approximately $3.5 billion dollars. Neither party disputes that these entities were incorporated in foreign jurisdictions including Costa Rica and Antigua.

even if it was owned and operated by a U.S. citizen and allegedly conducted illegal transactions in the United States. The court said that Congress can draft statues "so as to make clear that they reach foreign entities" but that they had not done so in the discussed statute. Chalmer, 474 F.Supp.2d 555, 565 (S.D.N.Y. 2007) ([T]he Supreme Court. . .has interpreted 'United States person' as excluding foreign corporations"); see also United States v. Yakou, 428 F.3d 241, 252 (D.C.Cir. 2005)("[T]he congressional choice to limit liability to 'U.S. persons' is highly significant and inconsistent with catching the non-U.S. person who happens to engage in [illegal] activities with a 'U.S. person.'"). The government's attempt to extend the reach of the excise tax statute by arguing that the corporate veil should be pierced because defendant owned and operated the foreign entities which accepted the wagers is, as argued by the defendant, "an impermissible end-run around Congress' clearly expressed limitation on the extraterritorial reach of the excise tax." Reply (Doc. 556) at 4.

The court finds the defendant's argument persuasive:

> It is a well established civil law concept that a corporate veil of limited liability can be pierced only as a means to shift to shareholders responsibilities *for the liabilities of a corporation* from which they would otherwise be shielded. There can be no veil piercing if there is no corporate liability. Meyer v. Holley, 537 U.S. 280, 291 (2003) ("*[T]he corporation's liability* may be imputed to the corporation's owner in an appropriate case through a 'piercing of the corporate veil.'") (quoting United States v. Bestfoods, 524 U.S. 51, 63 (1998)) (emphasis added); Bestfoods, 524 U.S. at 62 ("[T]here is an equally fundamental principle of corporate law, applicable to the parent-subsidiary relationship as well as generally, that the corporate veil may be pierced and the shareholder held liable *for the corporation's conduct* . . .") (emphasis added); Tamko Roofing Prods.v. Smith Eng'g. Co., 450 F.3d 822, 826 (8th Cir. 2006)("[P]iercing the corporate veil under an alter ego theory is best thought of as a remedy to enforce a substantive right, and *not as an independent cause of action*.")(emphasis added); Dakota Indus. v. Best Ever, Ltd., 28 F.3d 910, 915 (8th Cir. 1994) ("Generally, when the corporate veil is pierced, the individuals may be liable *for the corporation's actions*. . .") (emphasis added); LARRY D. SODERQUIST ET AL., CORPORATE LAW & PRACTICE § 7: 1 (2007) ("The courts have created

> an exception to the fundamental principle of limited liability . . . [U]nder certain circumstances, courts will 'pierce the corporate veil.' By disregarding the corporate entity, creditors of a corporation can then hold shareholders personally liable *for the corporation's obligations*.") (emphasis added); FRANKLIN A. GEVURTZ, CORPORATION LAW § 1.5 (2000) (If the corporate veil is pierced, the court will impose liability upon one or more of the corporation's shareholders *for the company's debt.*" (emphasis added); EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES § 20: 1 (2007) ("It is important to note that [the doctrine of piercing the corporate veil] is concerned with the imposition of liability on persons (or entities) who control the corporation and in some manner misuse the corporate form, *as opposed to the imposition of personal liability for active participation in the underlying tort or statutory violation which gives rise to corporate liability*. An officer, director or shareholder is liable for torts personally committed, without regard to any concept of disregard of the corporate entity.") (emphasis added); JAMES D. COX, THOMAS LEE HAZEN, CORPORATIONS § 7.08 (2d ed. 2003) ("In piercing the corporate veil, "*the contracts and obligations of a corporation* can be held to impose personal liability on the shareholders.") (emphasis added)
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> In other words, if a corporation does not have a specific liability, there is nothing for which to hold its shareholders liable and piercing the corporate veil is irrelevant.

Reply (Doc. 556) at 5-6.

