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PRACTICE POINT

Wives Need Their Own Lawyers When Their Husbands Are Accused of Tax Evasion and Other White-Collar Crimes

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The Sixth Amendment guarantees the right to conflict-free counsel in a criminal case. In addition to the obvious question of whether an attorney can represent co-defendants in a white-collar criminal case,[1] there is the less obvious question of whether the attorney owes a professional duty to non-clients: the criminal defendant's spouse and children. Whether an attorney owes a professional duty to a non-client, including the spouse of a client, depends on the state where the representation takes place.[2] Moreover, the question of whether an attorney-client relationship has formed is fact-specific and an attorney, through direct or indirect communications with the spouse or representations made to prosecutors, courts or others, may create an implied representation of the spouse without ever explaining the actual or potential conflicts of interest to the defendant and his spouse or receiving an informed waiver of those conflicts.[3]

Attorneys who represent defendants in white-collar criminal cases should recommend that their clients' spouses, referred to throughout this article as "White-Collar Wives,"[4] obtain their own counsel as soon as possible. Far too often, attorneys who represent clients in tax evasion and other white-collar criminal cases do not think about the conflicts that could arise between spouses during the life of a white-collar case, or equally as important, how the collateral consequences of a white-collar conviction such as forfeiture, restitution, and civil tax assessments will impact the defendant's spouse and family. As illustrated by the

1 *See*, *e.g.*, United States v. Carona-Vicenty, 842 F.3d 766, 771-72 (1st Cir. 2016) ("A lawyer can represent multiple defendants, but not if the joint representation gives rise to a conflict of interests adversely affecting the lawyer's performance—for then there would be a Sixth Amendment violation.") (internal quotations and citations omitted).

2 *Compare* Massachusetts, where attorneys have a professional duty to nonclients where the attorney knew, or should have reasonably foreseen, that the nonclient would rely on the attorney's services, International Strategies Group, Ltd. v. Greenberg Traurig, LLP, 482 F.3d 1 (1st Cir. 2007), *with* Illinois, where a duty is owed to a nonclient when the intent of the client to benefit the nonclient is the primary purpose of the representation. Oakland Police & Fire Retirement System v. Mayer Brown, LLP, 861 F.3d 644 (7th Cir. 2017).

3 Parker v. Carnahan, 772 S.W.2d 151, 157 (Tex. App. Texarkana 1989, writ denied) (plaintiff's husband was represented by attorneys in criminal tax evasion case based on jointly filed tax returns, plaintiff met and discussed her case with attorneys, and attorneys advised her to sign late-filed tax returns, fact issue on whether attorneys were negligent in failing to advise plaintiff that they were not representing her interests).

4 We refer to the white-collar defendants in this article as men and their spouses as "White-Collar Wives" because a significantly higher proportion of men than women are convicted of white-collar crimes. *See*, *e.g.*, National Incident Based Reporting System (NIBRS) 2016 data, sex of offenders by category. The advice obviously applies to spouses of criminal defendants equally regardless of gender.

Second Circuit's recent opinion in United States v. Daugerdas,[5] White-Collar Wives have important due process and other property rights separate and apart from the defendant. White-Collar Wives who wait too long to get their own attorney—or even worse, never do get their own attorney—risk forfeiting these due process and other property rights entirely, along with the increased risk of being civilly responsible for a tax bill that they didn't have a hand in generating. Money spent protecting and preserving her assets, as well as protecting her from collateral consequences of her husband's trial, is just as important and well-spent as the money spent on her husband's defense.

