No. 09-86

In the Supreme Court of the United States

MICHAEL H. BOULWARE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

ELENA KAGAN
Solicitor General
Counsel of Record
JOHN A. DICICCO
Acting Assistant Attorney General
ALAN HECHTKOPF
S. ROBERT LYONS
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTIONS PRESENTED

In *Boulware* v. *United States*, 128 S. Ct. 1168, 1180 (2008), this Court held that 26 U.S.C. 301 and 316, which govern the taxation of distributions by a corporation to a shareholder with respect to its stock, do not require "contemporaneous intent" to treat a corporate distribution as a nontaxable return of capital. The Court remanded to permit the court of appeals to determine whether petitioner's offer of proof on the return-of-capital defense was sufficient under a correct construction of the law. On remand, the court of appeals affirmed petitioner's conviction and sentence.

The questions presented are:

1. Whether the court of appeals correctly determined that petitioner's offer of proof was insufficient to justify the presentation of a "return of capital" theory to the jury because petitioner failed to tender evidence that the distributions were "with respect to * * * stock."

2. Whether the court of appeals exceeded this Court's mandate in concluding that petitioner's proffer was also insufficient for lack of evidence of sufficient stock basis.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-16) is reported at 558 F.3d 971. Prior opinions of the court of appeals (Pet. App. 17-32, 33-73) are reported at 470 F.3d 931 and 384 F.3d 794, respectively.

JURISDICTION

The judgment of the court of appeals was entered on March 9, 2009. A petition for rehearing was denied on April 22, 2009 (Pet. App. 88). The petition for a writ of certiorari was filed on July 20, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the District of Hawaii, petitioner was con-

victed on five counts of filing false tax returns, in violation of 26 U.S.C. 7206(1), four counts of tax evasion, in violation of 26 U.S.C. 7201, and one count of conspiring to make a false statement to a federally insured financial institution, in violation of 18 U.S.C. 371. Pet. App. 33-36. The court of appeals, in a prior appeal, affirmed the conspiracy conviction but reversed the tax convictions and remanded for a new trial. *Id.* at 34-35. This Court denied a petition for a writ of certiorari. 546 U.S. 814 (2005). On remand, petitioner again was found guilty by a jury on the tax counts, and he was sentenced to 36 months of imprisonment on the false return counts and 60 months on the tax evasion and conspiracy counts, to run concurrently. Pet. App. 18-19. On a second appeal, the court of appeals affirmed the convictions and sentence. *Id.* at 17-32.

This Court granted a writ of certiorari, and vacated the court of appeals' decision and remanded for further proceedings. See *Boulware* v. *United States*, 128 S. Ct. 1168, 1182 (2008) (*Boulware I*). The Court held that, contrary to the court of appeals' decision, petitioner did not need to establish contemporaneous intent as an element of his defense theory that the diverted funds were nontaxable as constructive returns of capital under 26 U.S.C. 301 and 316. *Boulware I*, 128 S. Ct. at 1173, 1179-1180. On remand, the court of appeals once again affirmed petitioner's conviction and sentence. Pet. App. 1-16.

1. The Internal Revenue Code (Code) requires "[e]very individual having for the taxable year gross income which equals or exceeds" a statutorily determined amount to file a tax return and pay taxes. 26 U.S.C. 6012(a)(1)(A). Section 61(a) of the Code defines "gross income" as "all income from whatever source de-

rived," a broad definition that includes both lawful and unlawful gains. 26 U.S.C. 61(a); see *James* v. *United States*, 366 U.S. 213, 219 (1961) (plurality opinion); *Rutkin* v. *United States*, 343 U.S. 130, 136-137 (1952).

Section 7201 of the Code makes it a felony to "willfully attempt[] in any manner to evade or defeat any tax imposed by this title." 26 U.S.C. 7201. To support a conviction for income tax evasion, the government must prove the existence of a tax deficiency, an affirmative act of attempted evasion of tax, and willfulness. See *Sansone* v. *United States*, 380 U.S. 343, 351 (1965).

