No. 06-1509

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

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in finding that a state-court jury verdict did not resolve the question whether corporate funds in the possession of petitioner's girlfriend belonged to petitioner.

2. Whether the diversion of corporate funds to a shareholder of a corporation without earnings and profits automatically qualifies as a non-taxable return of capital up to the shareholder's stock basis, see 26 U.S.C. 301(c)(2), even if the diversion was not intended as a return of capital.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases:

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OPINIONS BELOW

The opinions of the court of appeals (Pet. App. 1-14, 27-61) are reported at 470 F.3d 931 and 384 F.3d 794, respectively.

JURISDICTION

The judgment of the court of appeals was entered on December 13, 2006. A petition for rehearing was denied on April 23, 2007 (Pet. App. 63). The petition for a writ of certiorari was filed on May 11, 2007. 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 convicted 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. The court of appeals, in a prior appeal, affirmed the conspiracy conviction but reversed the tax convictions and remanded for a new trial. Pet. App. 27-61. 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 tax return counts and 60 months on the tax evasion and conspiracy counts, to run concurrently. Pet. App. 2. On a second appeal, the court of appeals affirmed both the convictions and sentence. *Id.* at 1-12.

1. Petitioner is the founder, former president, and majority owner of a closely held corporation, Hawaiian Isles Enterprises (HIE), that deals in tobacco distribution, coffee processing and sales, arcade games, vending machines, and bottled water. A trust for the benefit of petitioner's son also owns stock in the corporation. 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. Petitioner diverted at least $3.6 million by giving HIE checks to friends and employees and instructing them to cash the checks, then return the cash to petitioner. He diverted another $3.58 million by establishing two bank accounts in HIE's name but under petitioner's exclusive control, then depositing proceeds from HIE sales into the accounts without recording the sales on HIE's books. Petitioner also diverted HIE funds by instructing businesses that purchased coffee

from HIE to remit payment directly to petitioner and by using false invoices to obtain a loan from a federally insured bank. He 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, Jin Sook Lee, as well as his wife, Mal Sun Boulware. Pet. App. 2-3, 29-30; Gov't C.A. Br. 5-9 & n.3.

2. In 1994, Lee filed a complaint against petitioner and HIE in Hawaii state court, alleging, inter alia, that petitioner had taken $840,000 in cash from a safe in her home and had wrongfully acquired real property belonging to her. Pet. App. 33-34. Petitioner and HIE filed counterclaims seeking the return of approximately $5 million in corporate funds, paid to Lee in anticipation of petitioner's divorce settlement. According to petitioner and HIE, Lee had "promised to hold [the funds] for the benefit of [HIE] * * * and to reconvey them to [petitioner and HIE] upon demand." *Id.* at 35 (second set of brackets in original). Petitioner and HIE sought a declaration "that the transfers to Lee were not gifts." *Ibid*

In 1997, the state-court action proceeded to trial. The jury returned a special verdict form, finding that the monies were not "gifts to Jin Sook Lee," but instead "belong[ed] to Hawaiian Isle Enterprises." Pet. App. 32, 36. On equitable claims tried before the judge, the court awarded HIE a judgment of more than $4.5 million, finding that that amount "has been and is being held in constructive trust" for HIE. *Ibid.*

3. In 2000, a federal grand jury returned a superseding indictment charging petitioner with nine counts of filing false tax returns, four counts of tax evasion, four counts of making false statements to a federally insured financial institution, and one count of conspiracy to make

such false statements. Pet. App. 29. Petitioner ultimately was convicted on four counts of filing a false tax return, four counts of tax evasion, and the conspiracy count. He was acquitted on the four counts of making false statements. *Ibid.*

4. On appeal, the court of appeals affirmed petitioner's conviction on the conspiracy count, but reversed his conviction on the tax counts and remanded for further proceedings. Pet. App. 27-61.

