

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 MICHAEL H. BOULWARE, :

4 Petitioner :

5 v. : No. 06-1509

6 UNITED STATES. :

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8 Washington, D.C.

9 Tuesday, January 8, 2008

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11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States
13 at 10:52 a.m.

14 APPEARANCES:

15 JOHN D. CLINE, ESQ., San Francisco, Cal.; on behalf of
16 the Petitioner.

17 DEANNE E. MAYNARD, ESQ., Assistant to the Solicitor
18 General, Department of Justice, Washington, D.C.; on
19 behalf of the Respondent.

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P R O C E E D I N G S

(10:52 a.m.)

CHIEF JUSTICE ROBERTS: We'll hear argument next in Case 06-1509, Boulware v. United States.

Mr. Cline.

ORAL ARGUMENT OF JOHN D. CLINE

ON BEHALF OF THE PETITIONER

MR. CLINE: Mr. Chief Justice, and may it please the Court:

Congress placed the phrase "with respect to its stock" in section 301(a) of the Internal Revenue Code to make clear that the taxation rules in Section 301(c) do not apply to corporate payments that a shareholder receives in a non-shareholder capacity.

JUSTICE SOUTER: May I ask you a question which is going to come up sooner or later? And it's kind of a threshold question. So, if I may, let me interrupt you with it now. You emphasize the significance of the limiting condition "with respect to the stock." But before you get to that phrase, Section 301 refers to a distribution by the corporation. And my question is this: Let's assume that we -- we accept your -- your position that the circuit was wrong in requiring an offer of proof of intent to return capital. Isn't it also the case that you would still have an

1 obligation, if you're going to take advantage of this
2 section, to offer some evidence with respect to the fact
3 that there was a corporate distribution involved? And
4 as I understand it, your evidence is -- or the Government's
5 evidence and yours is -- that, you know, there was
6 skimming, there was misdirection, et cetera, but there
7 was no indication, there's no evidence that there was
8 any distribution, in the normal sense of that word, by a
9 corporation.

10 So it seems to me that if you -- if you win
11 the case in the sense of convincing us that the circuit
12 was wrong with respect to the specific intent
13 requirement, you would still be left without a defense
14 because you have not come forward with any evidence that
15 indicates a distribution. Am I wrong?

16 MR. CLINE: Yes, Your Honor, I believe you
17 are.

18 JUSTICE SOUTER: I thought you were going to
19 say that.

20 (Laughter.)

21 MR. CLINE: Although I agree that the
22 question of a distribution is important, and I think
23 implicit in that question, in that term, although the
24 courts have not addressed it, is some sort of corporate
25 action. Where you have a controlling shareholder, as we

1 do here with Mr. Boulware, who is a 50-percent share-owner,
2 he's the president, he's the founder, he
3 dominates this company. His action is action on behalf
4 of the corporation.

5 JUSTICE SOUTER: Well, it certainly can be,
6 and there's no question about that, but isn't there some
7 point of informality or some point, I guess, of
8 formality or relevance to corporate practice that has to
9 be reached? In other words, he may keep lousy books, he
10 may be very sloppy, but directing funds to one's
11 girlfriend is not the act of a corporation. And it
12 seems to me that the kind of -- of actions that he took
13 to get or to direct the payment of moneys could not, by
14 any stretch of the imagination, be regarded as an act of
15 this corporation or of any corporation.

16 MR. CLINE: With respect, Justice Souter,
17 Justice Souter, I disagree. There are, I've discovered,
18 hundreds of corporate diversion cases involving a very
19 similar fact pattern and a very similar fact pattern to
20 this, where have you a corporation that is really the
21 creature of one person. It's formed by one person. He
22 chose the corporate form, but in effect he is the
23 corporation. That's the case of Mr. Boulware and it's
24 the case in a lot of these diversion cases, and --

25 JUSTICE SOUTER: Well, in this case, he's a

1 50 percent owner, as I understand it. He formed the
2 corporation, but isn't 50 percent of the stock owned by
3 the trust for the love child of him and the girlfriend?

4 MR. CLINE: It is indeed, although it's
5 important to keep in mind that the girlfriend, according
6 to the Government's evidence, received a very large
7 chunk of this money. So in effect what we have here is
8 a situation where you not only have a 50 percent
9 shareholder who dominates the corporation; the other 50
10 percent -- the trustee for the other 50 percent
11 shareholder is the recipient of the money and is
12 certainly knowledgeable about most, if not all, of
13 what's going on.