In this case, the existence of a tax deficiency turned on Sections 301 and 316 of the Code, which govern distributions of property "made by a corporation to a shareholder with respect to its stock." 26 U.S.C. 301(a). Section 301(c) divides distributions made with respect to stock into three categories: (1) the portion that is a dividend (as defined by 26 U.S.C. 316) is taxable as ordinary income; (2) any portion that is not a dividend is treated as a return of capital up to the amount of the shareholder's basis in his stock and is nontaxable, but is "applied against and reduce[s]" the shareholder's "adjusted basis of the stock"; and (3) any amount in excess of the shareholder's basis is taxable as a capital gain. 26 U.S.C. 301(c).

Section 316 in turn defines a "dividend" as a distribution of property by a corporation to its shareholders "out of its earnings and profits." 26 U.S.C. 316(a)(2). Section 316(a) further provides, with exceptions not pertinent here, that "every distribution is made out of earnings and profits to the extent thereof." 26 U.S.C. 316(a). Read together, Section 301 and Section 316 establish that, if a corporation makes a distribution of funds to its shareholders "with respect to its stock," the tax conse-

quences of the distribution depend, in part, on whether the corporation has earnings and profits and the amount of the shareholder's adjusted stock basis.

2. Petitioner was the president, founder, and controlling shareholder of Hawaiian Isles Enterprises (HIE), a distributor of tobacco, water, coffee, vending machines, and video games. Pet. App. 18. Following a six-year investigation, the Internal Revenue Service (IRS) determined that petitioner had diverted more than $10 million from HIE and failed to report or pay taxes on that income. The scheme involved a variety of devices, including giving HIE checks to friends and employees and instructing them to cash the checks and return the cash to petitioner; and using false invoices to obtain a loan from a federally insured bank. Petitioner laundered the money through companies in the Kingdom of Tonga and Hong Kong, and used the diverted funds to support a lavish lifestyle, giving millions of dollars in HIE funds to his girlfriend, as well as his wife. *Id.* at 19, 35-39.

In his first trial, petitioner was convicted on five counts of filing a false tax return, in violation of 26 U.S.C. 7206(1); four counts of tax evasion, in violation of 26 U.S.C. 7201; and conspiracy to make a false statement to a federally insured financial institution, in violation of 18 U.S.C. 371. See Pet. App. 34; *Boulware I*, 128 S. Ct. at 1174 n.4. The court of appeals affirmed the conspiracy conviction, but reversed the tax convictions. Pet. App. 33-73.

Petitioner was retried and again convicted on the five counts of filing false tax returns and the four counts of willfully attempting to evade taxes. Pet. App. 19. At trial, the government presented evidence that petitioner diverted more than $10 million from the corporation for

his personal use and failed to report the funds as income on his personal tax returns. In response, petitioner asserted a number of alternative theories in an attempt to show that the diverted funds were nontaxable to him, including that the diversions were nontaxable returns of capital under Sections 301 and 316; that the diversions were actually loans; and that the funds were held in trust for the purchase of his then-wife's stock. *Id.* at 38, 64-66.

During the second trial, the government moved to preclude petitioner from introducing evidence concerning his return-of-capital theory. Pet. App. 4. In response, petitioner presented an offer of proof consisting of (1) evidence that he contended showed that the corporation had overreported its earnings; (2) evidence that petitioner was the controlling shareholder of HIE; and (3) expert testimony to the effect that, if the corporate funds were not loans or advances or if petitioner did not use those funds for corporate purposes, then the funds could be deemed a taxable constructive dividend or a nontaxable constructive return of capital, depending upon whether the corporation had earnings and profits. *Id.* at 20; J.A. at 96-99, *Boulware I*, *supra* (No. 06-1509).