Petitioner challenged his conviction on the tax counts on the ground that the state-court judgment had conclusively determined that the funds delivered to Lee belonged at all times to HIE, and therefore could not have been taxable income to petitioner. Pet. App. 36, 39. The court of appeals rejected that claim, reasoning that, "[e]ven assuming that the state court judgment is binding as to the ownership of the funds, the question becomes what the state court judgment determined." *Id.* at 41. The court noted that, although the state-court judgment included findings that the monies "belonged to HIE" and that Lee "had been and was holding it in 'constructive trust' for HIE," the ownership of the money "as between [petitioner] and HIE" was not at issue in the case, and "does not appear to have been subject to adversarial testing." *Id.* at 42. The court of appeals construed the special verdict form as asking the jury to determine ownership "only as between Lee and HIE, presumably because [petitioner] never claimed the money was his." *Ibid.* Accordingly, the court of appeals found that the district court did not err in ruling that the state-court judgment did not conclusively determine that HIE, rather than petitioner, owned the funds diverted to Lee. *Ibid.*

Nonetheless, the court of appeals vacated petitioner's conviction on the tax counts and remanded for a new trial, holding that the district court had erred in excluding the state-court judgment from evidence. According to the court of appeals, the state-court judgment was at least minimally relevant to the ownership of the funds, and that error was not harmless. Pet. App. 43-52. Judge Silverman dissented from that determination (*id.* at 61-62), arguing that the district court did not abuse its discretion in refusing to admit the state-court judgment because the judgment "has no bearing on whether [petitioner] diverted corporate funds to his girlfriend for his own benefit without paying tax on the money," and instead established "only that *she* was not entitled to keep the cash." *Id.* at 61.

The court of appeals also considered petitioner's challenge to the sufficiency of the evidence on the tax counts. Pet. App. 52. Petitioner contended that the government had failed to establish the existence of a tax deficiency because it failed to prove, beyond a reasonable doubt, that the corporate funds petitioner diverted for his personal use did not constitute non-taxable returns of capital under 26 U.S.C. 301(c)(2). The court of appeals rejected that argument based on its decision in *United States* v. *Miller*, 545 F.2d 1204, 1214 (9th Cir. 1976), cert. denied, 430 U.S. 930 (1977), which held that once the government establishes a prima facie case that the defendant received and failed to report unexplained corporate funds, the burden shifts to the defendant to establish that the funds were intended as a non-taxable return of capital. Pet. App. 54. The court of appeals held that the government had provided "ample evidence," based on the nature of the transactions, from which a rational juror could have determined that the deposits were not loans and that petitioner was guilty of tax evasion and willfully submitting false tax returns. *Id.* at 56.

5. On May 2, 2005, petitioner filed a petition for a writ of certiorari (No. 04-1468). He renewed his claim that the state-court judgment had conclusively determined that HIE owned the funds, and urged this Court to review the application of *Commissioner* v. *Estate of Bosch*, 387 U.S. 456 (1967) (*Bosch*), outside the estate-tax context. The government opposed the petition, arguing that because "[t]he dispute in the Hawaii case was whether Lee had received the money as a gift or whether she had been given the money to hold in trust for HIE," the jury "determined only that HIE had a better claim to the money than Lee did" and "did not determine whether the money belonged to HIE or petitioner." Br. in Opp. at 7, *Boulware* v. *United States*, *supra* (No. 04-1468). On October 3, 2005, this Court denied the petition. 546 U.S. 814 (2005).

6. After a retrial on the tax charges, a jury again found petitioner guilty on four counts of tax evasion and five counts of filing a false income tax return. The district court imposed concurrent sentences of 36 months of imprisonment on the false return counts and 60 months of imprisonment on the tax evasion and conspiracy counts. Pet. App. 2.

7. The court of appeals affirmed both the convictions and sentence. Pet. App. 2. Renewing the argument he pressed in his first appeal and petition for a writ of certiorari, petitioner argued that the state-court judgment had conclusively determined that the funds held by Lee belonged at all times to HIE, and therefore were not taxable as income to petitioner. *Id.* at 11. The court of appeals rejected that argument, holding that the prior

appeal had established the law of the case on that issue. *Id.* at 11-12.

Petitioner also argued that the district court erred in excluding evidence that, according to petitioner, would have shown that HIE lacked earnings and profits and that the funds he took from HIE were therefore non-dividend returns of capital, not subject to taxation. Pet. App. 3. The court of appeals (*id.* at 6), again citing *Miller*, 545 F.2d at 1215 & n.13, held that "once the government has shown that [petitioner] diverted funds from the corporation and failed to report them, the burden shifts to the taxpayer to show that the funds constituted a return of capital." Pet. App. 6. The court observed that nothing in HIE's corporate records indicated that the diverted funds were intended as a return of capital, and it held that the district court had properly rejected petitioner's proffer as inadequate. *Ibid.*

The court of appeals acknowledged that its approach in *Miller* conflicted with that of the Second Circuit, which held in *United States* v. *Bok*, 156 F.3d 157, 162 (1998), and *United States* v. *D'Agostino*, 145 F.3d 69, 72-73 (1998), that a taxpayer need not show that a distribution was intended as a return of capital when invoking the return-of-capital defense. It noted, however, that it was "by no means certain" that petitioner would prevail even under the Second Circuit's approach. Pet. App. 6.