The court acknowledges the cases cited by the government in support of its "piercing" argument. Response (Doc. 528) at 2-6. Many of the cases such as United States v. Bestfoods, 624 U.S. 51 (1998) deal with parent-subsidiary corporations and while expressing general principles of corporate liability, the holdings are not on point in this case. The facts of State on inf. of McKittrick v. Koon, 201 S.W.2d 446, 455 (1947) are so far attenuated from the instant case as to provide no support for the government's position. Mobius Management Systems, Inc. v. West Physicians Search, LLC, 175 S.W.3d 186 (Mo. Ct. App. 2005) deals with the debt *owed by a [sham] corporation*. The court held that to pierce the corporate veil, the creditor "must first show control not mere majority or stock control, but complete domination not only of finances but of policy and business practice

with respect to the transaction, such that the corporate entity had no separate mind, will or existence of its own." Mobius, 175 S.W.3d at 188 citing 66 Inc. v. Crestwood Commons Redevelopment Corp., 998 S.W.2d 32, 40 (Mo. banc 1999). In all of the cases - - both the government's and the defendant's - - there was a debt or tax actually owed. It was only then that the corporate veil was pierced. For example "It is not necessarily inconsistent to view a corporation as viable for the purpose of assessing a corporation tax, while disregarding it for the purpose of satisfying that assessment. Only those corporations that were established with no valid purpose are considered sham corporations and thus not entitled to separate taxable status." Wolfe v. United States, 798 F.2d 1241, 1243 (9th Cir. 1986). The government has alleged no facts on which to base a determination that the foreign corporations at issue were "sham" corporations. See, *infra*. In fact, the Superseding Indictment is replete with allegations of the gambling businesses' activities.

It is significant that the government impliedly recognized the principle set out above when it said "an individual can be held liable for taxes *owed by a corporation*. Response (Doc. 528) at 4. (emphasis added). The wagers alleged in Counts 14-16 which were accepted by the foreign corporations fall outside the territorial reach of the wagering excise tax, and therefore there is no liability to impose on defendant Kaplan as owner and operator. Since the foreign corporations were not subject to the excise tax, no amount of veil piercing can establish liability for such a tax. Reply (Doc. 556) at 6. It is only if excise tax liability exists at the corporate level that the court should conduct the "piercing the corporate veil" analysis. Such piercing could only be used to impose personal liability on defendant if corporate liability already existed. Because the court finds that the foreign entities that accepted the wagers are beyond the territorial limitation imposed by 26 U.S.C. § 4404(2)(A), the court will recommend that Counts 14-16 be dismissed.

2. Even if the district court should find that the congressional limitation on offshore imposition of the excise tax should not apply, the corporate veil nevertheless should not be pierced. First, there is a strong presumption in favor of respecting the corporate form. Anderson v. Abbott, 321 U.S. 349, 362 (1944) ("Limited liability is the rule, not the exception; and on that assumption large undertakings are rested, vast enterprises are launched and huge sums of capital attracted.") The Eighth Circuit, in Minnesota Laborers Health & Welfare Fund v. Scanlan, 360 F.3d 925, 928 (8th Cir. 2004), stated it is a "long-established principle that a corporation's existence is presumed to be separate and may be disregarded only under narrowly prescribed circumstances" citing Greater Kan. City Laborers Pension Fund v. Superior Gen. Contractors, Inc., 104 F.3d 1050, 1055 (8th Cir. 1997). The Eighth Circuit's test for piercing the corporate veil is: "(i) was there such unity of interest and lack of respect given to the separate entity of the corporation by its shareholders that personalities and assets of the corporation and the individual are indistinct, and (ii) would adherence to the corporate fiction sanction a fraud, promote injustice or lead to an evasion of legal obligations." Minnesota Laborers, 360 F.3d at 928.

As to the first prong of the test, the corporate veil cannot be pierced based on the face of the Superseding Indictment because it does not allege that the corporate form was not respected. The Grand Jury indicted Kaplan for tax liability in Counts 14-16 solely on the basis that he was the "owner and operator" of the entities that received the wagers. The Supreme Court has repeatedly made clear that this is insufficient to pierce the corporate veil. The Supreme Court stated "[s]urely the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities does not make the corporation the agent of its stockholders." Moline Properties, Inc. v. Comm'r. of