Eleanor Daugerdas: A Case-Study for White-Collar Wives

Paul Daugerdas is currently serving a 15-year prison sentence for tax evasion, mail fraud, and conspiracy to defraud the IRS, among other things. When he was arrested, Paul's assets were seized pursuant to a post-indictment restraining order, as is common in white-collar criminal cases. Asset seizure is a precursor to forfeiture. Assets are typically seized based on probable cause to believe that property is subject to forfeiture and generally (although not always) must be seized pursuant to a judicial warrant.[6]

Proceeds of most crimes—but not all—are subject to forfeiture. For example, section 891 of the federal money laundering and asset forfeiture statutes authorizes forfeiture of property derived from proceeds of over 200 crimes, including fraud, bribery, embezzlement, and theft.[7] Asset forfeiture is designed to remove all profit from criminal acts, and to restore as much property as possible to victims of crime. Property may be subject to forfeiture if the government can trace the seized property directly to the offense giving rise to the forfeiture.[8] Once Paul Daugerdas committed mail fraud, the government's interest in the proceeds of that mail fraud arose and attached to the money he gained because of the mail fraud.[9]

Following a lengthy jury trial, Paul Daugerdas was found guilty, but won a new trial due to juror misconduct.[10] A second trial again resulted in conviction, and the Court entered an order for criminal forfeiture in the amount of $164,737,500 and an order for restitution in the amount of $371,006,397 against Paul.[11]

When property subject to forfeiture is insufficient to satisfy the forfeiture order against the defendant, courts may order other property of the defendant to satisfy the forfeiture order, "up the value of the missing

5 United States v. Daugerdas, No. 17-898-CV, 2018 WL 2944310, at *9 (2d Cir. June 13, 2018).

6 21 U.S.C. § 853(e).

7 18 U.S.C. § 981(a)(1)(C).

8 21 U.S.C. § 853(a).

9 United States v. Daugerdas, 837 F.3d 212, 231 (2d Cir. 2016).

10 United States v. Daugerdas, 867 F. Supp.2d 455 (S.D.N.Y. June 4, 2012), *vacated and remanded sub nom.*, United States v. Parse, 789 F.3d 83 (2d Cir. 2015) (reversing and remanding for new trial). The fact that Paul had two trials is significant because Paul sought access to restrained funds to pay legal bills for his second trial. After a new trial was ordered but before the new trial began, Paul moved to vacate or modify the post-indictment order restraining his assets, arguing that unless the assets seized and held by the government were released, he would be unable to afford counsel, thus depriving him of his Sixth Amendment right to counsel. United States v. Daugerdas, No. S3 09 Cr. 581 (WHP), 2012 WL 5835203 (S.D.N.Y. Nov. 7, 2012). Although a defendant may be entitled to an adversarial, post-restraint, pretrial hearing to test the finding of probable cause to restrain assets, the defendant must demonstrate that "(1) that the restrained assets are necessary to pay for private counsel, and (2) that the assets were improperly seized." *Id.*, citing United States v. Monsanto, 624 F.2d 1186, 1203 (2d 1991) (*en banc*). Noting that his conviction was overturned due to juror misconduct and not insufficiency of evidence, the court found Daugerdas failed to meet the required elements for a *Monsanto* hearing and denied his motion. In his motion, Paul made many of the same commingling arguments that his wife, Eleanor, raised later.

11 *See* United States v. Daugerdas, Case No 1:09-cr-00581-LTS, Docket Nos. 836, 838.

White-Collar Wives have important due process and other property rights separate and apart from the defendant. White-Collar Wives who wait too long to get their own attorney—or even worse, never do get their own attorney—risk forfeiting these due process and other property rights entirely, along with the increased risk of being civilly responsible for a tax bill that they didn't have a hand in generating.

proceeds."[12] This is known as "substitute property."[13] While the government's interest in proceeds of fraud (and other crimes subject to forfeiture) vests as soon as the proceeds of a forfeiture crime exist,[14] the same is not necessarily true of substitute property. The "relation-back" doctrine that applies to proceeds of fraud does not apply the same way to substitute property, insofar as a third party's interest in substitute property may supersede the government's interest.[15]

Paul's wife, Eleanor Daugerdas, filed a petition in response to the forfeiture order, arguing that certain accounts in her name and the name of an investment company she owns should not be subject to forfeiture.[16] Eleanor's petition, filed almost five years after Paul's arrest and when the property was seized, requested that property in various accounts in various financial institutions be excluded from the forfeiture order.[17]