The district court held that petitioner's offer of proof failed to tender sufficient evidence to warrant submitting the return-of-capital theory to the jury. The court concluded that petitioner's proposed expert testimony was inadmissible legal opinion. Pet. App. 4. The court also held that the proffer as a whole was insufficient under *United States* v. *Miller*, 545 F.2d 1204 (9th Cir. 1976), cert. denied, 430 U.S. 930 (1977), because petitioner had not tendered any evidence that the diverted funds were intended, at the time of their disbursement, to be a return of capital. The court accordingly declined

to instruct the jury on petitioner's return-of-capital theory. Pet. App. 4

3. The court of appeals affirmed the convictions and sentence, holding that petitioner's return-of-capital proffer was properly rejected as inadequate under *Miller*. Pet. App. 19-23. The court of appeals therefore did not address whether petitioner's proffer satisfied the other conditions for asserting a nontaxable-return-of-capital defense.

4. This Court granted a writ of certiorari and vacated the court of appeals' decision on the ground that Sections 301 and 316 do not require a defendant to demonstrate contemporaneous intent in order to argue that a distribution should be treated as a return of capital. *Boulware I*, 128 S. Ct. at 1173, 1180.

The Court remanded the case to the court of appeals to permit that court to consider the sufficiency of petitioner's return-of-capital proffer in light of *Boulware I*. 128 S. Ct. at 1180-1182. The Court noted that it agreed with the government's argument that Section 301(a)'s use of the phrase "with respect to . . . stock" imposes "a limiting condition" on the application of that provision, contemplating that "the distribution of property by the corporation be made to a shareholder because of his ownership of its stock" and that "an amount paid by a corporation to a shareholder [be] paid to the shareholder in his capacity as such." *Id.* at 1180 (citations omitted). The Court stated that "[f]acts with a bearing on [that condition] may range from the distribution of stock ownership to conditions of corporate employment (whether, for example, a shareholder's efforts on behalf of a corporation amount to a good reason to treat a payment of property as salary)." *Id.* at 1180-1181 (footnote omitted). The Court accordingly declined to "home in on the

'with respect to . . . stock' condition," stating that "[t]he facts in this case have yet to be raked over with the stock ownership condition in mind, since *Miller* seems to have pretermitted a full consideration of the defensive proffer, and if consideration is to be given to that condition now, the canvas of evidence and Boulware's proffer should be made by a court familiar with the whole evidentiary record."[1] *Ibid.*

5. On remand, the court of appeals, in accordance with the Court's remand order, "conduct[ed] a thorough examination of the record to determine whether or not [petitioner's] offer of proof was sufficient to justify the presentation of a 'return of capital' theory to the jury." Pet. App. 2. After holding that the district court had properly excluded the expert testimony portion of petitioner's proffer as inadmissible legal opinion, *id.* at 7-8, the court of appeals turned to the remainder of petitioner's formal offer of proof—evidence that petitioner was a shareholder and that HIE had overreported earnings, *id.* at 8-9—and held that the proffer was "plainly insufficient to satisfy the elements necessary to assert a return of capital theory," *id.* at 9.

In examining whether there was evidence upon which a jury could rationally find that the diversions were distributions "with respect to * * * stock," as required by

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[1] The Court also noted that Section 301 contained other limiting conditions, including that the diversion of funds be a "distribution"; that the distribution not exceed the recipient's stock basis; and that the corporation have no earnings and profits. *Boulware I*, 128 S. Ct. at 1180 n.12. Citing the government's acknowledgment that although it viewed petitioner's proof as insufficient on these issues as well, it had not raised these grounds for affirmance in its opposition to a writ of certiorari, the Court stated that the government did not dispute these issues. *Ibid.* (citing U.S. Br. at 34 n.11, *Boulware I*, *supra* (No. 06-1509)).