Internal Revenue, 319 U.S. 436, 440 (1943). The Tax Court of the United States stated that based on the Supreme Court's holdings "[l]ong ago, the Supreme Court held that when a corporation carries on business activity the fact that the owner retains direction of its affairs down to the minutest detail makes no difference tax-wise." Bass v. Comm'r. of Internal Revenue, 50 T.C. 595, 601 (1968) citing National Carbide Corp. v. Commissioner, 336 U.S. 422, 433 (1949). Ownership and control, the only bases for liability alleged in Counts 14-16, are insufficient to pierce the corporate veil. There must be allegations that the corporation was a sham, indistinct from its owner with no business purpose. Moline Properties, 319 U.S. at 439. See United States v. Scherping , 187 F.3d 796, 801 (8th Cir. 1999) ("When an entity is without economic substance, it may be deemed to be the alter ego of the taxpayer.").

The Superseding Indictment never alleges that the entities accepting wagers were shams set up for tax evasion purposes. The Superseding Indictment makes it quite clear that the entities were engaged in a complex and successful business. Furthermore, the Superseding Indictment supports the conclusion that the business entities receiving the alleged wagers were distinct from Kaplan. Of particular significance is the fact that when the Grand Jury was charged with determining who participated in the alleged RICO conspiracy, it charged BetonSports PLC as a separate defendant and a distinct member of the enterprise. Certainly if the Grand Jury viewed BetonSports as a sham it could not have named it as a defendant capable of committing criminal activity in its own right. In addition, if the Grand Jury considered BetonSports as the RICO enterprise "front" for Kaplan, it could not have charged it as a separate defendant because a person or entity liable under § 1962(c) cannot be the enterprise itself. Bennett v. Berg, 685 F.2d 1053, 1061-62 (8th Cir. 1982), modified en banc, 710 F.2d 1361, 1364 & n.4 (8th Cir. 1983), cert. denied,

464 U.S. 1008 (1983). Although Counts 14-16 alleged that Kaplan was the owner and operator of the entities accepting wagers, the Superseding Indictment lists BetonSports PLC as a separate defendant that "owned and operated BetonSports.com and other internet telephone sports gambling businesses." Superseding Indictment, ¶ 17. BetonSports PLC pled guilty to Count I of the Indictment as an entity distinct and separate from defendant Kaplan. Therefore, the face of the Superseding Indictment demonstrates that BetonSports PLC and its associated entities carried on substantive business activities and were separate and distinct from Kaplan.

Based on the foregoing, the government has not alleged facts sufficient to satisfy the first prong of the Eighth Circuit's piercing test and therefore the corporate veil should not be pierced.

As to the second prong, as set out above, there is a crucial difference between evading a legal obligation to pay taxes and structuring a business so that no tax is due. Simply put, United States persons and corporations do not commit a crime when they set up foreign corporations and subsidiaries to receive favorable tax treatment. A contrary holding would criminalize legitimate tax planning, including the frequent use by United States individuals and multinational companies of foreign corporations to defer United States tax on foreign business income that otherwise would be owed by their domestic owners or parent corporations. See MICHAEL J. GRAETZ, FOUNDATIONS OF INTERNATIONAL INCOME TAXATION, 217-53 (2003) ("Taxation of profits earned by U. S. individuals and corporations from their ownership interests in foreign corporations is generally deferred until the earnings are repatriated to the U.S. shareholders in the form of a dividend or realized by U.S. shareholders as gained from the sale of shares. This postponement of taxation, commonly referred to as deferral, is a natural corollary of two

long-standing principles in U.S. international taxation: the decision to honor the distinct legal identity of foreign subsidiaries and the principle of not taxing the foreign earnings of foreign persons. . . this so-called deferral privilege is very valuable to U.S. multinational corporations."); JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ A1.03[2] (1991) ("[U]se of a foreign corporation [by U.S. citizens, residents, and corporations] to conduct a foreign activity holds out the possibility of having no current U.S. taxes on the income. As a result, an advantage of a foreign corporation can be the deferral of U.S. taxes.").