Judge Thomas concurred, stating that if the court "were writing on a clean slate, rather than under the controlling precedent of [*Miller*]," he would have adopted the Second Circuit's reasoning. Pet. App. 13. He emphasized, however, that even under the Second Circuit's approach, "the outcome would not be affected" in this case because petitioner's diversion of funds was unlawful, and the Second Circuit has expressly held that the return-of-capital defense is unavailable if the diversion itself was unlawful. *Id.* at 14 (citing *Bok*, 156 F.3d at 162).

Petitioner filed a petition for rehearing en banc, urging the court of appeals to abandon *Miller* and adopt the reasoning of the Second Circuit's *D'Agostino* decision. Pet. En Banc 1-2, 8-10. The court of appeals denied the petition, with no judge requesting a vote for en banc consideration. Pet. App. 63.

ARGUMENT

Petitioner renews (Pet. 7-11) his claim that the district court erred in failing to give binding effect or "proper regard" to the state-court judgment. The court of appeals correctly construed that judgment as resolving the ownership of the funds only as between HIE and Lee, not as between HIE and petitioner. Further review of that factbound determination is not warranted. Petitioner also asks this Court (Pet. 11-16) to resolve the conflict between the Second and Ninth Circuits concerning the proper application of the return-of-capital defense in criminal tax cases. As the court of appeals recognized, however, this case presents a poor vehicle for that review because petitioner cannot prevail under either approach.

1. In *Commissioner* v. *Estate of Bosch*, 387 U.S. 456 (1967), this Court considered "[w]hether a federal court or agency in a federal estate tax controversy is conclusively bound by a state trial court adjudication of property rights or characterization of property interests when the United States is not made a party to such proceeding." *Id.* at 456-457. The Court noted that Congress, in enacting the federal estate tax, had indicated "that 'proper regard,' not finality, 'should be given to

interpretations of the will' by state courts and then only when entered by a court 'in a bona fide adversary proceeding.'" *Id.* at 464 (quoting S. Rep. No. 1013, 80th Cong., 2d Sess. Pt. 2, at 4 (1948)). It also noted that under the Rules of Decision Act, 28 U.S.C. 1652, as construed in *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), "the decision of a state trial court as to an underlying issue of state law should * * * not be controlling" because, in the absence of a decision from the state's highest court, "federal authorities must apply what they find to be the state law" and need only give "'proper regard' to relevant rulings of other courts of the State." *Bosch*, 387 U.S. at 465. The Court therefore held that "where the federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law, federal authorities are not bound by the determination made of such property interest by a state trial court." *Id.* at 457.

Petitioner argues (Pet. 7-9 & n.3) that *Bosch* conflicts with this Court's earlier decisions in *Blair* v. *Commissioner*, 300 U.S. 5 (1937), and *Freuler* v. *Commissioner*, 291 U.S. 35 (1934), and that *Bosch* should be limited to the estate-tax context. In the alternative, he asks this Court (Pet. 10-11) to clarify the level of deference owed to a state-court judgment under the "proper regard" standard of *Bosch*.

Neither of those questions is presented in this case. The court of appeals assumed, for purposes of petitioner's appeal, that the state-court jury verdict deserved more than "proper regard" and was binding as to the ownership of the funds. Pet. App. 41. It found, however, that the state-court judgment did not address the ownership of the funds "as between [petitioner] and HIE." *Id.* at 42. As the court of appeals recognized, that question was not presented to the jury and "does not appear to have been subject to adversarial testing" before the state court. *Ibid*. Thus, in this case, unlike *Bosch*, "the matter decided" in state court does not resolve the question of ownership presented in federal court. 387 U.S. at 462.