14 But in these circumstances where you have a
15 close corporation typically run very informally, as this
16 one was, with one person who dominates it, the courts
17 have uniformly taken the view that -- the Tax Court has
18 and for that matter the Government has in every case
19 except this one -- that when the controlling dominant
20 shareholder takes money from his corporation, that's a
21 distribution by the corporation. And although, Your
22 Honor, I had thought about this question myself before
23 you raised it, the cases don't pause on that issue.
24 They move directly to the question of whether it's taken
25 in some other capacity, as compensation, for example, or

1 as a loan.

2 JUSTICE GINSBURG: Well, perhaps because --
3 because the Government might very well be on the other
4 side of that question, that is the dominant shareholder
5 takes money from the corporation, gives it to his
6 girlfriend, and the Government is saying that
7 corporation had earnings and profits, we want to tax
8 this as a dividend to you.

9 MR. CLINE: Well, yes, Justice Ginsburg.
10 The way this often comes up, the Government usually
11 takes the opposite position --

12 JUSTICE GINSBURG: Yes.

13 MR. CLINE: -- of what it's taken here. It
14 usually takes our position, and here's the reason why:
15 First of all, a lot of times, as in this case, some of
16 the money that is coming toward the corporation is
17 intercepted by the controlling shareholder. And the
18 question then is, was it ever income to the corporation?
19 Well, of course, the Government wants to say that it was
20 because they want to tax it twice, at the corporate
21 level and then again at the individual level. And the
22 issue there again is one of control. If it's the
23 controlling shareholder, even though he gets the money
24 before it ever hits the corporate bank account, it's
25 considered income to the corporation.

1 It also comes up when the corporation wants
2 to claim a theft deduction or an embezzlement deduction.
3 That again is a common fact pattern in these cases. The
4 corporation -- everything comes to light, the IRS
5 conducts its investigation, now the corporation wants to
6 avoid its tax. Sure the individual is going to get
7 taxed, but it wants to avoid its tax. And so it claims
8 that there was a theft or an embezzlement by the
9 shareholder and it's entitled to a deduction and
10 shouldn't have to pay tax on that money.

11 And again, the Government uniformly takes
12 the position that a controlling shareholder, such as
13 Mr. Boulware, can't embezzle from his own corporation,
14 which is essentially the position that we're taking
15 here. That --

16 JUSTICE SOUTER: Well, it may be that he
17 cannot embezzle in the sense that -- of committing a
18 separate private act or even a separate -- a separate
19 tort that the corporation could object to. But the
20 question still remains -- excuse me -- whether the act of
21 -- of taking the money in this unorthodox way could be
22 regarded as a corporate act within the meaning of the term
23 "distribution." And I think I understand your point,
24 but I guess the only point that I'm making is the fact
25 that it may not qualify as embezzlement, civilly or

1 criminally, does not necessarily answer the objection
2 that I'm raising.

3 MR. CLINE: I agree with that point, Justice
4 Souter.

5 One other point I would emphasize though
6 is that I think if you start to say that an act by the
7 controlling shareholder, which is Mr. Boulware, does not
8 constitute a distribution by his corporation, there are
9 going to be unintended consequences of that. One of
10 which is that in a situation where a controlling
11 shareholder such as Mr. Boulware intercepts money coming
12 into the corporation, you're going to have the
13 corporation coming in and arguing that that
14 interception, that taking in of money wasn't an act of
15 the corporation, and so, there is no income to us. And
16 I think that's why the courts in a whole series --

17 JUSTICE SOUTER: That explains why I'm
18 making the argument and the Government wasn't in its
19 brief.

20 MR. CLINE: I think it does. But --

21 JUSTICE GINSBURG: You did say something
22 about the interception that -- your argument is that
23 this corporation had no earnings and profits, so what
24 the shareholder got was a return of capital. But part
25 of what was involved was he was taking, I thought,

1 receipts for goods that customers were -- had paid and
2 giving them to the girlfriend.

3 In determining whether that corporation had
4 any earnings and profits, wouldn't you have to credit
5 the corporation? In other words, did you prove that
6 there was no -- that there were no earnings and profits?
7 You would have to prove that, wouldn't you?