It is legal to create a foreign corporation for purposes of avoiding U.S. taxes where the corporation is engaged in substantive business activity. Siegel v. Comm'r. of Internal Revenue, 45 T.C. 566, 576 (1966) (citing Aldon Homes, Inc. v. Comm'r of Internal Revenue, 33 T.C. 582, 597 (1959)). In Siegel, the only apparent purpose for the formation of Panamanian corporation was to avoid payment of tax, and the sole business purpose of the corporation was to hold stock in a joint venture. However, the tax court stated that "the Code. . .permitted that result, and petitioner was free to take advantage of it. The question [of whether to respect the corporate form]. . . is not to be clouded by the use of a foreign corporation rather than a domestic corporation to escape U.S. taxation." Id.

Because the corporate veil should not be pierced, the court will further recommend that Counts 14-16 be dismissed.

B. Whether There was An Affirmative Act of Evasion

As an alternative ground for dismissal defendant argues that there was no affirmative act of evasion. Because the court will recommend that Counts 14-16 be dismissed on the grounds set out above, this issue need not be reached. However, the

district court may disagree with the recommendation, and therefore the court will address the alternative issue. The court finds that this ground does not support dismissal.

The parties agree that the elements of a § 7201 offense are wilfulness, the existence of a tax deficiency and an affirmative act of evasion. Sansone v. United States, 380 U.S. 343, 351 (1965); United States v. Willis, 277 F.3d 1026, 1030 (8th Cir. 2002).[4] The only affirmative act of evasion alleged in the Superseding Indictment in Counts 14-16 is "causing and directing that the wagering funds be sent outside the United States." Response (Doc. 528) at 9. Defendant argues that directing the wagering funds be sent outside the United States occurred before the existence of any tax deficiency. Defendant cites United States v. Romano, 938 F.2d 1569 (2nd Cir. 2002) to support his premise that conduct that occurred before the imposition of a tax deficiency cannot constitute an affirmative act of evasion. The government counters with opposing holdings and citations to United States v. King, 126 F.3d 987 (7th Cir. 1997) and United States v. Jungles, 903 F.2d 468 (7th Cir. 1990). These three cases are very fact specific and it takes little analysis to distinguish each from the instant fact pattern. Nevertheless, the lesson to be learned from all three is that "[t]he essence of a § 7201 violation is the *attempt* in any manner to evade the assessment or payment of a tax. The defendant's intent is, of course, a key element of any attempted crime and is necessarily intertwined with defendant's conduct." King, 126 F.3d at 992 (emphasis in original).

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[4] ". . .[Section] 7201, which proscribes wilfully attempting in any manner to evade or defeat any tax imposed by the internal revenue code. As this court has recognized this felony provision is the 'capstone of a system of sanctions which singly or in combination were calculated to induce prompt and faithful fulfillment of every duty under the income tax law and to provide a penalty suitable to every degree of delinquency.'" Sansone, 380 U.S. at 350, quoting Spies v. United States, 317 U.S. 492, 497 (1943).

In Romano, the defendant attempted to take more than $350,000 into Canada purportedly to avoid paying taxes. However, at the time he did so, he had no tax obligation. The Second Circuit said "[i]n addition, transportation of currency out of the country, in and of itself is not a prohibited activity." Romano, 938 F.2d at 1572. Further, the court said:

> Without some intent to violate the law, we do not think it is correct to infer that merely carrying money to Canada can be used to fulfill the affirmative act requirement for the felony of tax evasion, especially if Romano had no obligation to disclose the amount of the money to the IRS at the time he was trying to transport the money.

Id. at 1573.

Defendant argues that this case is on point because directing that wagering funds be sent outside the United States to open off-shore wagering accounts is likewise not a prohibited activity and clearly there was no tax liability because at the time the accounts were opened, no wagers had been placed. The court notes that Romano states specifically that "[w]e hold that Romano's conviction for wilfully evading his income tax obligations for 1983 cannot be upheld in the *unique and specific circumstances revealed by this record*." Romano, 938 F.3d at 1574 (emphasis added).