Section 301, the court of appeals explained that "[a] defendant is entitled to an instruction concerning his theory of the case if the theory is legally sound and evidence in the case makes it applicable." Pet. App. 6 (quoting *United States* v. *Morton*, 999 F.2d 435, 437 (9th Cir. 1993)). To show that a distribution was with respect to stock, the court held that "at the very least a taxpayer must tender some evidence of nexus between the corporate distribution and stock ownership," either through affirmative evidence or evidence raising an inference that "there were no other alternative explanations" for the distribution. *Id.* at 13-14. Petitioner's proffer, the court concluded, was devoid of any affirmative evidence suggesting "that any nexus existed between the distribution and [petitioner's] stock ownership." *Id.* at 13. Similarly, petitioner failed to raise a negative inference "that he only could have received the distribution in his capacity as a shareholder," because his proffer did not attempt to exclude other non-shareholder capacities in which he could have received the distribution and, in fact, it "offered evidence and alternative theories that the distribution was a loan or was distributed in trust." *Ibid.*

The court also held that petitioner's proffer was insufficient on the independent ground that it contained no evidence upon which a jury could rationally find, as Section 301(c) requires, "that [petitioner's] basis exceeded the value of the distribution[s]." Pet. App. 14. Noting that petitioner's "offer of proof did not, on its face, purport to tender evidence on this element," the court "look[ed] to the entire record to ascertain whether there was sufficient evidence to make a threshold showing." *Id.* at 14-15. Examining the transactions that petitioner asserted created basis in his stock, the court concluded

that "[f]rom all of this evidence a jury could conclude that [petitioner] was a shareholder with a stock basis, but the evidence tendered was insufficient to meet the threshold requirement that he have a stock basis in excess of [the] $10 million" in diverted funds. *Id.* at 15.

ARGUMENT

Petitioner seeks review of the court of appeals' determination that petitioner failed to tender evidence supporting the elements of his return-of-capital theory. The court of appeals' conclusion—reached after performing the review of "the whole evidentiary record" that this Court contemplated in remanding the case, *Boulware I*, 128 S. Ct. at 1181—is correct, and petitioner's fact-bound challenge does not merit further review.

1. a. Petitioner first contends (Pet. 10-13) that the court of appeals erroneously imposed an excessive burden on petitioner in determining that his proffer contained insufficient evidence that the distributions were "with respect to * * * stock." Petitioner acknowledges (Pet. 10), however, that he bears the burden of production—of "tender[ing] some evidence," Pet. App. 13-14—with respect to his theory that HIE's distributions were constructive returns of capital. Petitioner also acknowledges (Pet. 11) that the court of appeals articulated the correct legal standard for analyzing the sufficiency of his evidentiary proffer, stating that "a defendant is entitled to an instruction concerning his theory of the case if the theory is legally sound and evidence in the case makes it applicable, even if the evidence is weak, insufficient, inconsistent, or of doubtful credibility." Pet. App. 6 (quoting *United States* v. *Kayser*, 488 F.3d 1070, 1076 (9th Cir. 2007)).

Petitioner's contention (Pet. 10-12) that the court actually held him "to a far more stringent burden," requiring him to "'establish' the fact that the jury would be asked to determine," is thus in essence an argument that the court erred in concluding that petitioner had not proffered sufficient evidence that the distributions were with respect to stock. That fact-bound contention does not merit this Court's review.

In *Boulware I*, this Court stated that a distribution may satisfy Section 301(a)'s requirement that the distribution be "with respect to . . . stock" if it is "made to a shareholder because of his ownership of its stock," or is "paid to the shareholder in his capacity as such." 128 S. Ct. at 1180. The court of appeals accordingly required petitioner to tender some evidence of a "nexus between the corporate distribution and stock ownership," Pet. App. 14, either through "affirmative evidence" or "negative inference," *id.* at 13.