8 MR. CLINE: The way I believe it would work
9 with a properly instructed jury in the district court is
10 as follows: I think Mr. Boulware would have the burden
11 of coming forward with some evidence that the
12 corporation did not have earnings or profits and that
13 his basis exceeded the amount of the diversion. I think
14 at that point, if he comes forward with some evidence,
15 and Bok talks about this, Leonard talks about this --

16 JUSTICE SCALIA: For which purpose you'd
17 include the receipts.

18 MR. CLINE: I beg your pardon?

19 JUSTICE SCALIA: For which purpose you would
20 include the receipts that he sent to his girlfriend
21 instead of putting it in the corporate treasury.

22 MR. CLINE: Your Honor, I believe that is
23 correct, but I'm not certain. What I can tell you about
24 earnings and profits and basis as well is this. It is a
25 very complicated calculation, and I think it would be

1 hotly disputed in the district court. I would expect
2 the Government to argue that the company did have
3 earnings and profits and that Mr. Boulware's basis is
4 less than he contends it is. I think it would
5 ultimately be a question of fact for the jury.

6 JUSTICE KENNEDY: I also wanted to know
7 is there in the record the corporation's balance
8 sheet? It was frankly hard for me to believe that this
9 was not an excess-of-basis. You don't usually
10 capitalize corporations for \$10 million. But I don't
11 have any basis other than just an assumption to make
12 that observation. Is the corporate balance sheet with
13 the capital structure in the record?

14 MR. CLINE: I don't believe so, Your Honor.
15 But what is in the record, and it's also in the joint
16 appendix, is the fairly sketchy evidence of both basis
17 and earnings and profits that was introduced. But there
18 was not a full presentation on those issues.

19 JUSTICE KENNEDY: Was it introduced by the
20 Government or by the defendant?

21 MR. CLINE: It came in -- I must say it came
22 in more or less by happenstance, because neither party
23 was really looking at the question of earnings and
24 profits or basis because the trial court had ruled those
25 out. But, for example, on cross-examination I believe

1 of Mr. Boulware's accountant -- this is at page 42 of
2 the joint appendix -- Mr. Boulware's lawyer elicited
3 that the corporation had not had earnings and profits
4 during the years in question. Now that was not explored at
5 all. But there is that statement in the record.

6 There is also -- I'm sorry, Your Honor.

7 JUSTICE KENNEDY: I'm not, I'm not sure if
8 what the Government is maintaining here is so
9 prejudicial to its position in other cases, which was
10 the earlier discussion we were having. Here there is
11 simply nothing on the corporate records to show that
12 this was a distribution with respect to stock. I don't
13 care whether this is earnings and profits or an excess
14 of basis. But there's just no indication of the
15 distribution with respect to stock, and you have two
16 shareholders. Under Hawaiian law, can you make a
17 disproportionate distribution to shareholders so one
18 person gets capital back and the other doesn't and
19 there's no redemption of shares?

20 MR. CLINE: I think it is entirely possible
21 that under Hawaiian law a minority shareholder or a
22 noncontrolling shareholder who was treated unfairly by
23 the controlling shareholder might have a cause of action
24 under State law. But I --

25 JUSTICE KENNEDY: That was, that was the

1 qualification that the Second Circuit made in its
2 D'Agostino case. It said if there's a violation of
3 corporate law then our rule doesn't apply.

4 MR. CLINE: Well, except, Your Honor, that
5 the way these cases have played out is that there are
6 numerous cases, dozens of them, where there are minority
7 shareholders oftentimes unwitting of what the majority
8 shareholder is doing. Those minority shareholders
9 certainly have rights. They can sue under State law.
10 They can do a number of things.

11 But their rights and the possible violation
12 of their rights -- and I emphasize possible, because no
13 one has ever established that Mr. Boulware did anything
14 wrong with respect to anyone here -- those don't drive
15 the Federal tax treatment.

16 JUSTICE KENNEDY: Well, but that's the whole
17 point. The fact that he doesn't show this as a
18 distribution indicates that he couldn't do this under
19 Federal law, so it must be something -- under State law,
20 so it must be something other than a distribution.

21 MR. CLINE: I think, Your Honor, that where
22 the controlling shareholder of a corporation does
23 something with corporate funds, and in this case
24 transfers them to himself, I think that's a
25 distribution. And I think that it is properly treated

1 under Federal law, under Federal tax law, for purposes
2 of Federal tax law as a distribution by the corporation.

3 JUSTICE SCALIA: I'm less concerned with the
4 word "distribution" in the statute than I am with the
5 phrase "with respect to its stock" -- "distribution made
6 by a corporation to a shareholder with respect to its
7 stock."

