IN THE UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF COLORADO

IN THE MATTER OF THE TAX LIABILITIES OF: JOHN DOES, United States Merchants who have established Merchant Sales Agreements with First Data Corporation or any of its subsidiaries or affiliates, to process debit card, credit card, charge card, or other payment card transactions pursuant to a referral or any other business arrangement involving or software provided by First Atlantic Commerce, Ltd., a Bermuda Corporation, that results in Net Payments being deposited into an account at a Merchant/Acquiring Bank located outside the United States, at any time during the period January 1, 2002 through the date of service of the summons.	)	Civil No.

MEMORANDUM IN SUPPORT OF *EX PARTE* PETITION
FOR LEAVE TO SERVE "JOHN DOE" SUMMONS

The United States of America respectfully submits the following Memorandum in support of its *Ex Parte* Petition for Leave to Serve John Doe Summons:

INTRODUCTION

This is an *ex parte* proceeding brought by the United States of America, pursuant to Sections 7609(f) and (h) of the Internal Revenue Code (26 U.S.C.), for leave to serve an Internal Revenue Service ("IRS") "John Doe" summons upon First Data Corporation ("First Data"). Section 7609(f) provides that a summons which does not identify the person with respect to

whose liability it is issued may be served only after a court proceeding in which the United States establishes certain factors. These types of summonses are known as "John Doe" summonses. Section 7609(h)(1) provides that a district court in which the person to be summoned resides or is found shall have jurisdiction to hear and determine any proceeding brought under Section 7609(f). First Data is found in this judicial district, as its headquarters is located in Greenwood Village, Colorado. Section 7609(h)(2) provides that any determinations required to be made under Section 7609(f) shall be made *ex parte* and shall be made solely on the petition and supporting affidavits.

QUESTIONS PRESENTED

Whether, as required by Section 7609(f), the United States of America has demonstrated (1) that the "John Doe" summons which the Internal Revenue Service desires to serve upon First Data relates to the investigation of an ascertainable group or class of persons; (2) that there is a reasonable basis for believing that such group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and (3) that the information sought to be obtained from the examination of the records or testimony (and the identities of the persons with respect to whose liability the summons is issued) is not readily available from other sources.

BACKGROUND

Attached to this memorandum is a Declaration by Revenue Agent Daniel Reeves ("Reeves Declaration"). In his Declaration, Reeves describes the tradition of offshore financial accounts in financial privacy jurisdictions. Through a review of numerous studies on the matter and his experience with the Internal Revenue Service, Revenue Agent Reeves explains that a growing number of United States taxpayers are making use of offshore accounts to evade the

reporting and payment of income taxes. In the instant case, the Internal Revenue Service seeks to serve a "John Doe" summons on First Data, a corporation that provides credit, debit, smart card, and stored-value card issuing and merchant-transaction processing services, Internet commerce solutions, and check processing and verification services to financial institutions in 37 countries, including the United States. As described in the Reeves Declaration, the Internal Revenue Service has learned that United States taxpayers who are also merchants, enter into contractual relationships with First Data or its subsidiaries or affiliates, including, but not limited to First Data Merchant Services ("FDMS") and Cardservice International, d/b/a First Data Independent Sales ("FDIS") to settle payment card sales to offshore merchant bank accounts in association with First Atlantic Commerce Ltd., a Bermuda Corporation. The United States seeks to learn the identities of these individuals with the proposed "John Doe" summons.

DISCUSSION

The Internal Revenue Service is conducting an investigation into United States taxpayers[1] who operate businesses, either online or from a physical location, and have some or all of their gross income from credit, debit, and other payment card sales deposited directly into a bank account maintained outside the United States. In furtherance of this investigation, the Internal Revenue Service is requesting authorization to serve a "John Doe" summons on First Data. As

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[1] The term "United States taxpayer" refers to all persons subject to tax in the United States. All United States citizens and resident aliens are liable for federal income taxes on income received from sources within or without the United States; nonresident aliens are only liable for taxes on income from sources within the United States. Pursuant to Section 7701(b)(1), an alien may be treated as a resident for purposes of income taxation if he (1) is a lawful permanent resident of the United States, (2) meets the substantial presence test (this is an objective test in which the number of days the alien is present in the United States are counted), or (3) makes an election to be treated as a resident. *See Lujan v. Comm'r*, T.C. Memo 2000-365, 2000 WL 1772503 (2000).

explained in detail below, the proposed summons meets the necessary elements of a "John Doe" summons.

