No. 16-810

In the Supreme Court of the United States

JOSEPH P. NACCHIO, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Petitioner Joseph Nacchio was convicted on multiple counts of insider trading. As part of his sentence, the district court ordered criminal forfeiture to the United States of the net proceeds realized by petitioner from his insider-trading offenses. The question presented is as follows:

Whether the criminal forfeiture imposed against petitioner constitutes a "fine or similar penalty" within the meaning of 26 U.S.C. 162(f) so as to bar any deduction for the forfeited amount.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-25a) is reported at 824 F.3d 1370. The opinion of the Court of Federal Claims (Pet. App. 29a-50a) is reported at 115 Fed. Cl. 195.

JURISDICTION

The judgment of the court of appeals was entered on June 10, 2016. A petition for rehearing was denied on September 23, 2016 (Pet. App. 51a-53a). The petition for a writ of certiorari was filed on December 21, 2016. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Section 162 of the Internal Revenue Code allows a deduction, with certain exceptions, for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

26 U.S.C. 162(a). Section 165 provides for the deduction of "any loss sustained during the taxable year and not compensated for by insurance or otherwise." 26 U.S.C. 165(a). For individuals, however, the availability of that deduction is limited to losses incurred in a "trade or business"; a "transaction entered into for profit, though not connected with a trade or business"; or losses from fire, storm, shipwreck, theft, or other casualty. 26 U.S.C. 165(c).

Before 1969, the availability of a deduction under 26 U.S.C. 162 or 165 was subject to an overriding public-policy limitation that precluded a deduction where its allowance "would frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some governmental declaration thereof." *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U.S. 30, 33-34 (1958) (citing *Commissioner* v. *Heininger*, 320 U.S. 467, 473-474 (1943)). In *Tank Truck Rentals*, this Court upheld the disallowance of a deduction for fines paid by a trucking company for violations of state maximum-weight laws, observing that "[w]here a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction for its payment." *Id.* at 34 (citation omitted). The Court explained that "[d]eduction of fines and penalties uniformly has been held to frustrate state policy in severe and direct fashion by reducing the 'sting' of the penalty prescribed by the state legislature." *Id.* at 35-36; see *Commissioner* v. *Tellier*, 383 U.S. 687, 694 (1966) (stating that allowance of a deduction for fines and penalties imposed under state penal statutes "would have directly and substantially diluted the actual punishment imposed"); *Jerry Rossman Corp.* v. *Commis-*

sioner, 175 F.2d 711, 713 (2d Cir. 1949) ("[W]hen acts are condemned by law and their commission is made punishable by fines or forfeitures, to allow these to be deducted from the wrongdoer's gross income, reduces, and so in part defeats, the prescribed punishment.").

In 1969, Congress codified the "frustration of public policy" doctrine in 26 U.S.C. 162, as part of the Tax Reform Act of 1969 (Tax Reform Act), Pub. L. No. 91-172, § 902(a), 83 Stat. 710. That statute denies a deduction for payments in situations "which are deemed to violate public policy." S. Rep. No. 552, 91st Cong., 1st Sess. 274 (1969). As relevant here, Section 162(f) provides: "Fines and Penalties.—No deduction shall be allowed under subsection (a) for any fine or similar penalty paid to a government for the violation of any law." 26 U.S.C. 162(f). Although the amendments to Section 162(f) did not explicitly affect Section 165, the "frustration of public policy" doctrine has continuing vitality with respect to loss deductions claimed under Section 165. See *Stephens* v. *Commissioner*, 905 F.2d 667, 671 (2d Cir. 1990) ("Although *Tellier* and *Tank Truck Rentals* were both decided pursuant to Tax Code provisions relating to business expenses, the test for nondeductibility enunciated in those opinions is applicable to loss deductions under Section 165."); *Wood* v. *United States*, 863 F.2d 417, 421 (5th Cir. 1989) (holding that "it is easy to sustain a public policy rationale for denying a loss deduction" sought under Section 165). Accordingly, a deduction that is barred by Section 162(f) would likewise be barred under Section 165 on public-policy grounds. See *Stephens*, 905 F.2d at 672; *Medeiros* v. *Commissioner*, 77 T.C. 1255, 1261 n.7 (1981).

2. From 1997 to 2001, petitioner Joseph Nacchio was the Chief Executive Officer (CEO) of Qwest Communications International, Inc. (Qwest). Pet. App. 4a. As part of his compensation, Nacchio received options to purchase shares of Qwest stock. *Ibid.* Between April 26, 2001, and May 29, 2001, Nacchio exercised options to purchase, and then sold, 1,330,000 shares of Qwest stock. Pets. Opp. to Summ. J., Ex. L, at 5. On his joint income-tax return (with petitioner Anne Esker) for 2001, Nacchio reported a net gain of $44,632,464.38 from those stock sales, and he paid $17,974,832 in taxes on that gain. Pet. App. 4a.