Although petitioner disputes the scope of the state-court judgment, pointing to Hawaii claim-preclusion decisions (Pet. 10), resolution of that issue presents no question of national importance warranting this Court's review. This Court's "custom on questions of state law ordinarily is to defer to the interpretation of the Court of Appeals for the Circuit in which the State is located." *Elk Grove Unified Sch. Dist.* v. *Newdow*, 542 U.S. 1, 16 (2004); see *Bowen* v. *Massachusetts*, 487 U.S. 879, 908 (1988) ("We have a settled and firm policy of deferring to regional courts of appeals in matters that involve the construction of state law."). There would be even less reason for this Court to conduct plenary review of the scope of a particular state-court judgment that has been interpreted by the regional court of appeals. This Court has already denied one petition for a writ of certiorari on this issue, *Boulware* v. *United States*, 546 U.S. 814 (2005), and there is no reason for a different result here.

2. Petitioner is correct that the decision of the court of appeals in *United States* v. *Miller*, 545 F.2d 1204, 1214 (9th Cir. 1976), cert. denied, 430 U.S. 930 (1977), conflicts with the Second Circuit's decision in *United States* v. *D'Agostino*, 145 F.3d 69, 72-73 (1998). That conflict is not squarely presented in this case, however, because petitioner's conviction would be affirmed even under the Second Circuit's approach.

a. As an element of tax evasion under 26 U.S.C. 7201, the government must prove the existence of a tax deficiency on the part of the defendant. Pet. App. 53. Section 301 of the Internal Revenue Code divides distributions of property "made by a corporation to a shareholder with respect to its stock," 26 U.S.C. 301(a), into three categories: (1) the portion of the distribution "which is a dividend (as defined in section 316)," which is taxable as gross income; (2) any non-dividend portion of the distribution, which is non-taxable to the extent it can be "applied against and reduce" the shareholder's "adjusted basis of the stock"; and (3) any non-dividend portion of the distribution "to the extent that it exceeds the adjusted basis of the stock," which is taxable as a capital gain. 26 U.S.C. 301(c)(1)-(2) and (3)(A). Section 316 in turn defines a "dividend" as a distribution made by a corporation to its shareholders "out of its earnings and profits." 26 U.S.C. 316(a)(2). Read together, those provisions establish that when a corporation distributes funds to a shareholder "with respect to its stock," the tax consequences of the distribution depend, in part, on whether the corporation has earnings and profits and the amount of the shareholder's adjusted stock basis.

In *Miller*, *supra*, the court of appeals correctly rejected the argument, pressed by petitioner here (Pet. 13), that unexplained distributions to a shareholder from a corporation without earnings and profits automatically qualify as non-taxable returns of capital up to the shareholder's stock basis, regardless of the reasons for the distribution. In that case, the president and sole shareholder of a closely held corporation failed to record more than $850,000 in corporate receipts on the corporate books, falsely recording some of the receipts as loans from the defendant to the corporation. *Miller*, 545 F.2d at 1209. Over the same period, the corporation paid virtually all of the defendant's personal expenses ("from the mortgage on his home to his 'Book-of-the-Month' Club obligations"), and the defendant falsely characterized the expense payments as repayments of loans. *Ibid.* Following a bench trial, the district court found that the distributions were taxable as salary, and were not constructive corporate distributions under Section 301(c). *Id.* at 1212, 1215-1216.

On appeal, the court of appeals rejected the defendant's "extremely technical argument" that any diversion of corporate funds by a shareholder must automatically be treated as a return of capital if the corporation lacks earnings and profits and the shareholder has a sufficient stock basis. *Miller*, 545 F.2d at 1210. Such a rule would result in "an anomalous situation" in which "[a] taxpayer who diverted funds from his close corporation when it was in the midst of financial difficulty and had no earnings and profits would be immune from punishment (to the extent of his basis in the stock) for failure to report such sums as income," but "that very same taxpayer would be convicted if the corporation had experienced a successful year and had earnings and profits." *Id.* at 1214. Instead, the court held, for a diversion to qualify as a return of capital "there must be some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be such a return." *Id.* at 1215. "To hold otherwise," the court reasoned, "would be to permit the taxpayer to divert such funds and if not caught, to later pay out another return of capital; or if caught, to avoid conviction by raising the defense that the sums were a return of capital and hence non-taxable." *Ibid.*

The court of appeals' focus on whether the distribution was "intended to be" a return of capital, *Miller*, 545 F.2d at 1215, follows from the text of Section 301(a).