Eleanor argued that she had a right to keep the accounts because they were substitute property, that her rights attached to the substitute property before the government's, and accordingly her interest in the substitute property required that it be returned to her instead of forfeited.[18] The crux of her argument is that not all of the proceeds in the bank accounts that were ordered to be forfeited could be traced back to the proceeds of fraud, and to the extent that they couldn't be traced back, her interest in that "substitute property" trumped the government's interest and that property could not be used to satisfy Paul's *in personam* forfeiture obligations.[19] Eleanor's accounts were traceable to Paul's fraud, but Eleanor maintained that Paul's "tainted income" (which was indisputably subject to forfeiture upon his conviction for fraud) was "untraceably comingled with other non-tainted funds of [Paul's law firm] while still in the law firm's accounts."[20] The district court granted the government's motion to dismiss Eleanor's petition, finding that even if she could plead additional facts, she lacked standing to petition for the property.

The Second Circuit vacated the district court's order and remanded the case for further proceedings, finding that while Eleanor had not sufficiently pleaded facts to state a claim to the property at issue, she has "significant constitutional rights potentially at stake" and "has a due process right to be heard" on her claim to the property.[21] "[I]f Eleanor's interest in Paul's untainted property . . . vested before, and is therefore superior to, the government's interest," then due process requires that she be allowed to petition the court

12 United States v. Daugerdas, 2018 WL 2944310, at *1. Criminal forfeiture is often characterized as part of the sentence in a criminal case, and is *in personam* against the defendant, compared with an *in rem* action against the property itself in civil forfeiture. *Id*.

13 21 U.S.C. § 853(p).

14 21 U.S.C. § 853(c).

15 United States v. Daugerdas, 2018 WL 2944310, at *6-8.

16 United States v. Daugerdas, Case No 1:09-cr-00581-LTS, Docket No. 853. Eleanor owned the investment company as a result of an assignment from Paul approximately seven years before he was indicted. *Id*. at ¶3.

17 United States v. Daugerdas, Case No 1:09-cr-00581-LTS, Docket No. 853.

18 United States v. Daugerdas, 2018 WL 2944310, at *1.

19 *Id.*

20 *Id*. at *3.

21 *Id*. at *9, 17 n.7.

accordingly.[22] Although Eleanor has been given another chance to show she is entitled to funds in her accounts, it will be difficult for her to gather and present evidence sufficient to prove that her accounts contain "untainted property" now, over nine years from when the property was seized. While it is true that Eleanor could not have brought her petition under section 853(n) until after the forfeiture order was entered, as she did, there are other steps she could have taken earlier to protect her interests.

For example, Eleanor and any White-Collar Wife whose property is seized pursuant to a post-indictment restraining order may file a Motion for Return of Property under Rule 41(g) of the Federal Rules of Criminal Procedure, long before a petition for determination of third-party interests can be filed under section 853(n). Rule 41(g) provides that a "person aggrieved by an unlawful search and seizure of property or by a deprivation of property may move for the property's return." The motion is to be filed in the district court where the property was seized, and "the court must receive evidence on any factual issue necessary to decide the motion."[23] In other words, even if the search was legal, a person who is deprived of her property may use a motion for return of property to ask for it back.

Filing a motion for return of property as early as possible in the criminal proceedings may reduce the amount ultimately due to the government because white-collar crimes have tax implications. All income, whether legal or illegal, must be reported to the Service.[24] When someone is convicted of a white-collar crime, the next step is often an increase in tax due to the failure to report and pay tax on the proceeds of the crime.[25] In addition to having to pay tax on the previously unreported income, someone convicted of a white-collar crime may also be responsible for a 75% fraud penalty on the amount of tax that was not reported due to the illegal activity.[26] If property that is seized is not ultimately forfeited, it can be applied to a tax or other civil liability as of the date that the motion for return of property should have been granted.[27] Because of the onerous penalties and interest that apply to unpaid tax liabilities, the sooner payments are applied, the better.[28]

[A]ny White-Collar Wife whose property is seized pursuant to a post-indictment restraining order may file a Motion for Return of Property under Rule 41(g) of the Federal Rules of Criminal Procedure, long before a petition for determination of third-party interests can be filed under section 853(n).