In 2005, a federal grand jury returned an indictment charging Nacchio with 42 counts of securities fraud (insider trading), in violation of 15 U.S.C. 78ff and 78j, and SEC Rules 10b-5 and 10b5-1 (17 C.F.R. 240.10b-5, 240.10b5-1). Pet. App. 4a. Pursuant to 28 U.S.C. 2461(c) and 18 U.S.C. 981(a)(1)(C), the indictment included criminal-forfeiture allegations that would require Nacchio, if convicted, to forfeit to the United States the proceeds of his insider-trading offenses. Pet. App. 4a-5a; C.A. App. 41-42. In April 2007, a jury found Nacchio guilty on 19 counts of insider trading. Pet. App. 5a. The district court sentenced him to 72 months of imprisonment and ordered him to pay a $19 million fine and forfeit to the United States $52,007,545.47 in gross proceeds that he had derived from the illegal stock sales. *Ibid.*; C.A. App. 113-122. In August 2007, the United States Marshals Service seized from Nacchio the forfeiture amount of $52,007,545.47 and later deposited it into the Department of Justice Asset Forfeiture Fund. C.A. App. 134-138; see 28 U.S.C. 524(c).

A panel of the court of appeals reversed Nacchio's convictions on the ground that the district court had erroneously excluded expert testimony that Nacchio had sought to introduce at trial. Pet. App. 5a; see 519 F.3d 1140. The court of appeals subsequently granted rehearing en banc, however, and the en banc court upheld the exclusion of the expert testimony and reinstated Nacchio's convictions. Pet. App. 5a; see 555 F.3d 1234 (en banc), cert. denied, 558 U.S. 815. On remand from the en banc court, the panel upheld most aspects of Nacchio's sentence but concluded that 18 U.S.C. 981(a)(2)(B), rather than 18 U.S.C. 981(a)(2)(A), governed the calculation of the amount that he was required to forfeit. Pet. App. 5a; see 573 F.3d 1062, 1087-1090. The panel held that Nacchio was required to forfeit his "net profit," rather than the "gross proceeds," resulting from his insider-trading offenses. 573 F.3d at 1087.

The district court resentenced Nacchio to 70 months of imprisonment and ordered him to pay a $19 million fine and forfeit $44,632,464.38 to the United States, the latter amount representing his net profit from insider trading.[1] Pet. App. 6a; C.A. App. 140-148. At the conclusion of the resentencing hearing, Nacchio's attorney asked whether the district court would "direct that the [forfeited] money go to a fund . . . set up for distribution to [Nacchio's] victims." Pet. App.

[1] The adjusted forfeiture amount reflected the gross sale proceeds from Nacchio's sales of Qwest stock in the counts of conviction ($52,007,545.47), less brokerage commissions and fees ($60,081.09) and the cost of exercising the options ($7,315,000.00). Pets. Opp. to Summ. J., Ex. L, at 5. In July 2010, the U.S. Marshals Service returned to Nacchio the $7,375,081.07 overage from the original forfeiture amount it had collected. C.A. App. 135.

6a (brackets in original) (quoting C.A. App. 494). Government counsel advised the court that "the Government's intention is for . . . the forfeiture funds[] to be used to compensate victims" through a separate process (known as "remission"), but that the decision would be made by the Asset Forfeiture and Money Laundering Section (AFMLS) pursuant to its regulations. *Ibid.* (brackets in original) (quoting C.A. App. 494-495).

In April 2012, the Chief of the AFMLS, on behalf of the Attorney General, authorized remission of Nacchio's forfeited funds to eligible victims of Nacchio's insider-trading crimes. Pet. App. 7a; C.A. App. 251-254; see 28 C.F.R. 9.1(b)(2) (delegating the Attorney General's authority to grant remission to the Chief of the AFMLS). The remission administrator retained by the Department of Justice distributed the forfeited funds, pro-rata, to Nacchio's victims, who claimed to have suffered cumulative losses of nearly $12 billion. Pet. App. 23a; C.A. App. 513.