That provision states that the dividend and return-of-capital rules set forth in Section 301(c) apply only to distributions to a shareholder "with respect to its stock"—that is, distributions made *by reason of* the corporation-shareholder relationship. A distribution does not qualify as a return of capital, for example, if the corporation pays an individual shareholder in his capacity as a debtor, creditor, employee, or vendee, or under other circumstances where the individual's status as a shareholder is incidental. See 26 C.F.R. 1.301-1(c) ("Section 301 is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such."). By looking to evidence that the distribution was intended as a return of capital (or dividend or capital gain), rather than a payment of salary or repayment of a debt, the standard adopted by the court of appeals ensures that Section 301(c) applies only to distributions made "with respect to" the shareholder's stock. See *Loftin & Woodard, Inc.* v. *United States*, 577 F.2d 1206, 1242 (5th Cir. 1978) ("[I]nterest paid to a stockholder who is a bona fide creditor is not a dividend nor are payments made to a stockholder who is a bona fide lessor."); cf. *Elliotts, Inc.* v. *Commissioner*, 716 F.2d 1241, 1245-1248 (9th Cir. 1983) (articulating standards for determining whether payments to a shareholder-employee qualify as compensation or dividends).

b. The Second Circuit has adopted a conflicting approach. In *D'Agostino*, that court held that under the "'no earnings and profits, no income' rule" adopted by the Tax Court in *Truesdell* v. *Commissioner*, 89 T.C. 1280, 1294-1295 (1987), action on decision, AOD 1988-025, 1988 WL 570761 (IRS Sept. 12, 1988) (Action on Decision), every distribution of funds to a shareholder from a corporation without earnings or profits qualifies as a return of capital up to the shareholder's stock basis, even if the distribution was not intended as a return of capital. *D'Agostino*, 145 F.3d at 72-73.* In *D'Agostino*, shareholders in a closely held corporation diverted more than $400,000 in corporate funds to their personal use and hid the cash in kitchen drawers. The distributions were not intended as repayments of capital; the court conceded that "[i]t is entirely possible the D'Agostinos intended to evade paying taxes." *Id.* at 73. Nonetheless, the court held that because the corporation did not have earnings or profits and the distributions did not exceed their stock basis, the distributions automatically qualified as non-taxable returns of capital. *Id.* at 72-73. The Second Circuit has since recognized that its approach conflicts with the holding of *Miller*. See *Bok*, 156 F.3d at 163 n.2.

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* Neither *Truesdell* nor the IRS's acquiescence in that decision supports the Second Circuit's rule automatically treating diversions of corporate funds to a shareholder as distributions "with respect to its stock." In *Truesdell*, the Tax Court rejected the government's argument that diverted funds are taxable as ordinary income in every case where the taxpayer exercises "dominion and control" over the funds. 89 T.C. at 1298. But the court also followed *Miller* in refusing "to apply the constructive distribution rules automatically to shareholder diversions of corporate funds." *Id.* at 1300 (noting that the case was appealable to the Ninth Circuit). Having rejected the automatic rules urged by both parties, the Tax Court concluded, in its capacity as the finder of fact, that the diversions at issue in the case were constructive dividends to the extent that the corporation had earnings and profits. See *id.* at 1293, 1300. The IRS subsequently acquiesced in the Tax Court's rejection of the "dominion and control" rule, but reiterated that a diversion of corporate funds cannot qualify as a constructive distribution where "the funds were additional salary or otherwise were received in a nonshareholder capacity." Action on Decision at *2, *Truesdell, supra* (AOD 1988-025).

The Second Circuit considers its approach "better reasoned" because, in its view, "plac[ing] greater emphasis on the intent element in criminal tax evasion cases" has the anomalous result of assigning the government "a higher burden of proof in a civil tax collection matter than in a criminal tax evasion prosecution." *D'Agostino*, 145 F.3d at 73. That comparison begins, however, from the faulty assumption that in civil cases, distributions of corporate funds to a shareholder are automatically treated as distributions "with respect to stock." Section 301 applies equally to civil and criminal tax proceedings, and courts have considered the parties' intent when evaluating whether a distribution qualifies as a dividend. See *Elliotts, Inc.*, 716 F.2d at 1244-1245 (the inquiry into whether a payment is compensation or a dividend "may expand into compensatory intent"); cf. *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974) (a taxpayer "must accept the tax consequences of his choice [of organization of his affairs] whether contemplated or not * * * and may not enjoy the benefit of some other route he might have chosen to follow but did not"). It is the Second Circuit's approach, not *Miller*, that departs from the ordinary rule in civil tax cases.

c. Although the decision of the court of appeals in *Miller* conflicts with the decision of the Second Circuit in *D'Agostino*, this case is not an appropriate vehicle to resolve the conflict because petitioner cannot prevail under either approach.

