

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS, LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. McGINN, DAVID L. SMITH,
LYNN A. SMITH, GEOFFREY R. SMITH, Trustee
of the David L. and Lynn A. Smith Irrevocable Trust
U/A 8/04/04, GEOFFREY R. SMITH, LAUREN
T. SMITH, and NANCY McGINN,

Case No.: 1:10-CV-457

(GLS/CFH)

Defendants,

LYNN A. SMITH and NANCY McGINN,

Relief Defendants, and

GEOFFREY R. SMITH, Trustee of the David L.
and Lynn A. Smith Irrevocable Trust U/A 8/04/04,

Intervenor.

PLEASE TAKE NOTICE that upon the accompanying Memorandum of Law in Support of Defendant David L. Smith and Lynn A. Smith's Joint Motion for Modification of the July 22, 2010 Preliminary Injunction Order to Release Assets to Pay Taxes Due and Owing, the Declaration of William J. Dreyer, Esq. and accompanying exhibits submitted in support thereof, defendants David L. Smith and Lynn A. Smith will move this Court, pursuant to Fed. R. Civ. P.

60(b)(6), before the Honorable Christian F. Hummel at the United States District Court for the Northern District of New York, 445 Broadway, Albany, New York, on July 18, 2013 at 9:00 a.m., for an Order granting the release of \$257,601.00 from Lynn A. Smith's assets to be used for payment of joint tax obligations to the Internal Revenue Service.

Dated: June 17, 2013
Albany, New York

DREYER BOYAJIAN LLP

/s/ William J. Dreyer

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Intervenor.

DECLARATION OF WILLIAM J. DREYER

WILLIAM J. DREYER, hereby declares under penalty of perjury:

1. I am an attorney duly admitted to practice in this Court. I am a partner in the law firm of Dreyer Boyajian LLP, counsel to David L. Smith in the above-captioned case and in the

parallel criminal proceedings. James D. Featherstonhaugh represents Lynn A. Smith in above-captioned case.

2. I submit this Declaration and the attached exhibit in support of David L. Smith and Lynn A. Smith's Joint Motion for Modification of the July 22, 2010 Preliminary Injunction Order to Release Assets to Pay Taxes Due and Owing.

3. On April 25, 2013, the government provided my office with Revenue Agent Reports (Form 4549) calculating Mr. and Mrs. Smith's joint taxes due and owing in an amount of \$257,601.00 for tax years 2006 - 2009. The Revenue Agent Reports also calculated the interest and penalties that have accrued. See **Ex. "A"**.¹

4. The taxes due and owing are currently outstanding and will continue to accrue penalties and interest charges unless paid.

5. The taxes due and owing have been conclusively determined and therefore have priority over any subsequent investor claim against the defendants' assets.

6. It is respectfully requested that this Court grant the relief sought in this Motion and direct the Receiver to release from Mrs. Smith's stock account the sum of \$257,601.00 and remit same to the IRS upon further instructions of the Court.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed on: June 17, 2013

/s/ William J. Dreyer
WILLIAM J. DREYER

¹ The Revenue Agent Reports will be filed separately under seal.

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T. SMITH, and NANCY McGINN,

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Defendants,

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GEOFFREY R. SMITH, Trustee of the David L.
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Intervenor.

**MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS
DAVID L. SMITH'S AND LYNN A. SMITH'S JOINT MOTION FOR
MODIFICATION OF THE JULY 22, 2010 PRELIMINARY INJUNCTION ORDER
TO RELEASE CERTAIN ASSETS TO PAY TAX OBLIGATIONS**

PRELIMINARY STATEMENT

Defendants David L. Smith and Lynn A. Smith respectfully submit this Memorandum of Law in support of their Motion requesting a Modification of the Preliminary Injunction Order issued on July 22, 2010, which froze all assets of both movants. This modification is requested in order to allow Mr. and Mrs. Smith to pay their joint tax obligations for the years 2006–2009 which are currently outstanding as a result of the February 6, 2013 convictions of Mr. Smith. See United States v. McGinn and Smith, 1:12-cr-00028 (DNH), Dkt. No. 108. These tax obligations continue to incur significant penalties and interest charges and Mr. and Mrs. Smith are seeking to satisfy the tax due and owing calculated by the IRS with certain assets of Lynn A. Smith. The Court is authorized to grant such relief pursuant to Rule 60(b)(6) of the Federal Rules of Civil Procedure.