Petitioner contends (Pet. 12-13) that a jury could have inferred this nexus because petitioner owned 50% of HIE's stock; he already "drew a substantial salary from HIE for his service as president and chairman," Pet. 13; and "the record evidence [does not] compel a finding that [the] distributions" were received as loans or repayments, rather than in a shareholder capacity, *ibid.* But as the court of appeals correctly concluded, petitioner's proffer did not contain any affirmative evidence that there was any connection or nexus between the distributions and petitioner's stock ownership. The mere fact that petitioner was a shareholder of HIE does not establish such a nexus with respect to the specific transactions at issue, given that a shareholder can receive funds in a non-shareholder capacity, for instance, as the recipient of a loan. Pet. App. 13. Nor can peti-

tioner rely on a negative inference that he did not receive the funds in a non-shareholder capacity, because his proffer did not attempt to exclude all such scenarios, and in fact it presented evidence that petitioner did receive the diverted funds in a non-shareholder capacity, *i.e.*, as loans or in trust for the purchase of his then-wife's stock. *Id.* at 14 n.7. The court of appeals therefore correctly held that petitioner did not proffer sufficient evidence of his return-of-capital theory to submit it to the jury.

b. Petitioner next contends (Pet. 13-17) that the court of appeals' requirement of some evidence of a nexus between the distribution and the stockholder's stock ownership creates "tax limbo," and conflicts with the treatment of the "with respect to * * * stock" condition in civil tax cases. Neither argument is correct.

First, petitioner asserts (Pet. 16) that the court of appeals' decision relegates the distributions at issue to "tax limbo," because the diverted funds are neither subject to Sections 301 and 316, nor subject to any other provision of the Code. Petitioner is correct that the purpose of Section 301(a)'s requirement that a distribution be "with respect to * * * stock" is to distinguish between distributions made to a shareholder because of his stock ownership, and those made to a shareholder in his non-shareholder capacity; and that if a distribution is not made "with respect to * * * stock," then other provisions, not Sections 301 and 316, govern its tax treatment. But the fact that petitioner was unable to present sufficient evidence that the funds should be subject to Sections 301 and 316, and was also unable to prove at trial that the funds were nontaxable under any other provision (for instance, as a loan or a trust distribution), does not suggest that the diversions fall into some unde-

fined category. Rather, it simply reflects the fact that petitioner received the funds as an embezzler, and embezzled funds that do not fall within any other provision are properly taxable as income under the general definition of income in Section 61(a). See *James* v. *United States*, 366 U.S. 213, 219 (1961) (plurality opinion).

Second, petitioner contends (Pet. 17) that the court of appeals' conclusion that his proffer was insufficient is inconsistent with civil cases wherein, he asserts, "courts simply infer (usually without comment) that a controlling shareholder receives the distribution because of his stock ownership in the absence of affirmative evidence that he received it in some other, nonshareholder capacity." But the decisions that petitioner cites (Pet. App. 17 n.5) did not comment on the "with respect to * * * stock" requirement because in each case, the court was engaged in deferential review of either the IRS's administrative determination or a jury's verdict that a corporate distribution was taxable as a constructive dividend, and the taxpayers did not challenge the determinations under review on the ground that the distributions were not "with respect to * * * stock."[2] The fact that these

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[2] See *Neonatology Assocs., P.A.* v. *Commissioner*, 299 F.3d 221, 231-232 (3d Cir. 2002) (taxpayer claimed distributions were deductible expenses); *Pittman* v. *Commissioner*, 100 F.3d 1308, 1313-1314 (7th Cir. 1996) (taxpayer argued that he did not personally benefit from distribution); *Crowley* v. *Commissioner*, 962 F.2d 1077, 1080 (1st Cir. 1992) (taxpayers claimed distributions were loans); *Green* v. *United States*, 460 F.2d 412, 419-421 (5th Cir. 1972) (taxpayer claimed distributions were not dividends because the funds went to his children); *King's Court Mobile Home Park* v. *Commissioner*, 98 T.C. 511, 514-515 (1992) (taxpayer claimed distributions were deductible wages); *Federbush* v. *Commissioner*, 34 T.C. 740, 749-751 (1960) (taxpayer claimed distributions were deductible loss expenses), aff'd, 325 F.2d 1 (2d Cir. 1963) (per curiam).