3. a. In 2009, petitioners filed an amended tax return for the year 2007. Pet. App. 10a. Pursuant to 26 U.S.C. 1341,[2] petitioners claimed a refund for the amount of tax (approximately $18 million) that Nacchio had paid for the year 2001 on the gain that he had realized from his insider-trading activity but had later been required to forfeit under the sentence imposed in his

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[2] Section 1341 provides special tax relief to a taxpayer who is required to restore funds to a third party (and is entitled to a deduction under some other provision of the Code for the restoration payment) where the taxpayer included the funds in his income in a prior taxable year because it then "appeared that the taxpayer had an unrestricted right" to the funds. 26 U.S.C. 1341(a)(1).

criminal case. *Ibid.*[3] The Internal Revenue Service (IRS) determined that Nacchio was not entitled to any refund because his criminal-forfeiture payment was not deductible under the Internal Revenue Code as it was "the payment of a penalty for a violation of the law." *Ibid.*

b. Petitioners filed this suit for refund in the Court of Federal Claims (CFC), seeking a refund of $17,974,832 pursuant to 26 U.S.C. 1341. Pet. App. 10a. The government moved for summary judgment. The government maintained that deduction of the criminal forfeiture was barred either by 26 U.S.C. 162(f) or by the pre-existing public policy that precluded any deduction for fines or similar penalties. The government further asserted that petitioners did not satisfy the requirements for invoking the special relief provisions of Section 1341. Pet. App. 10a-11a. Petitioners filed a cross-motion for partial summary judgment, arguing that Nacchio's forfeiture was deductible under Section 162 or 165 and that they were eligible for the special tax relief provided by Section 1341. *Id.* at 11a.

The CFC denied the government's motion for summary judgment and granted in part petitioners' motion for partial summary judgment. Pet. App. 29a-50a. The court held that Nacchio's criminal forfeiture payment, although not deductible under Section 162,[4]

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[3] Under *James* v. *United States*, 366 U.S. 213 (1961) (opinion of Warren, C.J.), Nacchio's unlawful insider-trading gains constituted income (and were properly taxed to him) when he received them in 2001.

[4] The CFC concluded that Nacchio's criminal-forfeiture payment was not an "ordinary and necessary" expense paid or incurred "in carrying on any trade or business," as required for a deduction under Section 162. Pet. App. 47a.

was deductible as a loss under Section 165. The court acknowledged that, in determining deductibility under Section 165, "it is appropriate to take into account the public policy considerations embodied in [Section] 162(f)." *Id.* at 44a. The court concluded, however, that Nacchio's forfeiture payment was not a "fine or similar penalty" within the meaning of Section 162(f). *Ibid.* The court reasoned that, unlike the $19 million fine, which was "clearly punitive" and was paid from assets unrelated to insider trading, the forfeiture "exclusively represented the disgorgement of Mr. Nacchio's illicit net gain from insider trading." *Id.* at 46a. The court then concluded that such disgorgement served a "compensatory purpose," akin to restitution, because the Department of Justice subsequently used the forfeited funds to grant remission to victims of Nacchio's insider trading crimes. *Ibid.*

The CFC also rejected the government's argument that Nacchio was collaterally estopped by his crim inal conviction from seeking relief under 26 U.S.C. 1341. The court held that the question whether it "appeared" to Nacchio that he had an "unrestricted right" to his insider-trading proceeds for purposes of Section 1341(a)(1) presented a genuine issue for trial. Pet. App. 47a-49a. Rather than proceed to trial on that issue, the government stipulated to the entry of final judgment in favor of petitioners, expressly reserving its right to appeal the court's adverse rulings on the applicability of Section 162(f) and collateral estoppel. *Id.* at 13a; C.A. App. 731-735. The government then appealed.[5]

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[5] The parties stipulated in the CFC that, if petitioners were ultimately determined not to be entitled to any deduction for the criminal forfeiture, petitioners would be entitled to no refund. The

4. The court of appeals reversed. Pet. App. 1a-25a. The court held that the availability of a deduction under Section 165 is subject to the same "frustration of public policy" doctrine that is codified in Section 162(f). Like the Second Circuit in *Stephens*, 905 F.2d 667, the court thus looked to Section 162(f) to interpret the scope of permissible loss deductions under Section 165. Pet. App. 8a-9a. The court concluded that no deduction was permissible for Nacchio's criminal forfeiture because that forfeiture was a "fine or similar penalty" within the meaning of Section 162(f). *Id.* at 14a-25a.[6]

The court of appeals first explained that "the plain language of the statutory provision under which the amount Nacchio forfeited was calculated supports the view that Congress intended the forfeiture to be paid with after-tax dollars." Pet. App. 15a. The court emphasized that 18 U.S.C. 981(a)(2)(B) expressly provides that the required forfeiture amount is *not* to be reduced by "any part of the income taxes paid." Pet. App. 15a-16a (emphasis omitted). The court next considered the applicable Treasury regulations and concluded that Nacchio's criminal forfeiture payment was a "fine or similar penalty" as defined therein. *Id.* at 16a-17a; see 26 C.F.R. 1.162-21(b)(1) ("a fine or

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parties further stipulated that, if petitioners were finally determined to be entitled to a deduction for the criminal forfeiture, but were not eligible to invoke the special relief provisions of 26 U.S.C. 1341, petitioners would be entitled to a much smaller refund than claimed, in an amount between $6370 and $1,038,695, depending on whether the deduction was allowable under Section 162 or under Section 165(c)(2). C.A. App. 731-733.