FACTUAL BACKGROUND

On July 22, 2010, this Court entered a Preliminary Injunction Order which froze all assets of Mr. and Mrs. Smith which are currently under the control of the Receiver appointed to this case. Through Mr. Smith's former counsel, he consented to the Preliminary Injunction Order but did not admit or deny the allegations of the Complaint and reserved his right to apply to this Court at any time for a modification of said Order.

On March 26, 2012, the civil proceedings in this case were stayed due to the related pending criminal case against Mr. Smith and currently remain stayed. See Dkt. No. 474. On February 6, 2013, Mr. Smith was convicted on 15 of 29 counts of the Superseding Indictment, including three counts of Filing a False Tax Return. See United States v. McGinn and Smith, 1:12-cr-00028 (DNH), Dkt. No. 108.

Mr. Smith's criminal convictions have resulted in tax liabilities for both Mr. and Mrs. Smith for the years 2006, 2007, 2008, and 2009 as they jointly filed for those years. On April 25, 2013 counsel for Mr. Smith received Revenue Agent Reports prepared by the IRS concerning the taxes and penalties for tax years ending in 2006 through 2009. The Revenue Agent Reports (Form 4549) result in tax due and owing in the amounts of \$63,286.00 for tax year 2006, \$97,049.00 for tax year 2007, \$80,679.00 for tax year 2008, and \$16,587.00 for tax year 2009, resulting in a total tax due and owing of \$257,601.00 by Mr. and Mrs. Smith.¹

ARGUMENT

POINT I

ASSETS SHOULD BE RELEASED BECAUSE THE TAXES DUE AND OWING HAVE PRIORITY OVER ANY FUTURE JUDGMENTS, PREDATE AND ARE UNRELATED TO ANY ALLEGATIONS OF FRAUD, AND PAYMENT OF TAXES IS IN THE BEST INTERESTS OF THE INVESTORS.

It is well-established that along with the power to freeze a defendant's assets, this Court also possesses the power to modify the order to best serve the interests of justice. See S.E.C. v. Unifund Sal, 917 F.2d 98, 99 (2d Cir. 1990). The primary goal of an asset freeze is to ensure "that any funds that may become due can be collected." Smith v. S.E.C., 653 F.3d 121, 127 (2d Cir. 2011). When weighing a request to modify a freeze, "the disadvantages and possible deleterious effect . . . must be weighed against the considerations indicating the need for such relief." S.E.C. v. FTC Capital Markets, Inc., 2010 WL 2652405, at *3 (S.D.N.Y. 2010) (citing S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d. 1082 (2d Cir. 1972)). "In considering the scope and propriety of such relief, the court should assess whether it is in fact in the allegedly

¹ The \$257,601.00 tax due and owing amount does not include interest and penalties calculated by the IRS to date or to be calculated in future at Mr. Smith's sentencing. Counsel for Lynn A. Smith intends to challenge any fraud penalties attributable to Mrs. Smith in further adjudication of this matter.

defrauded investors' interests.” S.E.C. v. Coates, 1994 WL 455558, at *1 (S.D.N.Y. 1994). By its nature, an order freezing an alleged wrongdoer’s assets is an instrument of equity, and as such, it should not be used as a means to heap penalties upon an alleged wrongdoer. Manor Nursing Centers, 458 F.2d at 1104.

A. Lynn Smith’s Assets Should Be Released Because Any Future Judgment is Subordinate to Current Tax Obligations.

“Absent provision to the contrary, priority [of creditors] for purposes of federal law is governed by the common-law principle that the first in time is the first in right.” I.R.S. v. McDermott, 507 U.S. 447, 449 (1993) (internal citations omitted). As the SEC has previously acknowledged, the government is equally as deserving of restitution for funds they were allegedly defrauded of. See Dkt. 249, p. 17 (“Regardless of whether the SEC distributes the disgorged profits to individual investors who suffered losses or to the Treasury, these profits remain a debt owed by culpable defendants to the government.”). There has been no judgment in the civil case and any amount allegedly owed to individual investors has yet to be determined. Furthermore, there have been no final conclusions made with respect to any wrongdoing on behalf of Mrs. Smith. In contrast, the movants’ liability to the IRS has been adjudicated by virtue of David Smith’s convictions for filing false joint tax returns and as such, the IRS, being the first creditor to conclusively establish entitlement to restitution, has established itself as “first in line” and is therefore entitled to payment out of the frozen assets.