I. The Summons for Which the Government Seeks Authorization Meets the Requirements of a "John Doe" Summons

Section 7601 of the Internal Revenue Code requires the Secretary of the Treasury to "cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax." Section 7602 authorizes the Secretary to summon records and testimony for that purpose. Specifically, Section 7602 authorizes the Secretary "[f]or the purpose of ascertaining the correctness of any return, making a return where none has been made, [or] determining the liability of any person for any internal revenue tax . . . [t]o summon . . . any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax . . ., or any other person the Secretary may deem proper, to appear . . . and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry."

Section 7602 is the Internal Revenue Service's principal information-gathering authority, and, accordingly, the courts have broadly construed it in light of its intended purpose of furthering the effective conduct of tax investigations. Thus, the courts have repeatedly rejected attempts to circumscribe or thwart the effective exercise of the Internal Revenue Service's summons power. *See, e.g., United States v. Euge*, 444 U.S. 707, 715-716 (1980); *United States v. Bisceglia*, 420 U.S. 141 (1975); *Couch v. United States*, 409 U.S. 322, 338 (1973).

In *Bisceglia*, the Supreme Court held that Sections 7601 and 7602 empowered the Internal Revenue Service to issue a "John Doe" summons to a bank to discover the identity of a

person who had engaged in certain bank transactions. This authority was explicitly codified in Section 7609(f) of the Internal Revenue Code, as added by the Tax Reform Act of 1976. Section 7609(f) provides as follows:

> Any summons . . . which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that –
>
> > (1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,
> >
> > (2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and
> >
> > (3) the information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

The "John Doe" summons for which the United States seeks authorization in the instant case meets those three requirements. It relates to the investigation of an ascertainable group or class of persons – United States taxpayers who have established Merchant Sales Agreements with First Data Corporation or any of its subsidiaries or affiliates, to process debit card, credit card, charge card, or other payment card transactions pursuant to a referral or any other business arrangement involving or software provided by First Atlantic Commerce, Ltd., a Bermuda Corporation that results in Net Payments being deposited into an account at a Merchant/Acquiring Bank located outside the United States, at any time during the period January 1, 2002, through the date of service of the "John Doe" summons. There is a reasonable basis for believing that such group or class of persons may fail, or may have failed, to comply with one or more provisions of the internal revenue laws. And the information sought to be

obtained from the examination of the records or testimony (and the identity of the persons with respect to whose tax liabilities the summonses have been issued) is not readily available from other sources. (Reeves Declaration at ¶ 7.)

A. The Investigation Is Related to an Ascertainable Class

As required by Section 7609(f)(1), the group or class of persons to be investigated here is ascertainable – United States taxpayers who have established Merchant Sales Agreements with First Data Corporation or any of its subsidiaries or affiliates, to process debit card, credit card, charge card, or other payment card transactions pursuant to a referral or any other business arrangement involving or software provided by First Atlantic Commerce, Ltd., a Bermuda Corporation that results in Net Payments being deposited into an account at a Merchant/Acquiring Bank located outside the United States, at any time during the period January 1, 2002, through the date of service of the "John Doe" summons.

This class is readily ascertainable by First Data. As explained in the Reeves Declaration, before a merchant can accept VISA or MasterCard branded debit or credit cards for payment of goods and services, several external business relationships must be established. First, the merchant must establish a direct deposit bank account at a bank that can accept deposits from an electronic processor of card transactions and is a member of the VISA and/or MasterCard network. This account is known as a "Merchant Account." Next, the merchant must contract with a card processor with access to the VISA and MasterCard networks. The card processor acts as an intermediary between the merchant, the merchant's bank, and the customer's card issuing bank. (Reeves Declaration at ¶ 26.)

Once these relationships are established, the card processor manages the authorizing of

the transactions, the securing of payments from card issuing banks, and the making of deposits directly into the merchant's bank account at the end of each business day. Since the card processor actually deposits the funds from payment card sales into the merchant's bank account, the card processor necessarily knows: (1) the identity of the merchant; (2) the location of the merchant's bank account; and (3) the daily amount of revenue from payment card sales. Accordingly, First Data as a card processor, can readily identify which of its clients fall within the ambit of the "John Doe" class. (Reeves Declaration at ¶ 27.)