[6] The court of appeals did not reach the government's additional argument that Nacchio was collaterally estopped by his criminal conviction from seeking relief under Section 1341. Pet. App. 25a.

similar penalty includes an amount—(i) Paid pursuant to conviction or a plea of guilty or *nolo contendere* for a crime (felony or misdemeanor) in a criminal proceeding").

The court of appeals rejected the CFC's conclusion that Nacchio's criminal-forfeiture payment was "compensatory" in nature and akin to restitution. The court explained that, in contrast to restitution, which "seeks to make victims whole by reimbursing them for their losses," criminal forfeiture under 28 U.S.C. 2461(c) "is meant to punish the defendant by transferring his ill-gotten gains to the United States Department of Justice." Pet. App. 18a-19a (quoting *United States* v. *Joseph*, 743 F.3d 1350, 1354 (11th Cir. 2014) (per curiam), and citing additional decisions of the Fourth, Fifth, and Seventh Circuits). The court noted that criminal forfeiture under Section 2461(c) is "mandatory" whenever a defendant in a criminal case "is convicted of the offense giving rise to the forfeiture." *Id.* at 17a. The court further observed that "other courts of appeals have * * * repeatedly conclud[ed] that forfeitures of property to the government similar to the one at issue are not deductible because they are punitive." *Id.* at 17a-18a (citing decisions of the Fifth, Ninth, and Tenth Circuits). The court distinguished the Second Circuit's decision in *Stephens*, 905 F.2d 667, on the ground that *Stephens* "involved court-ordered restitution * * * which was clearly remedial," whereas in Nacchio's case "forfeiture, not restitution, is at issue." Pet. App. 20a.

The court of appeals also rejected petitioners' argument that Nacchio's criminal forfeiture should be deductible because the forfeited funds were subsequently used by the Department of Justice to compen-

sate Nacchio's victims through remission. Pet. App. 21a-22a. The court held that "[t]he Attorney General's post-hoc decision to use the forfeited funds for remission did not transform the character of the forfeiture so that it was no longer a 'fine or similar penalty' under [Section] 162(f)." *Id.* at 21a. The court explained that "[t]he decision to use the forfeited funds to compensate the victims was discretionary." *Ibid.* The court further explained that petitioners' argument was contrary to congressional intent and settled tax law holding that "[t]he characterization of a payment for purposes of [Section] 162(f) turns on the origin of the liability giving rise to it," not on the government's subsequent discretionary decisions concerning the proper use of funds generated by a fine or similar penalty. *Id.* at 22a (first brackets in original) (citing *Bailey* v. *Commissioner*, 756 F.2d 44, 47 (6th Cir. 1985)). The court also explained that the amount Nacchio was required to forfeit "was pegged to his profits and not to the victims' losses," which "weighs against a conclusion that Nacchio's forfeiture was restitution to those victims." *Id.* at 23a.

ARGUMENT

The court of appeals correctly held that Nacchio's criminal-forfeiture payment was a "fine or similar penalty" within the meaning of 26 U.S.C. 162(f), and that petitioners therefore were not entitled to an income-tax deduction for the amount of the forfeiture. That holding does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. This Court has long recognized that "[w]here a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a

tax deduction for its payment." *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U.S. 30, 34 (1958) (quoting *Commissioner* v. *Heininger*, 320 U.S. 467, 473 (1943)). To allow a deduction in such circumstances would "frustrate" national or state policies proscribing such conduct by "reducing the 'sting'" of a penalty imposed by law. *Id.* at 36. In 1969, Congress codified this "frustration of public policy" doctrine in 26 U.S.C. 162(f), which precludes a deduction under Section 162 "for any fine or similar penalty paid to a government for the violation of any law." See Tax Reform Act, § 902(a), 83 Stat. 710. Petitioners do not dispute that the "frustration of public policy" doctrine underlying the enactment of Section 162(f) would bar any deduction under Section 165. See Pet. App. 8a-9a; *Stephens* v. *Commissioner*, 905 F.2d 667, 672 (2d Cir. 1990); *Medeiros* v. *Commissioner*, 77 T.C. 1255, 1261 n.7 (1981).