8 Now, the court below held that there had to
9 be a conscious intent to return capital. Even if I
10 disagree with that and think that that was wrong, isn't
11 the Government right that it nonetheless is the burden
12 to establish that the distribution here was a
13 distribution "with respect to stock," and the distribution
14 was given to the girlfriend who owns no stock in the
15 corporation. How does it become a distribution with
16 respect to stock?

17 MR. CLINE: Well, Your Honor, that gets back
18 to where I -- to where I began my argument. The phrase
19 "with respect to stock" has never received in any case
20 or any argument, as far as I know, the significance that
21 the Government is trying to accord it here. What that
22 phrase -- it was put in the 1954 Code. And the purpose
23 of putting it in the Code was simply to distinguish
24 transfers to shareholders in a capacity where the
25 shareholder is effectively returning consideration --

1 shareholder employees, shareholder vendors, shareholder
2 creditors --

3 JUSTICE SCALIA: Or girlfriends. I mean,
4 why doesn't it distinguish a girlfriend as much as it
5 distinguishes an employee who's receiving back a loan?

6 MR. CLINE: Because the issue, Your Honor,
7 is not the recipient of the funds. I mean, the money is
8 going to be taxed to Mr. Boulware if it's taxable
9 regardless of where he diverted it. For example, there
10 are again dozens of these cases where controlling
11 shareholders divert corporate assets to their family
12 members, and the issue is whether it's a constructive
13 dividend to that corporate shareholder. Here the
14 question, regardless of where Mr. Boulware --

15 JUSTICE SCALIA: And the Government would
16 say yes?

17 MR. CLINE: Absolutely. The Government in
18 every case says yes.

19 JUSTICE SCALIA: Yes, they're really --
20 they're really between a rock and a hard place on this
21 stuff.

22 MR. CLINE: Well, because, Your Honor, they
23 want -- they want the controlling shareholder, the
24 person in Mr. Boulware's situation, to pay tax. And, of
25 course in most cases -- in most cases, again, it's to

1 the Government's advantage to argue the position that
2 we're arguing here. And the reason is most corporations
3 have earnings and profits. Most shareholders don't have
4 enough basis to cover their tax until the Government
5 wants to hit it at both levels, it wants the corporate
6 tax and it wants the individual tax. And so, it argues
7 readily that this is a distribution with respect to
8 stock.

9 That phrase was -- was put in the 1954 Code
10 to distinguish one capacity from another. The
11 Government has argued that it should receive some sort
12 of a causal-type meaning. There should be a causal
13 link, that Mr. Boulware should have to establish that he
14 received the stock because he was a shareholder.

15 If that's the standard, first of all, it's a
16 different standard than what the district court and the
17 Ninth Circuit required Mr. Boulware to meet. So he
18 ought to have a chance to satisfy the standard.

19 Second, that standard doesn't necessarily
20 require any form of intent. There's nothing in the
21 phrase "with respect to stock" that talks about intent.

22 CHIEF JUSTICE ROBERTS: We don't -- and this
23 may be the point that you just made, but I want to
24 clarify it. We don't have to decide whether this
25 diversion was with respect to stock, because you put

1 that in issue, and you weren't allowed to make that --

2 MR. CLINE: Absolutely, Your Honor. What --

3 CHIEF JUSTICE ROBERTS: I suppose it would
4 be open on remand for the Government to argue it was not
5 with respect to stock for the reasons that have come
6 out, that it was just a diversion?

7 MR. CLINE: The Government could argue that,
8 but, Mr. Chief Justice, I have to say I --

9 JUSTICE SCALIA: You are pretty sure they
10 won't.

11 MR. CLINE: I would be astounded if they
12 took that position, because it would be so contrary to
13 the position they take in every other case.

14 But to get back to your basic point, yes,
15 Mr. Boulware was asked to meet a standard that no one
16 defends in this Court. The Government isn't here
17 defending the intent to have a return-of-capital
18 standard. And part of the reason they don't defend it
19 is it's an impossible concept. You don't know if you
20 have a return of capital until you know if you have a
21 dividend. And you don't know that until -- until the
22 end of the tax year.

23 JUSTICE GINSBURG: What about the -- the
24 Government did say that this accountant -- what was his
25 name, Monango, or something like that? --

1 MR. CLINE: Monago, yes.

2 JUSTICE GINSBURG: -- testified at the trial
3 that there was no return of capital in the relevant
4 years.

5 MR. CLINE: What Mr. Monago testified to was
6 that there weren't any payments out of the capital
7 account, and that's undisputed. But that's not the
8 question.