In King, the defendant filed false W-4 forms claiming he was an independent contractor and thus falsely claimed he was exempt from withholding taxes. After conviction, King argued on appeal that the indictment should have been dismissed because the false forms he filed in 1983, 1984 and 1987 could not, as a matter of law, constitute affirmative acts of evasion for the taxes owed in the years 1989-1993. The Seventh Circuit stated: "[A]n affirmative act is some conduct, undertaken at least in part because of a tax evasion motive 'the likely effect of which would be to mislead or conceal.'" King, 126 F.3d at 989 citing Spies v. United States, 317 U.S. 492, 499 (1943). The issue is whether the government can prove, for each felony charge of an attempt to evade taxation, an

affirmative act that the defendant undertook wilfully with the intention of evading taxes. King, 126 F.3d at 990 citing with approval the district court in the King case. King makes it clear that the affirmative act may take place before the tax liability is due but "a Section 7201 offense is not *complete* until a tax deficiency exists and a deficiency will not arise until the due date of a tax return." King, 126 F.3d at 992 (emphasis added). King finds significance under the facts of that case that the false W-4 forms were "maintain(ed) in the file" and thus carried over to future years if defendant filed with the requisite intent to evade taxes. Although there was no "file" created by way of the offshore wagering accounts, nevertheless the requisite nexus is present if properly proved. Whether defendant Kaplan caused and directed the wagering funds to be sent outside the United States with the requisite intent goes to the sufficiency of the evidence, King, 126 F.3d at 993, and does not provide grounds for dismissal at this time.

In Jungles, the Seventh Circuit held that taxpayer's act of entering an "independent contractor agreement" "even though a lawful activity in and of itself, can serve as an affirmative act supplying conviction for tax evasion if done with the *intent* to evade income tax." Jungles, 903 F.2d 468, 473-74 (1990) (emphasis in original). The Seventh Circuit relied on Spies v. United States, 713 U.S. 492 (1943):

> The court expressly noted, however, that Congress had not limited or defined the methods by which such an "attempt" could be achieved and declined the invitation to constrict the congressional provision that an attempt could be achieved "in any manner." Spies, 317 U.S. at 499, 63 S.Ct. at 368. Rather, the court concluded that if a tax-evasion motive plays a part in any conduct which could be described as an "attempt" to evade the payment of taxes, then the offense of tax evasion was made out. Id.

Jungles, 903 F.2d at 474.

Based on the forgoing, the court finds that Counts 14-16 of the Superseding Indictment should not be dismissed on the alternative ground that there was no affirmative

act. The Superseding Indictment adequately charges all the elements of a violation of § 7201. The government will be put to its proof at trial. If the jury finds that defendant Kaplan's lawful activity of causing and directing that the wagering funds be sent outside the United States was done with the intent to evade payment of excise taxes, it will support conviction for violation of § 7201.

II. COUNTS 17-22

Counts 17-22 allege that defendant Kaplan corruptly interfered with the administration of the revenue laws by directing that money for opening and funding wagering accounts be sent to third parties outside the United States in violation of 26 U.S.C. § 7212(a)("§ 7212(a)").

Section 7212(a) states in pertinent part:

> Whoever corruptly or by force or threats of force (including any threatening letter or communication) endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title shall, upon conviction thereof, be fined not more than $5,000 or imprisoned not more than three years, or both. . . .

Defendant was charged under the second clause of § 7212(a) which begins, "or in any other way corruptly...". Defendant argues that because the wagers in this case are not subject to taxation, there can be no violation of § 7212(a). The court agrees that on this ground alone, as set out in detail above, Counts 17-22 should be dismissed. However, assuming arguendo that the district court finds that the wagers were subject to taxation and that there are applicable revenue laws with which defendant could interfere, his conduct of instructing persons to send money to third parties does not constitute a violation of § 7212(a) because there was no pending IRS investigation or proceeding of which defendant

Kaplan was aware at the time the instructions were given and the instructions themselves do not violate the revenue laws.

In determining the meaning of "corruptly" it is useful to study how the word is interpreted in other obstruction of justice statutes because courts have frequently held that § 7212(a) should be construed similarly to other obstruction of justice statutes particularly 18 U.S.C. § 1503. See United States v. Dykstra, 991 F.2d 450, 454 (8th Cir. 1993).

In its Response to defendant's Motion the government makes a distinction between the "due administration of justice" in § 1503 and the "due administration of this title [Title 26]." The court acknowledges that Title 26, which contains the Internal Revenue laws, deals with innumerable activities involving more than audits, investigations and administrative and judicial proceedings. Nevertheless under the facts of this case this is a distinction without a difference.