22 *Id*. at *9.

23 Fed. R. Crim. P. 41(g).

24 Rutkin v. United States, 343 U.S. 130, 137 (1952) ("An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it.").

25 *See*, *e.g.*, Crouse v. Commissioner, T.C. Memo 2011-97 (holding "embezzled funds are includable in gross income for the year in which those funds are embezzled").

26 I.R.C. § 6663; Wright v. Commissioner, T.C. Memo 2000-336 (holding taxpayer who concealed his receipt of embezzled funds was responsible for increase in tax due to embezzled funds as well as 75% fraud penalty on the increase in tax). "Convictions for such crimes are highly probative of petitioner's intent to evade taxes because the activities involve perjury, deceit, breach of fiduciary duty, and concealment of criminal proceeds." *Id*.

27 *In re* Search of 2847 East Higgins Road, Elk Grove Village, Illinois, 390 F.3d 964, 965-66 (7th Cir. 2004) (hereinafter, *East Higgins Road*).

28 *See*, *e.g.*, IRC §§ 6601, 6662.

In *East Higgins Road*, the owner of seized cash filed a motion for return of property.[29] The government argued that the cash was proceeds of tax evasion, but conceded that it was otherwise lawfully earned income.[30] The Court of Appeals for the Seventh Circuit found that income earned from a lawful business is not the fruit of a crime—and therefore is not subject to forfeiture—even if the recipient failed to pay tax on that income.[31] In that case, the taxpayer had directed the government to apply the seized cash to payment of his tax liabilities rather than return it to him shortly after the seizure.[32] As a result, the court did not order the physical return of the cash, but rather found that the funds should be applied to the taxpayer's tax liabilities "as of the date that a motion for return of property should have been granted."[33] If the funds had been subject to forfeiture, they essentially would have vanished into thin air because forfeited funds do not reduce tax liabilities or any other liabilities. Instead, by filing a motion for return of property, the taxpayer succeeded not only in getting the funds applied to his tax liabilities, but also in erasing significant penalties and interest that had accrued while the motion was being litigated. White-Collar Wives who have grounds to file a similar motion may net similar benefits.

Together with other accounts she claims should not be subject to forfeiture, Eleanor's petition, filed in August of 2014, requests that a Goldman Sachs trading account number 4XDG (titled in her name and part of the post-indictment asset seizure) be returned to her.[34] The fact that this account was owned by Eleanor and titled in her name was known early in the criminal proceedings. The government explained in a letter to the Court that it "conferred with counsel for the defendant, Paul M. Daugerdas, who expressed a preference for maintaining the status quo."[35] It isn't clear from the docket entry whether Paul's attorneys consulted Eleanor, as well as Paul, to understand her "preference" along with his, whether Paul's attorneys were considering what was best for Eleanor or what was best for Paul, or whether Eleanor received the legal advice she needed to make an educated decision to give up her right to seek return of those funds at that point in time.

The amounts Eleanor alleged were deposited in her accounts prior to Paul's indictment, which she argues in her petition belong to her, are in excess of $30 million.[36] The petition alleges that $1 million alone was deposited into her Goldman Sachs account over a year before the indictment.[37] Even if all of Paul's accounts and assets were forfeited, if Eleanor had filed a successful motion for return of property with regard to that one account in 2009, she would be in a materially different position than she is today. This is not to say that Eleanor *should* have filed a motion for return of property back in 2009. There are many very good reasons why an attorney representing a White-Collar Wife would decide *not* to file a motion for return of property. Above all, no amount of property being returned is worth being indicted as a co-conspirator, and if there is any risk that asserting ownership over property would lead to that result, then it is not worth trying to get the property returned. But it is important for each White-Collar Wife in this position to make an informed and reasoned decision together with an experienced attorney who is looking out only for her interests.

