

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

UNITED STATES OF AMERICA,)	CASE NO. 1:06CR394
)	
Plaintiff,)	
)	JUDGE ANN ALDRICH
v.)	
)	
JOSEPH H. SMITH, et al.,)	GOVERNMENT’S OPPOSITION TO
)	DEFENDANT ZGOZNIK’S MOTIONS
Defendants.)	TO EXCLUDE EXHIBITS 14, 28-35,
)	147 AND SUMMARIES

The United States respectfully submits the following opposition to Defendant Zgoznik’s Motion to Exclude Exhibits 14, 28-35, 147, and Summaries [dkt no. 104]. As explained below, all of the exhibits that Zgoznik cites are relevant and probative to the allegations in the Indictment.

I. Motion to Exclude Exhibits 14 & 147

Zgoznik asks the Court to exclude tax forms that the Diocese issued to Zgoznik (GX 14) and Zgoznik’s individual tax returns (GX 147). These documents are relevant and probative of Zgoznik’s criminal intent. The purpose of the conspiracy between Zgoznik and Joseph H. Smith, at its most basic level, was to enrich themselves by defrauding the Diocese and the IRS. The

magnitude of the financial benefit that they enjoyed from their scheme is relevant to their intent to commit the crimes alleged in the Indictment. *See, e.g., United States v. Barnes*, 604 F.2d 121, 147 (2nd Cir. 1979) (admitting individual tax returns of defendant to prove, *inter alia*, their criminal intent and motive to commit non-tax crimes; “[i]t has long been the rule that ‘where a defendant is on trial for a crime in which pecuniary gain is the usual motive, evidence of the sudden acquisition of money by the defendant is admissible . . .’”) (quoting *United States v. Jackskion*, 102 F.2d 683 (2^d Cir. 1939)). The evidence demonstrates that Zgoznic’s income increased multi-fold from his modest five-figure salary as Assistant Treasurer at the Diocese in 1997 and 1998, as his businesses grew and profited largely from the outsourced work they performed and billed to the Diocese through 2003, all while secretly kicking back over \$780,000 to Smith. The jury should be able to know about the large financial incentive that Zgoznic had to make these kickback payments.

Zgoznic cites *United States v. Reiss*, 2005 WL 2337917 (D. Minn. 2005) apparently to argue that the government offers Exhibits 14 and 147 to show that Zgoznic had engaged in prior bad acts.¹ *See* Zgoznic Motion at 3 (“Mr. Zgoznic’s personal tax information . . . is used only to

¹Zgoznic cites two other cases in support of his argument, but neither of these cases involved the admission of tax returns and both are irrelevant here. *See United States v. Carter*, 969 F.2d 197 (6th Cir. 1992); *United States v. Apodaca*, 666 F.2d 89 (5th Cir. 1982).

In *Carter* the government, in a case involving solely drug charges, introduced evidence that defendants failed to file their tax returns. The Sixth Circuit concluded that this was an abuse of the district court’s discretion, because tax returns – particularly a failure to file tax returns – had no evidentiary value in proving the drug charges. 969 F.2d at 200-01.

The court’s holding in *Apodaca* – contrary to Zgoznic’s suggestion – did not even involve the introduction of tax returns. Defendant tried to introduce evidence that he had no tax liability, which the court did not allow. The district court also sustained defendant’s objection during closing argument to the government’s reference to his individual tax returns. 666 F.2d at

attempt to prove bad character.”) FRE 404(b). The district court in *Reiss* ruled that evidence concerning defendant’s unfiled tax returns was not admissible as prior bad acts to prove that he assisted in the preparation of a false return. As the court held, “the prior acts evidence is relevant only to show that Reiss engaged in other misconduct with the Internal Revenue Service, thereby showing that Reiss has a propensity to disregard tax law. This is precisely what Rule 404(b) prohibits.” 2005 WL 2337917, at *3.

In this case, the exhibits at issue do not purport to prove prior bad acts or bad character by Zgoznic. The tax documents that the Diocese provided to Zgoznic from 1995 to 1998 cannot possibly show any bad acts by him. Similarly, Zgoznic’s tax returns are not bad acts; the government does not argue that he did anything improper with them. They are being offered to show Zgoznic’s motive and intent when he decided to leave the Diocese and subsequently defraud it. There is no basis to exclude them here.