B. Reasonable Basis Exists for the Belief That the Unknown Persons May Fail, or May Have Failed to Comply with the Internal Revenue Laws

With respect to the second requirement, set forth in Section 7609(f)(2), the Reeves Declaration reflects a reasonable basis for believing that the unknown persons whose identities are sought by the summonses may fail, or may have failed, to comply with one or more provisions of the internal revenue laws.

In the first instance, maintaining a merchant account in any offshore jurisdiction with a widely-known reputation for protecting the identity of its account holders and for not reporting the assets held there for taxation purposes, is inherently suggestive of tax avoidance. More importantly, as described in the Reeves Declaration, offshore merchant accounts are marketed specifically to business owners as a way to operate their businesses in a tax-free environment. (Reeves Declaration at ¶¶ 19-22.) Further, the marketers advertise, another benefit of maintaining an offshore merchant account is taxpayers need not worry about getting their income offshore once they receive it (and presumably triggering any domestic bank reporting requirements) from whatever business they conduct, because its already deposited away offshore directly from whatever business transaction that has occurred. These advertised benefits lead to

the reasonable suspicion that United States taxpayers who maintain these offshore merchant accounts have failed to report these taxable items of sales income on their income tax returns. United States taxpayers are legally bound to report their various items of worldwide income, and failing to do so would be in direct violation of applicable internal revenue laws. *See* 26 U.S.C. Section 6012(a) (imposing a duty to file tax returns reporting income).

In *United States v. Pittsburgh Trade Exchange, Inc.*, 644 F.2d 302, 306 (3d Cir. 1981), the court held that the "reasonable basis" test had been met based upon a revenue agent's testimony that barter transactions of the type arranged by the Pittsburgh Trade Exchange were "inherently susceptible to tax error." In *United States v. Ritchie*, 15 F.3d 592, 601 (6th Cir. 1994), the court held that the mere payment for legal services with large amounts of cash is a reasonable basis for the issuance of a "John Doe" summons. Likewise, as detailed in the Reeves Declaration, the "prime reason" for utilizing and maintaining an offshore merchant account is to ensure that a merchant can pick and choose which sort of tax structure it would like to participate in, including none. (Reeves Declaration at ¶ 20.) This advertised ability of a merchant to purposefully fail to report items of income to the Internal Revenue Service leads to the reasonable suspicion that the "John Does" similarly failed to report such income on their income tax returns. In short, there is a reasonable basis for the issuance of the summons at issue.

The likely similarities between the tax-avoidance activity advertised to would-be offshore merchant account holders described in the Reeves Declaration and the "John Doe" class provide further support for the IRS's reasonable belief that the "John Does" violated internal revenue laws. (Reeves Declaration at ¶¶ 9-22); s*ee, e.g., United States v. Brigham Young University*, 679 F.2d 1345, 1349-50 (10th Cir. 1982), *vacated for consideration of mootness*, 459 U.S. 1095

(1983) (prior audit experience with other contributors that had overvalued "in kind" contributions was a reasonable basis for issuing a "John Doe" summons for the identity of all "in kind" contributors to Brigham Young University); *United States v. Kersting*, 891 F.2d 1407 (9th Cir. 1989) ("John Doe" summons enforced after district court found "the existence of at least one case in which a Tax Court found some of Kersting's programs to be abusive of the tax code." 891 F.2d at 1409. The Ninth Circuit affirmed: "There was ample basis for believing that the persons about whom records were sought had not complied with the tax law." 891 F.2d at 1412).

C. The Identity of Persons in the Class Is Not Readily Available from Other Sources

With respect to the third and final requirement set forth in Section 7609(f)(3), the information sought (and the identity of the persons with respect to whose tax liabilities the summonses have been issued) is not readily available to the Internal Revenue Service from other sources, but is available from First Data. (Reeves Declaration at ¶¶ 35-63.)