B. Lynn A. Smith’s Assets Should be Released Because the Assets Predate and are Unrelated to Any Fraud Alleged by the SEC.

The scope of assets frozen to ensure recovery by allegedly defrauded investors should be narrowly tailored. See, e.g., S.E.C. v. Am. Bd. of Trade, Inc., 645 F. Supp. 1047, 1050 (S.D.N.Y. 1986) aff’d, 830 F.2d 431 (2d Cir. 1987) (finding asset freeze permissible because it

was “narrowly tailored.”). However, a large portion of assets frozen by the Preliminary Injunction Order predate the alleged fraudulent activities and have not been shown to have furthered or benefited from the alleged fraud. Nevertheless, stock and other assets inherited by Mrs. Smith in 1968 were included in the assets frozen by the Preliminary Injunction Order. Since 1968, Mrs. Smith held these assets as her separate property and exercised sole authority for their disposition. Mr. Smith’s involvement was limited to providing investment advice and administering her stock account in accordance with her wishes and duties as her broker. Any assertions by the SEC that Mr. Smith controlled her stock account as his own is misplaced as they are well aware that Mr. Smith had a brokerage account in his own name alone. Furthermore, Mrs. Smith’s stock assets had already amassed significant value prior to commencement of the alleged fraud in 2003. See Dkt. 456-1. As such, in the interest of equity, this Court should modify the Preliminary Injunction Order to allow the release of Lynn A. Smith’s assets that are unrelated to, and predate, any allegations of fraud to pay the joint tax obligations.

C. Lynn Smith’s Assets Should be Released Because Payment of the Taxes Due and Owing is in the Best Interest of the Investors.

On a motion to release funds from an asset freeze, a party “must establish that such a modification is in the interest of the defrauded investors.” S.E.C. v. Grossman, 887 F. Supp. 649, 661 (S.D.N.Y. 1995) aff’d sub nom. S.E.C. v. Estate of Hirshberg, 101 F.3d 109 (2d Cir. 1996). Here, the release of sufficient to satisfy the taxes due and owing is in the best interests of the investors in order to ensure that potentially recoverable assets are not wasted. As discussed supra, the existing tax liability has priority over any subsequent judgment obtained on behalf of investors. By refusing to allow the release of sufficient funds to satisfy the outstanding tax

obligation, the funds available to pay any future judgments obtained on the behalf of investors will be substantially diminished as the result of the accrual of interest charges and penalties. Therefore, the release of these funds is in the best interest of the allegedly defrauded investors in order to protect any future judgment they might obtain.

POINT II

IF THE ASSETS ARE NOT RELEASED, THE IRS MUST BE ESTOPPED FROM CHARGING ADDITIONAL PENALTIES AND INTEREST AGAINST DAVID AND LYNN SMITH.

If funds necessary to satisfy the taxes due and owing are not released, the IRS must be estopped from charging additional penalties and interest charges to David and Lynn Smith. To require a defendant to default on established tax obligations as the result of an asset freeze “would effect a nonsensical result.” United States v. Madeoy, 652 F. Supp. 371, 377 (D.D.C. 1987) (authorizing release of funds to avoid default on federal taxes owed). Under 26 U.S.C. § 6651, penalties imposed as a failure to pay taxes due and owing are excused upon a showing of “reasonable cause.” A taxpayer exercises reasonable cause where they utilized “ordinary business care and prudence but nevertheless w[ere] unable to file the return within the prescribed time.” United States v. Boyle, 469 U.S. 241, 246 (1985) (internal citations omitted). Here, the defendants have made all possible attempts to secure funds to pay their taxes due and owing. However, despite their efforts, a denial of this motion would effectively prevent them from meeting their obligation. A court order preventing them from acting would clearly constitute good cause, and therefore, the IRS should be estopped from holding them liable for additional penalties and interest. It would be unjust and inequitable to hold the defendants responsible for penalties on a tax obligation that they have made all reasonable efforts to pay.

CONCLUSION

Based on the foregoing and the accompanying Declaration of William J. Dreyer, Esq., defendants David L. Smith and Lynn A. Smith respectfully request that their Motion to Modify the July 22, 2010 Order to Release Funds to Pay Taxes Due and Owing be granted.

Dated: June 17, 2013
Albany, New York

DREYER BOYAJIAN LLP

/s/ William J. Dreyer

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