II. Motion to Exclude Government Exhibits 28-35

Zgoznic also moved to exclude government exhibits 28 through 35 on the ground that they are not relevant and are prejudicial. As an initial matter, it must be noted that the revised exhibit list that the government provided to Zgoznic’s defense counsel did not include GX 31, 32, 34, and parts of 35, because we viewed these documents as not sufficiently relevant to the allegations that Zgoznic faces. In addition, GX 33 is reserved. It is unclear why Zgoznic identifies an exhibit range of 28-35 when half of these exhibit numbers were not included in the government’s list.

96-97. This case says nothing about the use of returns to show Zgoznic’s income and intent to defraud.

In any event, the remaining exhibits that the government may introduce at trial are directly relevant to Smith and Zgoznic's conspiracy to defraud the IRS. These documents detail payments Joseph Smith received from an insurance brokerage firm, Willis Corroon ("Willis"), which was doing substantial business with Diocese. Although the indictment alleges that Smith received these payments as kickbacks, our primary focus on the payments in Zgoznic's trial involves Zgoznic's false representations concerning Smith's reported Schedule C income -- which included the Willis payments. While Willis initially recorded the payments to Smith as "consulting" fees, in May 1998 the CEO of the Willis Cleveland office signed an agreement with Smith for Willis purportedly to rent a condo Smith owned in Florida for \$1,250 per month. Willis made the monthly "rental" payments by checks to JHS Enterprises. Willis never, in fact, used the condo under this supposed lease. Despite the ostensible lease arrangement, Smith reported the receipts as business income on his JHS Enterprises Schedule C for at least two years -- 1998 and 1999 (and not as rental income on his Schedule E).²

Count 18 of the Indictment alleges as part of the Smith-Zgoznic conspiracy to defraud the IRS, that:

During an IRS examination ("audit") of SMITH's 1999 federal income tax return, ZGOZNIK represented SMITH, during which time ZGOZNIK made false representations to the IRS Revenue Agent that JHS Enterprises was a legal and consulting business, the receipts of which represented payments for consulting services, and concealed the fact that most of the amounts reported as receipts were actually kickback payments. ZGOZNIK also fraudulently presented documentation of expenses purportedly incurred by SMITH in the course of the supposed consulting business.

²For the 2000 tax year, Smith reported \$15,000 on his Schedule C, but it is unclear whether this income was from Willis or from a \$15,000 check from Catholic Cemeteries Association payable to JHS Enterprises.

Count 18, ¶ 11 p. 25. Among the payments included as supposed consulting services on the 1999 return was the \$15,000 Smith received from Willis that year pursuant to the “rental” agreement from Willis. *See*, Indictment, Count 19 at 28. We expect the evidence to show, consistent with the allegations, that Zgoznik falsely characterized the receipts in his meeting with the IRS agent conducting the audit.

As a result, the documents that the government may introduce are probative of the fact that the payments from Willis were not receipts of an actual consulting business operated by Smith, which Zgoznik must have known when he represented Smith at the audit. This is especially important since Zgoznik presented documents to justify the expenses Smith supposedly incurred to operate this business. More specifically:

- GX 28 shows a transactions listing of payments by Willis to JHS from May 1994 through December 2000.
- GX 29 is the “Rental Arrangement Agreement” between Smith and Willis, supposedly justifying the monthly \$1,250 payments from Willis to JHS Enterprises.
- GX 30 are the Willis vouchers for payments to JHS Enterprises.
- GX 35 are documents related to Smith’s ownership of the Florida condo that Willis allegedly leased from Smith.

All of these documents are relevant to prove that the \$15,000 of payments from Willis included in Smith’s Schedule C receipts were not from a legal consulting business, as Zgoznik falsely told the IRS auditor. By misleading the auditor, Zgonzik took an affirmative step to perpetuate the IRS conspiracy scheme, which also included concealment of the fact that most of the JHS Enterprises reported receipts were actually kickbacks from Zgoznik’s companies.

In short, Zgoznik's conspiratorial conduct during the 1999 audit cannot be fully shown without an understanding of the Willis component in Smith's Schedule C reported receipts.

III. Motion to Exclude Summaries of Payments by the Diocese to the Zgoznik Entities

Zgoznik also moves the Court to exclude from evidence the summaries of payments from the Diocese to the Zgoznik entities. Zgoznik argues that "[t]hese are payments as to which there is no dispute that the payments were properly earned." (Motion at 5).

