

**NOT INTENDED FOR PUBLICATION IN PRINT**

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF INDIANA  
INDIANAPOLIS DIVISION

USA,	)	
	)	
Plaintiff,	)	
vs.	)	
	)	
ELLIS, SUSAN B,	)	CAUSE NO. IP06-0076-CR-01-H/F
	)	
Defendant.	)	

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF INDIANA  
INDIANAPOLIS DIVISION

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
v.	)	CAUSE NO. IP 06-76-CR-1 H/F
	)	
SUSAN B. ELLIS,	)	
	)	
Defendant.	)	

ENTRY ON DEFENDANT'S MOTION FOR DISCOVERY

A grand jury indicted defendant Susan B. Ellis on eight counts of violating 26 U.S.C. § 7202 by failing to account for and pay over taxes withheld from employees' paychecks for eight consecutive quarters from 2001 to 2003. Trial is scheduled for February 12, 2007. On December 20, 2006, the court addressed and denied a number of pending defense motions. The court's entry summarized the evidence the government expects to present at trial. See *United States v. Ellis*, 2006 WL 3776379, \*2-3 (S.D. Ind. Dec. 20, 2006). In essence, the government expects to show willful, prolonged and repeated failures to pay to the government many hundreds of thousands of dollars of federal employee tax withholdings that defendant used instead to fund a lavish lifestyle.

Two days after the court denied those motions, on December 22, 2006, defendant filed a motion for extensive discovery to explore potential defenses

based on theories of selective prosecution based on race, sex, and religion, vindictive prosecution, and misuse of the IRS's civil summons authority to aid a criminal investigation. The motion is a classic fishing expedition that seeks to impose enormous costs and delay on the government, and to require the government to turn over virtually every scrap of information about the case, including its internal communications, without a colorable basis for doing so. The defense motion is denied in its entirety.<sup>1</sup> The court should also note at this point that it intends to ensure that the trial focuses on the charges against the defendant and her actions, and not on the government's investigation of her.

I. *Selective Prosecution*

Defendant Ellis is African-American and attends a church that is predominantly African-American. She contends she is the only person prosecuted in this district for a criminal violation of 26 U.S.C. § 7202 in the last 12 years or more. She infers that she might be the victim of unconstitutional discrimination.

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<sup>1</sup>The motion seeks: (a) depositions of six named IRS personnel, their supervisors, other IRS supervisory personnel; (b) personnel records for all persons to be deposed; (c) all internal correspondence between and among IRS and Department of Justice personnel concerning defendant Susan Ellis; (d) IRS and DOJ records of eight categories of tax cases in the Southern District of Indiana in the last 12 years and all such cases assigned to IRS agent Grimes during his career; (e) all IRS and DOJ internal memoranda or guidance regarding criminal referrals for cases under 26 U.S.C. § 7202 (apparently without time or geographic limit); (f) all IRS Forms 2797 and Forms 11661 relating to defendant Ellis; (g) all materials the IRS submitted to the DOJ in this criminal prosecution; (h) all communications between the IRS and DOJ (both in Washington and Indianapolis) regarding defendant Ellis; (i) all internal memoranda or guidance from the IRS and/or DOJ regarding efforts to collect delinquent employment taxes and when the cases should be handled as civil and when as criminal.

Ellis has offered no evidence at all suggesting any hint of sex discrimination. On the issues of race and religion, she has testified in an affidavit that in one meeting, Revenue Agent Grimes “spent considerable time asking questions unrelated to my tax status that were inappropriate and made me uncomfortable, including questions about my religious faith, my church, and several members of my church’s congregation, all of whom were African-American.” Ellis Aff. ¶ 17. Grimes has submitted an affidavit about that meeting. His account is that he asked a number of background questions relevant to Ellis’s knowledge of her tax obligations. He says that Ellis told him there were three important things in her life: her family, her church, and her work, and that she tithed at her church by paying between \$1,000 and \$2,000 per week. Grimes Aff. ¶ 7. He denies asking questions about her church or religious affiliation but said it is possible he might have acknowledged general familiarity with the church.

A prosecutor’s decision to bring criminal charges may not be based on an unjustifiable standard such as race, religion, or other arbitrary classification. *United States v. Armstrong*, 517 U.S. 456, 464 (1996). To obtain even a fraction of the discovery she seeks, however, Ellis would need to make a much stronger preliminary showing of unconstitutionally selective prosecution. In *Armstrong*, the Supreme Court explained that a defendant seeking discovery to support such a theory must come forward with evidence tending to show both discriminatory effect and discriminatory intent. 517 U.S. at 468. Such evidence must include evidence that similarly situated defendants of other races (or religions or sex)

could have been prosecuted but were not. *Id.* at 469. The defendant in *Armstrong* offered evidence that went well beyond what Ellis has presented. The Supreme Court held in *Armstrong* that the district court had abused its discretion by ordering discovery relevant to the suggestion of racially discriminatory prosecution.