29 *East Higgins Road*, 390 F.3d 964.
30 *Id.* at 965-66.
31 *Id*.
32 *Id*. at 966.
33 *Id*. at 966.
34 United States v. Daugerdas, Case No 1:09-cr-00581-LTS, Docket No. 853 ¶10.
35 *Id*.
36 *See generally* United States v. Daugerdas, Case No 1:09-cr-00581-LTS, Docket No. 853.
37 United States v. Daugerdas, Case No 1:09-cr-00581-LTS, Docket No. 853 ¶10

Kathleen Manafort, the wife of recently indicted white-collar defendant Paul Manafort, presents another example of the unique problems White-Collar Wives face. Paul Manafort has been indicted for crimes that are subject to forfeiture.[38] The indictments specify assets that are allegedly subject to forfeiture as the fruits of specific alleged crimes, and also declare an intent to seek forfeiture of substitute assets, as in *Daugerdas*. The government has alleged that foreign financial accounts that should have been, but were not, reported to the government are subject to forfeiture.[39] Although Kathleen Manafort is not named in the indictment, her property is included in the list of "records to be seized" on the search and seizure warrant authorized by the court, including any and all foreign financial records.[40]

United States persons who have a direct or indirect interest in foreign financial accounts over a certain amount must report those accounts to the government.[41] Penalties for the failure to do so include significant monetary penalties and up to five years in prison.[42] An attorney representing Kathleen Manafort would need to carefully weigh whether Kathleen has a separate interest in property that was seized, including bank records or bank accounts, before acting. Without question, the primary goal would be to protect Kathleen: arguing that she had an interest in undisclosed foreign financial accounts could potentially expose her to criminal charges and significant civil penalties. On the other hand, if domestic financial accounts of Kathleen's were seized that contain funds that do not have anything to do with her husband's allegedly illegal activity, then she may be able to bring a motion for return of property for those funds.

In addition to the issues surrounding asset seizure and forfeiture, White-Collar Wives face significant collateral consequences from their husbands' battles with the government over funding costs of defense, plea negotiations, the financial statements that must be provided as part of a pre-sentencing investigation, civil tax issues that necessarily follow a conviction for a white-collar crime, and restitution for unpaid taxes. It is well settled that when a defendant pleads guilty to tax evasion and enters into a restitution agreement with the U.S. government, that agreement does not "preclude the IRS from assessing tax liabilities and civil penalties that differ from the restitution for the same period."[43] White-Collar Wives will have different defenses than their husbands to additional assessments, even if they filed tax returns jointly.[44] In addition, an "innocent spouse" may be granted relief from joint and several liability of a portion of the tax allocable to the other spouse.[45] This defense, however, often creates a clear conflict between the two spouses.[46]

Given the rights and defenses available to White-Collar Wives that are not available to defendants, and the significant collateral consequences that families face when a family member is charged with a white-collar crime, white-collar attorneys should counsel their clients regarding the significant benefits of separate representation for their spouses. Particularly where, as in *Daugerdas*, assets that belong to the White-Collar Wife are seized and forfeited along with the defendant's assets, attorneys who are engaged to represent the husband may not be able to advise the wife about her potential rights due to a conflict of interest.[47] If

38 United States v. Manafort, et al., District of Columbia 1:17-cr-00201-ABJ; United States v. Manafort, et al., Eastern District of Virginia, 1:18-cr-00083-TSE.

39 United States v. Manafort, et al., Eastern District of Virginia, 1:18-cr-00083-TSE, Docket No. 9.

40 United States v. Manafort, et al., Eastern District of Virginia, 1:18-cr-00083-TSE, Docket No. 48-1 pg 14.

41 31 U.S.C. §§ 5314, 5322.

42 31 U.S.C. § 5322.

43 Cantrell v. Commissioner, T.C. Memo 2017-20 at *17.

44 I.R.C. § 6013.

45 I.R.C. § 6015.

46 Dorchester Industries Inc. v. Commissioner, 108 T.C. 320, 339 (1997) (stating that "one spouse's claim that she (he) is an innocent spouse can present a conflict of interest to counsel trying to represent both spouses").

47 ABA Rules of Professional Conduct, Rule 1.7.

a spouse does not obtain her own counsel, attorneys representing the defendant should not speak on the spouse's behalf with the government or with the court for fear of creating an implied representation without getting a formal waiver of the potential conflict of interest. ■