The court of appeals correctly held that Nacchio's criminal forfeiture payment was a nondeductible "fine or similar penalty" under 26 U.S.C. 162(f) because it was imposed as a mandatory punishment for his insider-trading crimes. For purposes of 26 U.S.C. 162(f), the relevant Treasury regulation defines "fine or similar penalty" to include, *inter alia*, "an amount—(i) Paid pursuant to conviction or a plea of guilty or *nolo contendere* for a crime (felony or misdemeanor) in a criminal proceeding." 26 C.F.R. 1.162-21(b)(1). Nacchio's criminal forfeiture falls squarely within that definition because it was imposed pursuant to 28 U.S.C. 2461(c) and 18 U.S.C. 981(a)(1)(C) as part of Nacchio's criminal sentence.[7] Section 2461(c) requires forfeiture

[7] Although 18 U.S.C. 981 typically governs "civil forfeitures," 28 U.S.C. 2461(c) "permits the government to seek *criminal* for-

whenever a defendant in a criminal case "is convicted of the offense giving rise to the forfeiture," in which case the court "shall order the forfeiture of the property as part of the sentence in the criminal case." 28 U.S.C. 2461(c); see Pet. App. 17a. Forfeiture is mandatory when the relevant prerequisites are met. See *United States* v. *Blackman*, 746 F.3d 137, 143 (4th Cir. 2014); *United States* v. *Newman*, 659 F.3d 1235, 1239-1242 (9th Cir. 2011), cert. denied, 566 U.S. 915 (2012).

Every other court of appeals to have addressed the question has concluded that forfeitures of property to the government similar to the one at issue here are not deductible because they are punitive. See Pet. App. 17a; *King* v. *United States*, 152 F.3d 1200 (9th Cir. 1998); *Wood* v. *United States*, 863 F.2d 417 (5th Cir. 1989); *United States* v. *Algemene Kunstzijde Unie, N.V.*, 226 F.2d 115 (4th Cir. 1955), cert. denied, 350 U.S. 969 (1956); *Fuller* v. *Commissioner*, 213 F.2d 102 (10th Cir. 1954). Similarly, the decisions of courts of appeals in non-tax cases confirm that, although restitution is compensatory, criminal forfeiture under 28 U.S.C. 2461(c) and 18 U.S.C. 981(a)(1)(C) serves a distinct, punitive purpose. See Pet. App. 18a-19a (citing cases by the Fourth, Fifth, Seventh, and Eleventh Circuits); cf. *United States* v. *Bajakajian*, 524 U.S. 321

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feiture whenever civil forfeiture is available *and* the defendant is found guilty of the offense." *United States* v. *Newman*, 659 F.3d 1235, 1239 (9th Cir. 2011), cert. denied, 566 U.S. 915 (2012). "Section 2461(c) thus authorizes criminal forfeiture as a punishment for any act for which civil forfeiture is authorized, and allows the government to combine criminal conviction and criminal forfeiture in a consolidated proceeding." *United States* v. *Razmilovic*, 419 F.3d 134, 136 (2d Cir. 2005). See generally *United States* v. *Bajakajian*, 524 U.S. 321, 330-332 (1998) (discussing the distinction between civil (*in rem*) forfeiture and criminal (*in personam*) forfeiture).

(1998) (holding that criminal forfeiture imposed pursuant to 18 U.S.C. 982 as part of the sentence of the defendant in a criminal case constitutes a "fine" for Eighth Amendment purposes); *Libretti* v. *United States*, 516 U.S. 29, 39 (1995) ("Our precedents have * * * characterized criminal forfeiture as an aspect of punishment imposed following conviction of a substantive criminal offense.").[8] Indeed, Nacchio argued during his criminal appeal (inconsistently with his position in this case) that his forfeiture was a "penalty" and that its imposition, together with the fine, raised "a serious Eighth Amendment question." 573 F.3d at 1090 n.28.[9] Petitioners have cited no decision that permits a tax deduction for the amount of a criminal forfeiture.

Furthermore, the statute under which Nacchio's forfeiture amount was calculated directs that the forfeiture amount is *not* to be reduced by "any part of the income taxes paid" on the amount subject to forfeiture. 18 U.S.C. 981(a)(2)(B). The statute thus manifests Congress's intent that the forfeiture be paid with after-tax dollars. See Pet. App. 15a-16a. Allowing petitioners to recover the income tax that Nacchio paid on the insider-trading profits he was ordered to forfeit unconditionally to the United States would

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[8] Section 2461(c), the forfeiture provision in this case, incorporates the substantive (and procedural) provisions of the same forfeiture statute, 21 U.S.C. 853, that the *Libretti* Court held was punitive, 516 U.S. at 32, 39.