The Second Circuit has qualified its "'no earnings and profits, no income' rule" by maintaining that the rule does not apply in cases "of *unlawful* diversion, such as embezzlement, theft, a violation of corporate law, or an attempt to defraud third party creditors."

D'Agostino, 145 F.3d at 73. It repeated that note of caution in *Bok*, explaining that *D'Agostino* had "made clear" that the rule had no application in cases of unlawful diversion. 156 F.3d at 162 n.1 (citing *D'Agostino*, 145 F.3d at 73). That exception has deep roots in the civil tax cases on which the *D'Agostino* court relied. See Pet. App. 14 (Thomas, J., concurring); *Truesdell*, 89 T.C. at 1298 (emphasizing that "petitioner's diversions of income * * * were not per se unlawful" and did not appear to be "stolen, embezzled, or diverted in fraud of creditors"); *DiZenzo* v. *Commissioner*, 348 F.2d 122, 125 (2d Cir. 1965) (emphasizing that "[w]e are not here dealing with sums stolen or embezzled by a taxpayer" and that "[t]here has been no suggestion that the diversions in this case were improper as a matter of corporate law").

In this case, the distribution of corporate funds to petitioner was unlawful for at least three reasons. First, petitioner was not the sole shareholder of HIE; a trust for the benefit of petitioner's son also holds stock in the corporation. Gov't C.A. Br. 5 n.3. Although petitioner introduced minutes from HIE meetings in 1990 and 1991 purporting to grant him broad authority to use corporate funds, an expert witness for the government testified at trial those documents had been falsified. *Id.* at 10. By unilaterally diverting corporate funds to himself and his girlfriend, in excess of his authority, petitioner acted to the detriment of the remaining shareholder and in breach of his fiduciary duties. See *D'Agostino*, 145 F.3d at 73 (indicating that the "no earnings and profits, no income" rule has no application where the diversion of corporate funds was "a violation of corporate law"); *DiZenzo*, 348 F.2d at 125 (same).

Second, petitioner's pleadings in the state-court action suggest that he diverted corporate funds to his girlfriend for the purpose of preventing his wife from obtaining the portion of HIE's assets to which she was entitled in their divorce. Pet. App. 14 (Thomas, J., concurring); see *id.* at 31-32, 34-35. Such diversions "may be properly considered unlawful." *Id.* at 14 (Thomas, J., concurring); see *D'Agostino*, 145 F.3d at 73 (indicating that the "no earnings and profits, no income" rule would not apply where corporate funds were diverted in "an attempt to defraud third party creditors"); *Truesdell*, 89 T.C. at 1298 (same).

Third, the government alleged and proved at the first trial that petitioner had diverted corporate funds in furtherance of a conspiracy to make false statements to a federally insured institution. Petitioner's conviction on that count was affirmed on his first appeal, and it has become final. Pet. App. 61. As Judge Thomas recognized, because the distributions in this case were unlawful, "the outcome would not be affected" even under the Second Circuit's approach. *Id.* at 14 (Thomas, J., concurring); see *id.* at 6 (finding it "by no means certain" that "the facts in this case would implicate the Second Circuit's rule"). This case therefore is not an appropriate vehicle to resolve the conflict.

Petitioner argues (Pet. 15) that the relevant statutes do not admit of any exception for the unlawful diversion of corporate funds. On this view, a shareholder may steal or embezzle corporate funds but still maintain, in a subsequent prosecution for tax evasion, that the diversion was a distribution "to a shareholder with respect to its stock" under Section 301(a). He also argues (Pet. 15-16) that all of his diversions of corporate funds were lawful, and proposes a remand for further factfinding on that question. No court of appeals has endorsed petitioner's approach, and an inquiry into the lawfulness of the distributions would not address the conflict between the Second and Ninth Circuits. Further review by this Court is unwarranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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