

## Dropped by I.R.S.

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SAN DIEGO, June 25 — The Internal Revenue Service has withdrawn from a Federal grand jury's criminal investigation of C. Arnholt Smith and has notified the long-time friend of President Nixon that it will not prosecute him on charges of income tax fraud.

The reasons behind the I.R.S. decision, following three years of intensive investigation by a study group of up to 15 agents of the I.R.S. and the Federal Bureau of Investigation.

An I.R.S. source in Washington said the agency was stepping aside in deferment to other elements of the Smith criminal investigation, including the Securities and Exchange Commission, the Federal Deposit Insurance Corporation,

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the Controller of the Currency and the Justice Department. He said the decision had been prompted by the Justice Department.

On instructions from Washington, the tax agency's district counsel was understood to have recalled testimony and documentary evidence already given to the grand jury that has been in session here nearly a year, delving into Mr. Smith's tangled finances and the collapse of his \$1.5-billion banking and industrial empire.

Instead of seeking his indictment on criminal charges, the I.R.S. will concentrate on negotiating a civil settlement of its \$22.8-million assessment for unpaid 1969 personal income taxes that it levied last Aug. 3 against 75-year-old Mr. Smith.

The \$22.8-million claim, the largest tax lien ever brought against an individual for a single year, has been held in abeyance pending the grand jury's action on criminal indictments.

Thomas Sheridan, Mr. Smith's chief tax attorney, said he had received notification from the I.R.S. regional counsel's office in Los Angeles that the tax agency would not prosecute his client for criminal tax evasion.

The brief letter, received six weeks ago, did not go into the reasons for the decision, Mr. Sheridan added.

Deputy United States Attorney Warren P. Reese, who is directing the grand jury investigation, confirmed that the revenue agency had called off its criminal prosecution of Mr.

Smith and described it as "a rational conclusion in view of all the circumstances." He declined to elaborate on the nature of those circumstances.

The I.R.S. regional counsel Emory R. Lungdon, acknowledged that the Smith case had recently come under reconsideration.

He said agency regulations had prevented him from providing further information because it was not a matter of court record.

Such decisions, Mr. Langdon explained, are made in Washington on the basis of recommendations by the service's intelligence division and after consultation with the Treasury and Justice Departments.

Richard Trattner, a former I.R.S. agent and one of Mr. Smith's tax attorneys at the time of the I.R.S. notification, was asked if pressure had been applied by Mr. Smith and his lawyers to quash the criminal action.

"Yes, at every opportunity, at the regional level and in Washington, and the Government evidently came around to agreeing with us that any basis for criminal tax action was very flimsy indeed," he said.

In early 1970, Harry Steward, the United States Attorney in San Diego was accused of refusing to issue a grand jury subpoena sought by agents for the Internal Revenue Service and the Federal Bureau of Investigation for Frank Thornton, a Smith associate, during an investigation of bribery and corruption involving several city officials.

Mr. Steward once said he counted on Mr. Smith to help him obtain a Federal judgeship.

Mr. Thornton, according to the investigators, would have been a key witness linking Mr. Smith to illegal 1968 Nixon campaign contributions disguised as tax-exempt business expenses of Smith-controlled companies.

When the agents complained of Mr. Steward's conduct to the Department of Justice in Washington, where he was exonerated of any wrongdoing by then Deputy Attorney General Richard G. Kleindienst, one of the I.R.S. agents, no longer in Government service, came under White House pressure.

The agent, David Stutz, told the staff of Leon Jaworski, the special Watergate prosecutor, during two days of questioning last November of attempts by White House aides to obtain from him, without the knowledge of his superiors in the tax agency, details of the evidence collected against Mr. Smith in 1970.

He said he twice resisted efforts by John J. Caulfield, through an intermediary, to persuade him to meet secretly

and discuss the Smith evidence with John D. Ehrlichman, then Presidential counsel, first in Washington and later at the Western White House at San Clemente.

To what extent if any the I.R.S. about-face will affect the Government's over-all criminal case against Mr. Smith and several business associates was unclear.

Mr. Reese said withdrawal of the I.R.S. tax fraud evidence had neither weakened the Government's case nor hampered the work of the grand jury.

This was disputed by an associate of Mr. Smith who said the Government's hopes of convicting Mr. Smith had rested largely on the I.R.S. case.

The over-all case involves "massive frauds" charged to Mr. Smith and several others in the near-collapse of his Westgate - California Corporation and its 39 subsidiaries and the failure last Oct. 13 of the Smith-controlled United States National Bank.