[9] The district court rejected that argument and explained that Nacchio's sentence of imprisonment, fine, and forfeiture constituted "three forms of penalty." Pet. App. 20a; C.A. App. 486. The court of appeals in Nacchio's criminal appeal did not reach that argument. 573 F.3d at 1090 n.28.

enable Nacchio to obtain through 26 U.S.C. 165 the same economic offset that Congress specifically precluded in the calculation of the proper forfeiture amount.

2. Contrary to petitioners' contention (Pet. 10-15), the decision below does not conflict with the Second Circuit's decision in *Stephens*. See Pet. App. 20a.

a. In *Stephens*, the defendant was convicted of defrauding Raytheon Corporation through an embezzlement scheme. He was sentenced to a term of imprisonment and also fined. The court suspended execution of an additional five-year term of imprisonment on the condition that the defendant make restitution to Raytheon. 905 F.2d at 668. The defendant paid restitution and claimed the payment as a loss deduction under 26 U.S.C. 165. The Second Circuit agreed with the government that the claimed deduction should be disallowed on public-policy grounds if the taxpayer's payment constituted a fine or similar penalty within the meaning of Section 162(f). *Stephens*, 905 F.2d at 670-671. The court determined, however, that the restitution payment was deductible because it was "a remedial measure to compensate [Raytheon], not a 'fine or similar penalty'" paid to a government. *Id.* at 672-673.

Stephens involved discretionary restitution ordered by the court to be paid to the injured party, which the court viewed as remedial. Mandatory criminal forfeiture of profits to the United States, in contrast, has uniformly been characterized as punitive. See *Blackman*, 746 F.3d at 143 ("These two aspects of a defendant's sentence serve distinct purposes: restitution functions to compensate the victim, whereas forfeiture acts to punish the wrongdoer."); *United States* v.

Venturella, 585 F.3d 1013, 1019-1020 (7th Cir. 2009), cert. denied, 559 U.S. 955 (2010); *Newman*, 659 F.3d at 1241; *United States* v. *Taylor*, 582 F.3d 558, 566 (5th Cir. 2009) (per curiam), cert. denied, 558 U.S. 1136 (2010). The fact that Nacchio's criminal forfeiture was calculated based on his net profits from his insider-trading crimes, and was thus unrelated to the amount of loss suffered by his victims, further demonstrates that the forfeiture was not restitution. Pet. App. 23a; see *United States* v. *Torres*, 703 F.3d 194, 203 (2d Cir. 2012) ("[F]orfeiture and restitution statutes serve different purposes * * * The measures are different, and the purposes distinct."), cert. denied, 133 S. Ct. 2782 (2013); *United States* v. *McGinty*, 610 F.3d 1242, 1247 (10th Cir. 2010) ("[R]estitution is calculated based on the victim's loss, while forfeiture is based on the offender's gain.") (citation omitted).

The payment in *Stephens*, moreover, "was made to Raytheon, and not 'to a government,'" and it ensured that "Raytheon [would] get its money back." 905 F.2d at 673 (citation omitted). Section 162(f), which precludes a deduction "for any fine or similar penalty *paid to a government* for the violation of any law," 26 U.S.C. 162(f) (emphasis added), therefore was inapplicable by its terms. In contrast, the judgment in Nacchio's case and the applicable forfeiture statutes required Nacchio to forfeit his insider-trading profits "to the United States." C.A. App. 144; see 18 U.S.C. 3554 and 21 U.S.C. 853(a) (made applicable by 28 U.S.C. 2461(c)). Petitioners' reliance (Pet. 12) on 26 C.F.R. 1.162-21(b)(2) ("Compensatory damages * * * paid to a government do not constitute a fine or penalty.") is misplaced, both because Nacchio's criminal forfeiture was punitive rather than compensatory and because it did

not compensate *the government* for damages it sustained as a result of Nacchio's insider-trading crimes.[10]

b. Petitioners further contend (Pet. 12-14) that, under *Stephens*, Nacchio's criminal forfeiture was tantamount to restitution because the Attorney General later decided to use the forfeited funds to grant remission to Nacchio's victims. They contend (Pet. 13) that the "correct test [for deductibility] under *Stephens*" is "whether funds extracted from a criminal defendant are earmarked and *used* to compensate victims." (emphasis added). *Stephens* does not support petitioners' argument.