The records at issue are in the possession of First Data. Persons in the "John Doe" class may have filed tax returns with the Internal Revenue Service, but their names are unknown, and an inspection of a particular taxpayer's return is not likely to reveal understatements or misstatements of income resulting from transactions concealed through the use of offshore merchant accounts. The only readily available means for the Internal Revenue Service to identify these taxpayers and obtain the records is pursuant to a "John Doe" summons.

II. Courts Have Approved "John Doe" Summonses in a Similar Investigation

The circumstances discussed above have led the Internal Revenue Service to make this request for the Court's approval of the proposed "John Doe" summons. In previous efforts to identify United States taxpayers holding offshore payment cards for which transactional data was obtained from the card associations and merchants, the Internal Revenue Service focused upon U.S. based third-party processors of card transactions, who sometimes maintain records on a contract basis for card issuing banks, including offshore banks.

In this context, on August 2, 2004, the United States District Court for the District of Colorado in Case No. 04-F-1548 (OES), issued an order approving the service of a "John Doe" summons upon First Data because of its involvement then as third-party processor for a number of banks in tax haven or financial privacy jurisdictions. Connected with the same investigation but prior to the previous summons' issuance upon First Data, on September 11, 2003, the United States District Court for the Southern District of Florida in Case No. 03-22177 CIV-MARTINEZ, issued an order approving the service of a "John Doe" summons upon Credomatic of Florida, Inc., another third-party processor for a number of banks in tax haven or financial privacy jurisdictions. The court subsequently entered an order approving service of a modified "John Doe" summons on Credomatic of Florida, Inc., on April 2, 2004. Next, on August 5, 2004, the United States District Court for the Southern District of Florida in Case No. 04-21986 CIV-UNGARO-BENAGES, issued an order approving the service of a "John Doe" summons upon TecniCard, Inc., also a third-party processor for banks in tax haven or financial privacy jurisdictions. Finally, on August 15, 2004, the United States District Court for the Middle District of Georgia in Case No. 4:04CV94-1(CDL), issued an order approving the service of a

"John Doe" summons upon Total Systems Services, Inc., an additional third-party processor for a number of banks in tax haven or financial privacy jurisdictions.

Similarly, courts have also approved the issuance of "John Doe" summonses to credit card companies for the identities of United States taxpayers using offshore credit cards as a means of tax evasion. For example, on October 30, 2000, the Southern District of Florida in Case No. 00-3919 CIV-JORDAN issued an order approving the service of "John Doe" summonses upon American Express and MasterCard International, Inc. Based on the results of the continuing analysis of information obtained from MasterCard, the IRS sought approval for additional summonses and on March 27, 2002, the Northern District of California in Case No. 02-MC-49, issued an order approving the service of a "John Doe" summons upon VISA International. Further, on August 20, 2002, the Southern District of Florida in Case No. 02-22404-CIV-UNGARO-BENAGES issued an order approving the service of a second "John Doe" summons upon MasterCard International. This second summons reflected the larger time period and increased number of offshore jurisdictions the investigation had grown to include since the first "John Doe" summons. Most recently, on February 21, 2006, the United States District Court for the Northern District of California in Case No. C 05-04167 JW issued an order approving service of a "John Doe" summons on PayPal, Inc., an internet-based money transfer service which enables any person with an email address and a bank account or a MasterCard, VISA, or American Express card issued by, through, or on behalf of a bank, to transfer money to any person with an email address.

As a result of the information received and the investigations conducted, the Internal Revenue Service determined that merchants could identify persons who used a particular card to

purchase products or services from them. In an effort to identify the owner of some of the MasterCard payment cards for whom the cardholders remained unidentified, the Internal Revenue Service sought permission to serve "John Doe" summonses on particular merchants. In 26 petitions filed between August 2002 and December 2003, the Internal Revenue Service requested permission to serve "John Doe" summonses on 141 merchants. The information sought from the merchants included names and addresses associated with the transactional data previously produced by the credit card companies. Each summons request was granted.

CONCLUSION

The summons for which the government seeks authorization meets the requirements of a "John Doe" summons. Accordingly, the Court should enter an order granting the Internal Revenue Service leave to serve a "John Doe" summons upon First Data in substantially the form as attached to the Exhibits Appendix to the Declaration of Revenue Agent Daniel Reeves as Exhibit A.

DATED this 14th day of April, 2009.

Respectfully submitted,

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