The cases cited by the government mostly predate the Supreme Court's decision in United States v. Aguilar, 515 U.S. 593 (1995) in which the scope of § 1503 was significantly narrowed by requiring a nexus that "the [obstructive] act must have a relationship in time, causation, or logic with the judicial proceedings." Id. at 599. Noting that § 7212(a) is frequently interpreted in light of § 1503, the Sixth Circuit applied Aguilar's nexus requirement to tax cases by requiring an ongoing proceeding requirement in two § 7212(a) cases: United States v. Kassouf, 144 F.3d 953 (6th Cir. 1998) and United States v. Bowman, 173 F.3d 595 (6th Cir. 1999). Kassouf limited the application of § 7212(a) to cases where there was a pending investigation or proceeding of which the defendant was aware.[5] The

[5] In Kassouf the Indictment charged *inter alia* that the defendant violated § 7212(a) by not keeping records necessary to determine the tax consequences of transactions he conducted for his personal benefit through his partnerships making it more difficult for the IRS to trace his activities.

Sixth Circuit affirmed the district court's dismissal of the 7212(a) count for failure to state an offense, holding that the count did not allege, as an element of the offense, that there was a pending proceeding or investigation by the IRS of which defendant was aware. Kassouf, 144 F.3d at 960. Bowman[6] created an exception to the general rule requiring pending proceedings or investigation where the action directly violated other provisions of the Internal Revenue laws, most commonly filing false forms or submitting false information to the IRS. The court held it was not necessary to allege a pending proceeding or investigation of which the defendant was aware because, unlike the activity in Kassouf, "[t]he filing of false tax forms is not legal when undertaken; it is not speculative; it is specifically designed to cause a particular action on the part of the IRS." Bowman, 173 F.3d at 600.

The cases addressing § 7212(a) post-Aguilar are consistent with this interpretation of § 7212(a). The parties have not cited nor has the court located a single published opinion post-Aguilar that affirms a conviction under § 7212(a) where the defendant was not aware of a pending proceeding or investigation or his actions did not deliberately violate other provisions of the Internal Revenue laws. Significantly, there has never been an Eighth Circuit opinion affirming a § 7212(a) conviction outside these two circumstances.

The cases cited by the government pre-date Aguilar. Most are consistent with the narrowed scope of § 7212(a): in three of them the defendant was aware of a pending proceeding or investigation. See United States v. Reeves, 752 F.2d 995, 996 (5th Cir. 1985); United States v. Dykstra, 991 F.2d 450, 451-52 (8th Cir. 1993); United States v. Bostian, 59 F.3d 474, 476 (4th Cir. 1995) (argued pre-Aguilar and decided 16 days after Aguilar with no

[6] In Bowman defendant knowingly supplied false information to the IRS to harass his creditors at a time when no proceedings or investigations were underway.

discussion of Aguilar). In three other cases the defendant's conduct fell within the exception created by Bowman of a violation of other provisions of the Internal Revenue laws: United States v. Yagow, 953 F.2d 423, 424-27 (8th Cir. 1992); United States v. Hansen, 2 F.3d 942, 944 (9th Cir. 1993); United States v. Mitchell, 985 F.2d 1275, 1279 (4th Cir. 1993).

The court finds that Counts 17-22 should be dismissed because the wagers in this case are not subject to taxation as set out above. Alternatively, the court finds Counts 17-22 should be dismissed because the Superseding Indictment does not allege that there was a pending proceeding or investigation of which defendant was aware and directing that money be sent to third parties before tax is imposed does not violate any provision of the Internal Revenue laws.

Accordingly,

IT IS HEREBY RECOMMENDED that defendant Gary Kaplan's Motion to Dismiss Counts 14-22 be **GRANTED**. [Doc. 450]

The parties are advised that they have eleven (11) days in which to file written objections to this report and recommendation pursuant to 28 U.S.C. §636(b)(1), unless an extension of time for good cause is obtained, and that failure to file timely objections may result in a waiver of the right to appeal questions of fact. See Thompson v. Nix, 897 F.2d 356 (8th Cir. 1990).

/s/Mary Ann L. Medler
MARY ANN L. MEDLER
UNITED STATES MAGISTRATE JUDGE

Dated this 28th day of April, 2008.