The Attorney General's decision to use the forfeited funds for remission was discretionary and did not transform the character of Nacchio's criminal forfeiture. Pet. App. 21a-22a. Petitioners' argument is contrary to established tax law that "[t]he character of a payment for purposes of [Section] 162(f) turns on the origin of the liability giving rise to it" (here, the criminal judgment and statutes imposing forfeiture as a mandatory punishment for Nacchio's insider-trading crimes), and not on the government's subsequent discretionary choices concerning the use of the funds. *Bailey* v. *Commissioner*, 756 F.2d 44, 47 (6th Cir. 1985) (citing *Middle Atl. Distribs.* v. *Commissioner*, 72 T.C. 1136, 1145 (1979)); *Uhlenbrock* v. *Commissioner*, 67 T.C. 818, 823 (1977)). To hold otherwise

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[10] Payments made to private parties, and not "to a government," are beyond the scope of Section 162(f) and its implementing regulations. See 26 U.S.C. 162(f); 26 C.F.R. 1.162-21(a). Thus, the exception provided under 26 C.F.R. 1.162-21(b)(2) applies only to payments made "to a government" that compensate the government for damages. *Colt Indus., Inc.* v. *United States*, 880 F.2d 1311, 1314 (Fed. Cir. 1989).

would undermine the congressional purpose of Section 162(f) and lead to arbitrary tax results for similarly situated taxpayers. See Pet. App. 22a ("Allowing Nacchio to deduct his forfeiture because the AFMLS decided to distribute it to victims through remission would mean that whether two people convicted of the same crimes could deduct their criminal forfeiture would turn not on their actions, or the statutes governing their sentencings, but on the after-the-fact discretionary decisions of a third party.").

The Second Circuit in *Stephens* acknowledged this settled rule of tax law and distinguished *Bailey* on the grounds that "the payment in *Bailey* was originally imposed as a fine," whereas the restitution payment in *Stephens* was imposed "in addition" to a fine, which indicated that "the sentencing judge intended to exact restitution from Stephens." 905 F.2d at 674. *Stephens* thus does not support petitioners' argument that Nacchio's criminal forfeiture—imposed as a mandatory punishment for his insider-trading crimes—lost its character as a "fine or similar penalty" under Section 162(f) when the Attorney General used the forfeited funds to grant remission to Nacchio's victims.

c. Petitioners' related assertions that the funds forfeited by Nacchio were "earmarked" for his victims (Pet. i, 13), and that the sentencing judge in Nacchio's criminal case imposed forfeiture with the "intent that the forfeited funds would be used to compensate [Nacchio's] victims" (Pet. 7), are unfounded. Because forfeiture was a mandatory punishment imposed by law, the sentencing judge had no discretion whether to impose forfeiture and no say in how the forfeited funds would be used by the United States. Pet. App. 17a; see *Blackman*, 746 F.3d at 143; *United States* v.

Phillips, 704 F.3d 754, 769 (9th Cir. 2012), cert. denied, 133 S. Ct. 2796 (2013). Thus, contrary to the inference petitioners would have this Court draw, the district court ordered criminal forfeiture in Nacchio's case because it was required by statute to do so, without regard to the Attorney General's intended use of the forfeited funds.

d. Petitioners are also wrong in asserting (Pet. 13, 19) that remission by the Attorney General was not discretionary. Section 981(e) authorizes the Attorney General to "retain" or "transfer" forfeited property for specified uses "on such terms and conditions as he may determine." 18 U.S.C. 981(e); see also 18 U.S.C. 981(d) ("The Attorney General shall have sole responsibility for disposing of petitions for remission or mitigation with respect to property involved in a judicial forfeiture proceeding."). Recognizing this, petitioners argued for the first time in a petition for rehearing in the court of appeals that remission of Nacchio's forfeiture was governed not by Section 981(e)(6), but instead by 21 U.S.C. 853(i)—an argument they renew in their petition for a writ of certiorari. Pet. 20 n.9. But remission under Section 853(i) is likewise entirely discretionary. See Pet. App. 21a-22a; *Willis Mgmt., Ltd.* v. *United States*, 652 F.3d 236, 243 (2d Cir. 2011) (Section 853(i) provides "a 'non-judicial remedy' that is left entirely to the Attorney General's discretion."); *United States* v. *Shefton*, 548 F.3d 1360, 1365 (11th Cir. 2008) (per curiam) (same). The regulations governing remission procedures (see Pet. 19) confirm that remission by the Attorney General is discretionary. See, *e.g.*, 26 C.F.R. 9.8(b) (eligible victims "may be granted remission"); 26 C.F.R. 9.8(e) ("In the exercise of his or her discretion, the ruling

official may decline to grant remission [in specified instances].").