Ellis emphasizes that she is the first person to be prosecuted in this district for this crime in the last 12 years and possibly as many as 27 years. She asserts that there probably were hundreds of people in this district who were delinquent in paying employment taxes during those years who were not criminally prosecuted. Two points are relevant in response. First, if there has been a lull in such prosecutions, someone would have to be first. The first defendant would have some race, some gender, and some religious affiliation or lack of affiliation. The first defendant would not be entitled to an inference of discrimination on any of those grounds.

Second, the government's summary of its evidence removes any mystery as to why the government could reasonably choose to pursue this case as a criminal charge. The government intends to offer evidence that between 1996 until 1999, accountants prepared quarterly employment tax returns and calculated the amounts that Ellis needed to deposit, and gave them to Ellis so that she could file the returns and deposit the funds. The accountants discovered in 1999 that Ellis had not filed any returns or made any deposits since 1995. Ellis and the

defendants eventually filed the returns, and she paid at least a portion of the taxes for those years. She then hired an outside payroll processing company to calculate the withholding, to make the tax payments, and to file the returns. Ellis then terminated that contract in early 2001. She took over the responsibilities herself, and then quickly stopped making deposits and filing returns. The indictment covers eight quarters beginning in 2001. Yet throughout the time charged in the indictment, she continued to withhold taxes from her employees' paychecks and kept the money for herself.

It remains to be seen whether the government can prove these allegations at trial. But if the government can establish that Ellis had this history of previously failing to pay and to file returns, then corrected her conduct for a brief time when her accountants discovered her failures, and then reverted to the prior pattern of withholding taxes from paychecks while failing to pay the government or to file returns, its evidence of criminal willfulness could be very strong. Those facts could easily distinguish this case from most in which a delinquent employer might convince the government that she might be able to convince some jurors to have reasonable doubts about whether she understood her legal obligations. The government intends to prove that Ellis had just had a crash course in those obligations only shortly before the conduct that is the subject of the indictment.<sup>2</sup>

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<sup>2</sup>This discussion suggests that the court could not meaningfully address whether other subjects of employment tax investigations were "similarly situated" without trying the merits of both Ellis's case and the cases of the other subjects. The court is confident that the prohibition on unconstitutional prosecutions does  
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The evidence from Ellis, even if the court credits her version of the meeting with Grimes, does not show or even suggest any discriminatory motivation. Her evidence does not identify any other similarly situated defendants or suspects of different races, religions, or sex who were known to the prosecutor<sup>3</sup> but not prosecuted. Instead, Ellis seeks court orders to enable a fishing expedition for information that would allow her to explore whether such defendants or suspects exist. Under *Armstrong*, she is not entitled to such discovery or to a hearing on the selective prosecution theory. Accord, *United States v. Westmoreland*, 122 F.3d 431, 434 (7th Cir. 1997) (defendant failed to offer evidence sufficient to obtain a hearing on theory of racially selective prosecution).<sup>4</sup>

## II. *Vindictive Prosecution*

Ellis argues that prosecutions like this are rare and that she has evidence of retaliation by the IRS for her assertion of her constitutional rights to counsel

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<sup>2</sup>(...continued)  
not expose the government to such a burden of discovery every time it decides to prosecute what it might reasonably perceive to be an especially egregious case. More specific evidence of unconstitutional motivation is needed.

<sup>3</sup>The relevant intent would be the intent of the prosecutor or those who caused the prosecution, perhaps but not necessarily the investigating government agency. See *United States v. Monsoor*, 77 F.3d 1031, 1035 (7th Cir. 1996) (affirming denial of motion to dismiss without evidentiary hearing); *United States v. Goulding*, 26 F.3d 656, 662 (7th Cir. 1994) (affirming denial of dismissal without allowing discovery).

<sup>4</sup>The court denies the requested discovery without addressing the government's argument that allowing the discovery would violate federal law protecting the privacy of tax information, such as 5 U.S.C. § 552a *et seq.* and 26 U.S.C. § 6103.

and to “wage a full and complete defense against criminal prosecution.” First, she notes that IRS records first expressly indicate that the case might be referred for criminal investigation just a few days after the attorney she hired had contacted the IRS. The IRS recognition of a possible criminal referral came shortly after the January 30, 2004 meeting with Grimes. The detailed discussion that occurred in that meeting, followed by Grimes’ further investigation, quite understandably provided a basis for thinking the case might be a possible criminal prosecution. Perhaps at that time Ellis also began to recognize the gravity of the case and acted on the repeated notices from the IRS that she had a right to have a lawyer assist her. There is no indication that the IRS was hostile to her employment of an attorney.