That is precisely the opposite of what the government alleges. The basis premise of the kickback conspiracy is that Smith's receipt of the concealed kickbacks deprived the Diocese of his honest services -- that is, he had an improper, undisclosed financial incentive to make sure the Zgoznik companies were sufficiently compensated to assure the continued flow of kickback payments to himself. One of the key features of the scheme was that the payments -- while totaling roughly \$17 million over the years -- were made through numerous, relatively small amounts billed to separate offices of the Diocese and certain constituent organizations. Although the defense has indicated that outsourcing was a known and approved process by the Diocesan Financial Advisors, the budgets they approved for the various offices only showed the type of expenses and not whether they were performed in-house or through outsourcing (or, in the latter case, what particular vendor). One of our exhibits will include a sample of invoices from Zgoznik companies for a single month, consisting of 47 separate invoices (largely to different Diocese offices or organizations, each with its own separate budget), from three different Zgoznik companies. (Exhibit 50-1 through 50-47). Indeed, we have included on the exhibit list and are considering offered as a bulk exhibit all of the invoices for the entire kickback period.

Regardless of whether all of the invoices are offered, the summary listing of the invoices will help the jury understand how the outsourcing occurred without the large total dollar amount -- or Zgoznik's control over all of the companies receiving the payments -- being readily apparent.³ The summaries in issue are actually a compilation of all of the invoices and related payments, running numerous pages in length. They are admissible, regardless of whether the underlying invoices are in evidence, under Federal Rule of Evidence 1006. A kickback scheme has two components: money going to a vendor and money coming back from the vendor to the dishonest employee. The summaries in question properly show the payments-to-vendor component.⁴

Zgoznik nevertheless maintains that the amount of the payments itself -- over \$17.5 million -- will be prejudicial, and that the government will ask the jury to "speculate that the mere amount of the accounting fees is evidence itself of impropriety." (Motion at 5). On the contrary, the amount that the businesses grossed, combined with the personal income that Zgoznik drew (as discussed above in connection with his request to exclude his personal tax

³Part of the conspiracy was for the nominal ownership of one of the Zgoznik Entities -- ZJA, later IFA, to be in the name of Zrino Jukic.

⁴Although proof of a scheme to violate an employee's duty of honest service through kickbacks does not require proof of actual financial harm, the indictment also alleges that "Zgoznik and Smith caused the Diocese and constituent organizations to pay for more outsourced services by the Zgoznik Entities and to pay higher costs for the outsourcing than they would have otherwise have paid to order to generate funds to pay the kickbacks to Smith." (General Allegation ¶ 21). Thus, while we do not doubt that many honest employees of the Zgoznik Entities performed valuable services to the Diocese, we will offer evidence that to some degree the Diocese purchased more services, or paid more for the services than would be the case absent the improper financial relationship between Smith and Zgoznik. Contrary to Zgoznik's contention, the government very much disputes that all the payments to the Zgoznik entities were properly earned, and the government expects that the Court will hear substantial evidence at trial in this regard.

returns), provide the context in which he had the incentive and wherewithal to pay the kickbacks to Smith. Moreover, we expect members of the Financial Advisors to testify that they were misled into believing that Zgoznic's companies were receiving substantially less than the summaries reveal and were shocked when they learned the actual magnitude.

The kickbacks were not paid in a vacuum. The money that Zgoznic's companies received and profit it generated for him personally provide the context to explain Zgoznic's motive and intent for his conspiracies with Smith. The jury is entitled to see invoice-by-invoice, and in total, the way in which Zgoznic generated the profits from which he paid Smith -- money Smith would not otherwise have been able to receive.

CONCLUSION

For the foregoing reasons, the government respectfully submits that Zgoznic's Motion should be denied.

Respectfully submitted,

GREGORY A. WHITE
United States Attorney

By: s/John M. Siegel
John M. Siegel (#210336 (D.C.))
Assistant U.S. Attorney
801 West Superior Avenue
Cleveland, Ohio 44113
(216) 622-3820; (216) 522-2403 (fax)
E-mail: john.siegel@usdoj.gov

s/Jerrod C. Patterson
Jerrod C. Patterson (#481438 (D.C.))
Trial Attorney
U.S. Department of Justice, Tax Division
Northern Criminal Enforcement Section
601 D Street, NW
Washington, D.C. 20530
(202) 305-2672; (202) 616-1786 (fax)
E-mail: Jerrod.Patterson@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certify that on August 15, 2007, a copy of the foregoing pleading was filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. All other parties will be served by regular U.S. mail. Parties may access this filing through the Court's system.

s/John M. Siegel
John M. Siegel (#210336 (D.C.))
Assistant U.S. Attorney
801 West Superior Avenue
Cleveland, Ohio 44113
(216) 622-3820; (216) 522-2403 (fax)
E-mail: john.siegel@usdoj.gov