decisions addressed only the specific arguments raised by the taxpayers cannot be taken as implicitly holding that a distribution can be assumed to be with respect to stock in the absence of any evidence. Notably, petitioner cites no case in which the "with respect to * * * stock" issue was actually contested and the court refused to require a nexus between the distribution and stock ownership, or suggested that no such "*express* evidence" (Pet. 16) was necessary.[3]

2. Petitioner next challenges (Pet. 18) the court of appeals' conclusion that petitioner's failure to tender proof of sufficient stock basis "provid[ed] an additional justification for the trial court to preclude [petitioner] from presenting a return of capital theory," Pet. App. 14-15, because, in his view, examination of that issue exceeded the scope of this Court's remand. Further review of this question is unwarranted, both because the court of appeals' ruling on the "with respect to * * * stock" element of petitioner's proffer is sufficient to support the judgment, and because the court's fact-specific stock-basis ruling is correct.

Boulware I did not bar the court of appeals from considering on remand whether petitioner had proffered evidence of sufficient stock basis. In its brief before this Court in *Boulware I*, the government stated that petitioner's proffer was insufficient as to the stock-basis element, but acknowledged that it had not raised that

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[3] Contrary to petitioner's argument (Pet. 17 n.6), the Tax Court's approval of the Commissioner's fact-specific conclusion that certain distributions made by HIE to pay petitioner's legal expenses— distributions that are not at issue in this case—were "with respect to * * * stock" does not suggest that the Tax Court applied a different standard to the Section 301 inquiry in that case. See *HIE Holdings, Inc.* v. *Commissioner*, 97 T.C.M. (CCH) 1672, 1745 (2009).

issue in its opposition to the petition for a writ of certiorari or in its briefing before the court of appeals, except in opposition to petitioner's petition for rehearing. Pet. 6 n.2 (quoting brief). Citing that acknowledgment, the Court noted that the government did not "dispute that [petitioner] offered sufficient evidence of his basis and HIE's lack of earnings and profits." *Boulware I*, 128 S. Ct. at 1180 n.12.

The Court's recognition that the government did not urge the stock-basis point as an additional ground for affirmance in *Boulware I* did not purport to limit the issues that the court of appeals could consider in conducting the full record review that the Court contemplated on remand. See 128 S. Ct. at 1180 n.12; *id.* at 1180-1181. As a result, the question whether to address the stock-basis issue, even though the government did not raise it before the rehearing stage or rely on it before this Court in *Boulware I*, was a matter for the court of appeals' discretion. See Pet. App. 15 n.9; cf. *United States Nat'l Bank* v. *Independent Ins. Agents of Am., Inc.*, 508 U.S. 439, 447-448 (1993) (court of appeals has discretion to consider issues notwithstanding waiver). The court did not abuse that discretion, particularly in view of the fact that *Miller* "pretermitted a full consideration of the defensive proffer" not only as to the "with respect to * * * stock" element, but also the stock-basis element. *Boulware I*, 128 S. Ct. at 1181.

Contrary to petitioner's argument (Pet. 19), it was not unfair for the court of appeals to consider the stock-basis issue without allowing petitioner to supplement his formal proffer. As the court of appeals noted, the focus of the arguments before the district court on *Miller*'s intent requirement did not relieve petitioner of his burden of tendering evidence with respect to each element

of the return-of-capital defense in his proffer to the district court. Pet. App. 13 n.5; *United States* v. *Dorrell*, 758 F.2d 427, 430 (9th Cir. 1985). After examining not only petitioner's formal proffer, but all of the transactions that petitioner asserts created basis in his stock, the court of appeals correctly determined that the "evidence tendered was insufficient to meet the threshold requirement that he have a stock basis in excess of $10 million." Pet. App. 15. That fact-bound conclusion does not warrant this Court's review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ELENA KAGAN
Solicitor General
JOHN A. DICICCO
Acting Assistant Attorney General
ALAN HECHTKOPF
S. ROBERT LYONS
Attorneys

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