Ellis also asserts that in late 2006, the IRS threatened and then initiated a new civil enforcement action for the tax periods after those covered by the indictment. With her reply brief, she asserts that the IRS has very recently started a civil audit of her brother, whom the government might call as a witness at trial in this case. She infers vindictive retaliation. The court sees no reason to draw that inference. The government appears to be faced with evidence of massive, repeated, and consistent disregard of an employer’s tax obligations, a case in which the employer was deducting the taxes from her employees’ paychecks and keeping the money for herself, with unusually strong evidence of willfulness.<sup>5</sup> In

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<sup>5</sup>At this point, the court is describing only appearances. The court has only heard the government’s summary of its expected evidence, laid out in response to  
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the face of such conduct, the government need not remain passive. Under Ellis's theory, the criminal prosecution would entitle her and all witnesses to an automatic delay on other civil enforcement actions for different tax periods until this criminal prosecution is finally concluded. The court sees no basis for such an entitlement.

The Seventh Circuit appears to apply essentially the same standard for deciding whether discovery is warranted for claims of both selective and vindictive prosecution. See *United States v. Monsoor*, 77 F.3d 1031, 1035 (7th Cir. 1996) (affirming denial of motion to dismiss for both vindictive and selective prosecution without evidentiary hearing); *United States v. Goulding*, 26 F.3d 656, 662 (7th Cir. 1994) (affirming denial of dismissal without allowing discovery); *United States v. Heidecke*, 900 F.2d 1155, 1159 (7th Cir. 1990) (adopting same standard for ordering discovery in cases claiming vindictive and/or selective prosecution). The standard has not been met here.<sup>6</sup>

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<sup>5</sup>(...continued)  
defendant's motions *in limine* and in response to this motion. Defendant has not laid out any evidence she intends to offer to defend herself on the merits of these charges.

<sup>6</sup>Ellis also relies on an affidavit from a retired criminal investigator with the IRS, Marion J. Siara, who testified that criminal prosecutions under 26 U.S.C. § 7202 are rare in this district. Siara claims that he was "unable to identify any evidence of affirmative acts of deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or make things seem other than what they are by Ellis." Siara Aff. ¶ 15. This issue has not been explored yet, but two preliminary observations are in order. First, such affirmative acts of fraud do not appear to be an independent element of the crime charged under § 7202. Willfulness is the standard, and it may be proved in different ways. Second, one  
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### III. *Transition from Civil to Criminal Investigation*

The IRS and many other federal agencies have the power to issue and enforce administrative subpoenas and civil summonses for purposes of administrative and civil investigations without meeting the probable cause standard required for issuance of a search warrant in a criminal case. If the government agency uses administrative or civil procedures in bad faith for the purpose of aiding a case the agency has decided to pursue as a criminal investigation, the case may present some delicate problems. Suppression of evidence obtained by misuse of civil and administrative procedures may become necessary. See generally *United States v. Utecht*, 238 F.3d 882, 886-87 (7th Cir. 2001), citing *Abel v. United States*, 362 U.S. 217, 230 (1960), and *Michigan v. Tyler*, 436 U.S. 499, 508 (1978); *United States v. Peters*, 153 F.3d 445, 451 (7th Cir. 1998). In the IRS context, civil matters generally should be suspended once a criminal investigation begins. *Utecht*, 238 F.3d at 887, citing *Peters*, 153 F.3d at 454. Failure to comply with such requirements in IRS regulations or even

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<sup>6</sup>(...continued)

might consider every single employee pay stub – showing that Ellis’s company was withholding federal employment taxes from the employee’s pay – as an affirmative act of deception. Each pay stub clearly communicated to the employee that the withheld sums *earned by that employee* were being paid over to the United States Treasury. And the employer could reasonably expect her employees to inform the government that the money had been withheld when the employees filed their own tax returns and claimed credit for the payment of those sums.

The court understands that defendant argues this same conduct shows an absence of fraudulent intent. The same conduct would also be consistent with fraudulent intent combined with a foolish hope that the government might not notice, or might not have the resources and will to pursue the case so as to exact a penalty beyond the amounts originally owed.

statutes does not, however, require suppression of evidence obtained by reason of such failures. *United States v. Konzny*, 238 F.3d 815, 818 (7th Cir. 2001). To obtain suppression, a defendant must show a violation of her federal constitutional rights, such as through a coercive custodial interrogation, threat, or false promise. See *id.* at 817-19.

