

Insights

FINRA PANEL BARS REGISTERED INDIVIDUAL FOR FAILURE TO PRODUCE TAX TRANSCRIPTS NOT IN HIS IMMEDIATE POSSESSION, BUT RATHER MAINTAINED BY THE IRS

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In a recent decision by a FINRA Office of Hearing Officers Panel, FINRA barred a registered individual who failed to produce his personal IRS tax transcripts, which were not in his immediate possession but rather maintained by the Internal Revenue Service (“IRS”). View the case [here](#). FINRA Rule 8210 gives FINRA “the right,” as part of an authorized investigation, complaint, examination, or proceeding, to “inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation, complaint, examination, or proceeding that is in such member's or person's **possession, custody or control**” (emphasis added). In a divided Hearing Panel decision, the Panel majority held that the registered individual had the authority to request the transcripts from the IRS, by providing a Form 4506-T to the IRS, and thus the tax transcripts were “controlled” by the registered individual and should have been produced. This decision and other official guidance¹ further demonstrate FINRA's increasingly expansive view of the scope of Rule 8210, to require individuals to authorize obtaining documents that are not in the individual's immediate control or possession.

FINRA's decision in *Dept. of Enforcement v. Wilfredo Felix and Primex Prime Electronic Execution, Inc. d/b/a Primex*, followed an investigation into various business practices of Primex and Felix. Felix was the firm's sole shareholder, as well as the Chief Executive Officer, Chief Financial Officer, and Chief Compliance Officer. Felix was also the firm's FINOP and was responsible for making entries in the general ledger, filing FOCUS Reports, and had sole signatory authority over the firm's bank accounts. Interestingly, Felix did not maintain any bank accounts of his own. The FINRA investigation began after a cycle examination uncovered suspicious ledger entries believed to represent personal expenses. FINRA suspected that Felix was using firm funds for his own expenses in order to avoid personal tax liability.

Between 2016 and 2018, FINRA staff made a total of five requests for Felix to produce his personal IRS tax transcripts. Included in the requests was a request that, if Felix did not actually have the transcripts, to complete a Form 4506-T to obtain the transcripts. Felix did not produce any tax transcripts, nor did he complete the Form 4506-T. In 2018, FINRA staff investigating Felix and

Primex twice renewed the earlier requests and added the years 2016 and 2017. These requests included Rule 8210 language warning Felix that failure to respond may expose him to sanctions, including a bar from association with a member firm. Once again Felix failed to produce any transcripts. In response to all five requests made between 2016 and 2018 Felix asserted that the records being sought were not authorized under Rule 8210. In its complaint, FINRA only charged Felix for his failure to produce a transcript for the year 2013.

The Panel majority expressly found that “Rule 8210 obligated Felix to obtain his 2013 IRS Transcript.” *Id.* at 49. The Panel majority held that Felix violated FINRA Rules 8210 and 2010 for his failure to produce or request from the IRS his personal tax transcript for the year 2013². In particular, the Panel majority found that the transcripts were in fact “of” Felix, because they concerned his own tax related information and were analogous to phone records maintained by a phone company. Also relevant was that the transcripts were created with information provided by Felix to the IRS. Because Felix had the authority to request the transcripts from the IRS, the Panel determined that the records were under his “control” as envisioned by Rule 8210. Given Felix’s failure to take any steps to obtain the transcripts to provide to FINRA, the Panel majority determined that a bar was appropriate, simply relating to this issue.³ The Panel’s decision in this case is currently on appeal to the FINRA National Adjudicatory Council.

While dissents are exceedingly rare in FINRA Hearing Panel decisions, a Panellist dissented on this particular issue. Specifically, the dissent stated that Rule 8210 “is not intended to compel an associated person to produce the sort of information preserved in an IRS Transcript that is only indirectly created by the taxpayer and sign and submit a form to the IRS to obtain a copy.” *Id.* at 57. The dissent believed that the tax transcripts were of a different nature of document than tax returns, bank statements or telephone records, all of which are the types of documents FINRA has in the past ruled are subject to Rule 8210. For these reasons, the dissenting Panellist disagreed with the liability findings and sanctions with respect to the IRS tax transcripts.

The thrust of the majority’s decision was predicated on amendments made to Rule 8210 in December 2012, and set forth in Regulatory Notice 13-06. The amendments expanded the scope of Rule 8210 to more closely align with the existing case law supporting Rule 34 of the Federal Rules of Civil Procedure. According to Notice 13-06 the addition of the word “control” now “requires firms, associated persons, and other persons over whom FINRA has jurisdiction to provide records that they have the legal right, authority, or ability to obtain upon demand.” The notice also states that the supplementary material attached to the amended rule “further indicates that all aspects of the relationship between a broker-dealer and its associated persons are potentially the subject of a Rule 8210 request.” The amendments were intended to clear up the legal uncertainty which followed the Securities Exchange Commission’s decision in *Jay Alan Ochanpaugh*, in which the Commission overturned an NASD disciplinary decision compelling a registered individual to turn over checks written on the account of a religious organization for which the individual was an officer. By explicitly adding the “possession, custody, or control” standard and linking the scope of Rule 8210

to a well-developed and robust body of federal case law, FINRA made clear its intent to significantly expand the scope of Rule 8210 and avoid a future outcome like that in *Ochanpaugh*.

Firms and their associated persons should carefully consider the plain language of the *Wilfredo Felix and Primex* decision, and also evaluate its potential scope. Responses to future Rule 8210 requests from FINRA will not only have to be evaluated in terms of documents that are in the Firm's immediate possession, but also those documents for which FINRA could credibly argue the firm and its registered persons effectively have access to or the ability to obtain. It is likely that FINRA Enforcement will continue to push the envelope on the scope of Rule 8210. Given the dire consequences of failing to take action with respect to a Rule 8210 request, Firms should carefully discuss with FINRA the precise documents FINRA is seeking in a Rule 8210 request, and then document that understanding.

1. See, e.g., Frequently Asked Questions About FINRA Rule 8210 (Information and Testimony Requests) available at <https://www.finra.org/rules-guidance/guidance/faqs/finra-rule-8210-information-testimony> (last visited Oct. 12, 2020).

2. The panel also reached a decision on five additional causes of action against both Felix and Primex. Two involving keeping of false books and records and misleading or false FOCUS reports. One regarding an untimely response to a November 2015 request for information. The other two alleged that Felix provided false or misleading information to FINRA during the course of an examination or investigation.

3. FINRA issued additional sanctions against both Felix and Primex for separate violations. However, the additional sanctions leveled against Felix were not imposed in light of his bar in all capacities.

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