Granting remission to victims is only one of the "variety of important and useful ways" that Congress has authorized the Attorney General to use forfeited assets. *Caplin & Drysdale* v. *United States*, 491 U.S. 617, 629 (1989); see 28 U.S.C. 524(c) (listing numerous "law enforcement purposes" for which the Attorney General may use the Justice Asset Forfeiture Fund). The Attorney General's decision to use Nacchio's forfeited funds for remission did not transform the criminal forfeiture from punitive to compensatory so that it was no longer a "fine or similar penalty" under Section 162(f). Pet. App. 23a.

e. Petitioners rely (Pet. 14) on *United States* v. *$4,224,958.57*, 392 F.3d 1002 (9th Cir. 2004), in which (petitioners assert) victims of a large fraudulent investment scheme were found to have established "a sufficient interest in the forfeited illegal proceeds so as to have rights in the forfeited property under a theory of constructive trust." Petitioners contend (Pet. 15) that, under that constructive-trust theory, "the remission process merely returns the *res* to the victims who had held rights in the forfeited property all along." That decision is irrelevant here because petitioners have never established that the victims of Nacchio's crimes had a property interest in the funds forfeited by Nacchio, under a constructive-trust theory or otherwise.

3. a. Petitioners further contend (Pet. 15-17) that the decision below conflicts with the First Circuit's decision in *Fresenius Medical Care Holdings, Inc.* v. *United States*, 763 F.3d 64, 70 (2014), which holds that a court must look to the "economic reality" of a pay-

ment, rather than to its form, to decide whether it is deductible. The decision below does not conflict with *Fresenius*.

Fresenius involved the deductibility of a payment made to the United States in settlement of a claim under the False Claims Act, 31 U.S.C. 3729 *et seq*. The First Circuit focused on the punitive-versus-compensatory nature of the treble-damages provision of the False Claims Act and noted the "fundamental tenet of tax law" that "amounts paid or received in settlement should receive the same tax treatment * * * as would have applied had the dispute been litigated and reduced to judgment." 763 F.3d at 71. In looking at the "economic reality" of the transaction, the First Circuit did not consider how the government had subsequently used the settlement funds. The "economic reality" in petitioners' case is that "Nacchio was punished through forfeiture, not that Nacchio's victims were fully compensated." Pet. App. 23a. The court of appeals appropriately distinguished *Fresenius* from petitioners' case.

b. Petitioners argue (Pet. 17 n.8) that the decision below will incentivize parties "to structure compensatory payments to victims so as to bring about [that party's] preferred tax result." That contention rests on the false premise that the parties may choose in a given case whether restitution or forfeiture applies. In fact, the availability of either or both of those remedies in a particular case is dictated by Congress. See, *e.g.*, 18 U.S.C. 3663 (restitution); 18 U.S.C. 981 (civil forfeiture) and 982 (criminal forfeiture); 21 U.S.C. 853 (criminal forfeiture). That point is illustrated by Nacchio's criminal case, in which the district court explained that "restitution, sadly [] is not applicable

here" because "there is no provision in the law for restitution." Pet. App. 20a (brackets in original; citation omitted). The forfeiture of Nacchio's insider-trading profits, on the other hand, was mandatory. See 28 U.S.C. 2461(c); Pet. App. 17a.

4. In *Kokesh* v. *Securities & Exchange Commission*, No. 16-529 (oral argument scheduled for Apr. 18, 2017), this Court granted certiorari to decide whether claims for disgorgement in a civil enforcement suit brought by the Securities and Exchange Commission are subject to the five-year statute of limitations in 28 U.S.C. 2462, which applies to claims for "any civil fine, penalty, or forfeiture." In *Kokesh*, the government argues, *inter alia*, that an order to disgorge illicit gains in such a suit is not a "penalty" within the meaning of Section 2462.

The disgorgement order in *Kokesh* resembles the forfeiture order in Nacchio's criminal prosecution to the extent that both were intended to divest wrongdoers of unlawfully acquired funds. The two cases, however, involve different statutory schemes. In addition, the disgorgement order in *Kokesh* was entered by a court of equity in a *civil* enforcement action, while the forfeiture of Nacchio's illicit gains was a mandatory *criminal* sanction, giving it an inherently punitive aspect that a civil disgorgement remedy lacks. Cf. Gov't Br. at 25, *Kokesh*, *supra* (discussing this Court's holding in *Kelly* v. *Robinson*, 479 U.S. 36, 50 (1986), that "any condition a state criminal court imposes as part of a criminal sentence" is nondischargeable under a Bankruptcy Code provision that bars discharge of a debt for a "fine, penalty, or forfeiture payable to and for the benefit of a governmental unit"). It therefore

is unnecessary to hold the petition in this case pending the Court's disposition of *Kokesh*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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