Ellis claims that the government acted in bad faith by using its civil investigative powers to pursue its criminal investigation in her case. The first explicit reference to a possible criminal investigation is Grimes' note on February 17, 2004 that the case Rose was investigating would be transferred to the more experienced Grimes because it was then "a potential CI referral." Def. Ex. 4 at 11. There is an earlier signal that Grimes might have been considering a possible criminal referral on January 30, 2004. His report of his meeting with Ellis includes the statement: "At no point did I request that she file the returns, nor have I in either [of] our two prior phone conversations." Def. Ex. 4 at 9. Ellis says this comment must have been aimed at showing compliance with a directive in the IRS Manual that collection employees should not solicit delinquent returns if there is evidence that the taxpayer acted willfully or if there is any indication of fraud, and thus shows that Grimes believed he had a criminal case as early as January 30, 2004. See *Konzny*, 238 F.3d at 819 (noting cases exploring "the nebulous distinction" between "first" and "firm" indications of fraud).

Ellis's attorney Fred Scott has testified that he spoke with Grimes on February 13, 2004, and Grimes told him that he still expected Ellis to comply with a pending civil summons. Scott Aff. ¶ 6. That was after the January 30, 2004 interview and note but before Grimes's February 18 note describing the case as a possible criminal referral. On April 8, 2004, after another meeting with Ellis and her attorney, Grimes referred the case for criminal investigation. Grimes Aff. ¶ 11. Some time in May or perhaps early June, it appears, the IRS informed Ellis's attorney Scott that the investigation had become a criminal investigation. See Neukam Aff. ¶ 2; Scott Aff. ¶ 13.<sup>7</sup>

The only specific incident of later civil activity Ellis has identified is a telephone call between her agent Kim West Padgitt and an unidentified female with the IRS on or about August 26, 2004. Padgitt has testified that the unidentified woman "did solicit tax returns for outstanding federal employment taxes owed by Pharmasource and asked when she could expect to have them filed." Def. Ex. 6 (Padgitt Aff.). Ellis and Padgitt give no indication of their response, if any. Even accepting Padgitt's account of this telephone call, there is

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<sup>7</sup>Ellis describes as "stunning" the statement that Grimes drove by Ellis's home to see if it appeared to have a high value. Def. Reply Br. at 4. She contends this could only have been relevant to a criminal investigation. The court sees no conceivable intrusion on Ellis's privacy or rights by driving by her residence on a public street. The court also does not view the home evidence as relevant only to a criminal case. The line between civil and criminal fraud is not a bright one, especially in the early stages of an investigation. Grimes was entitled to probe for information that might be relevant to a civil or criminal investigation.

nothing further about the incident that would suggest a need for the massive and intrusive discovery Ellis seeks shortly before trial.<sup>8</sup>

Ellis has not identified any specific evidence that the government intends to offer against her that it obtained from any alleged misuse of civil processes. Nor has Ellis shown any “affirmative misrepresentations,” “affirmative deceit,” or “affirmative misleading” to obtain evidence from her, see *United States v. Kontny*, 238 F.3d at 819, quoting *United States v. Peters*, 153 F.3d at 456-57, where even such evidence would not necessarily be sufficient to suppress evidence. At most, Ellis has shown a basis for exploring that “nebulous distinction” between “first” and “firm” indications of fraud, but that is neither unusual nor a sufficient ground for thinking there might be a basis for suppressing evidence. *Kontny*, 238 F.3d at 219. Ellis has not come anywhere close to stating facts that would hint at, let alone prove, a violation of her constitutional rights under the Fourth or Fifth Amendments. She contends that she and her attorney provided documents, payments and information after Grimes began preparing the criminal referral but before the IRS told her and her attorney that a criminal investigation had begun. She has not argued that there was any requirement that the IRS tell her as the investigation began to shift toward the criminal side. In any event, they did

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<sup>8</sup>IRS Special Agent Emily Neukam has submitted an affidavit testifying that she spoke with Padgitt on August 25, 2004, which was after the IRS had informed Ellis and her attorney that a criminal investigation was proceeding. Neukam denies that she solicited the filing of returns, and asserts that she and Padgitt discussed tax returns only in the context that Padgitt needed certain records to prepare returns, and Neukam was insisting on a timely response to a pending *criminal* summons for records. Neukam Aff. ¶¶ 5-7.

inform her and her attorney, apparently some time in May or perhaps early June 2004, that the case had in fact been referred for criminal investigation. *Neukam Aff.* ¶ 2.

The threshold for obtaining discovery on such a claim of misuse of civil tax collection procedures to aid a criminal investigation is not low. The Seventh Circuit has required a defendant to show a colorable basis for the claim before discovery is allowed, in light of the potential for imposing “enormous administrative costs and delays in tax evasion prosecutions by engaging in extended fishing expeditions to support frivolous challenges.” *Utecht*, 238 F.3d at 887. The defendant’s showing must present “specific, detailed, and material facts in order to carry this burden.” *Id.* Ellis has not done so.

Defendant’s motion for discovery is denied in its entirety. Trial remains scheduled for February 12, 2007.

So ordered.

Date: January 24, 2007

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DAVID F. HAMILTON, JUDGE  
United States District Court  
Southern District of Indiana

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