9 Those sorts of corporate formalities are not
10 determinative, or even particularly helpful, in these
11 constructive dividend types of cases.

12 JUSTICE KENNEDY: Well, under the
13 Government's intent test, I suppose if you have a
14 calendar year and the distribution is made in June, that
15 the Government could say: What we want to show -- we
16 want you to show that there was an intent to make a
17 distribution with respect to stock at that time.

18 Whether or not it was a dividend, whether or
19 not it was a return of capital, we won't know until the
20 end of the year. I suppose they could try to argue
21 that.

22 MR. CLINE: That is what they're arguing.
23 Two things about that Justice Kennedy:

24 First, that's not the standard Mr. Boulware
25 was required to meet in the district court. The

1 standard there was intent that it be a return of
2 capital. And that's a different thing than an intent
3 that it be with respect to stock.

4 An intent that it be a return of capital
5 suggests that you know what a return of capital is. You
6 know about earnings and profits. You know about basis.
7 And I can tell you that Mr. Boulware, who was an
8 unsophisticated man, didn't know any of those things at
9 the time; and so, of course, he couldn't meet the
10 standard he was required to meet. If this Court were to
11 agree with the Government that --

12 JUSTICE KENNEDY: You mean to say the
13 Government can't argue that this -- the defendant has to
14 show that it was a distribution with respect to stock
15 and that that was his intent. Whether or not it was a
16 dividend, whether or not it was a return of capital, we
17 wait.

18 MR. CLINE: I don't think that's the right
19 standard, but even if this Court decides that it is,
20 that's not the standard Mr. Boulware was required to
21 meet in the trial court. He was required to show an
22 intent that it be a return of capital, and he couldn't
23 meet that standard.

24 If this Court were to decide -- and I
25 suggest it would be the wrong standard -- but if this

1 Court were to decide that the correct standard were an
2 intent that it be with respect to stock, Mr. Boulware
3 could meet that standard.

4 He was never given the opportunity to meet
5 it before, but he could meet that if this Court were to
6 decide that that was the standard in the sense that he
7 could certainly show that, to the extent he got this
8 money personally, he got it because he was a
9 stockholder. And he knew he was getting it because he
10 was a stockholder.

11 But he never had a chance to meet the
12 standard, because it wasn't the standard that the
13 Government urged in the trial court or even before the
14 panel on appeal.

15 Unless the Court has further questions, I'd
16 like to reserve the remainder of my time.

17 CHIEF JUSTICE ROBERTS: Thank you,
18 Mr. Cline.

19 Ms. Maynard.

20 ORAL ARGUMENT OF DEANNE E. MAYNARD

21 ON BEHALF OF THE RESPONDENT

22 MS. MAYNARD: Mr. Chief Justice, and may it
23 please the Court:

24 In the Government's view, to make a
25 sufficient proffer of a return of capital defense a

1 Defendant must point to some factual evidence to support
2 three elements:

3 First, that there was a distribution with
4 respect to stock. Second, that the corporation lacked
5 earnings and profits during the relevant tax years.
6 And, third, that the Defendant had a sufficient basis in
7 his stock to cover the funds received.

8 The question before this Court relates to
9 the first element.

10 JUSTICE SCALIA: The court below didn't give
11 him a chance --

12 MS. MAYNARD: No, Your Honor.

13 JUSTICE SCALIA: -- to establish that. The
14 court below required him to show an intent to distribute
15 capital.

16 MS. MAYNARD: And the Government here
17 believes that the correct test is the rule of the Ninth
18 Circuit, Your Honor. The Government believes that
19 before a defendant may present a return of capital
20 defense to the jury, there must be some evidence that
21 the corporation intended, as objectively inferred from
22 all the facts and circumstances, to make a distribution
23 with respect to its stock at the time the funds were
24 taken.

25 JUSTICE GINSBURG: But if it turned out that

1 there were earnings and profits and everything else was
2 the same, would the Government be taking the position
3 that the proper test is: Was this a distribution with
4 respect to stock?

5 MS. MAYNARD: In -- in every case, Your
6 Honor, the question about whether or not the Section 301
7 tax treatment applies, the Government believes that it
8 turns on all the facts and circumstances and that there
9 must be some facts and circumstances suggesting that it
10 was a distribution with respect to stock.

11 JUSTICE GINSBURG: Suppose the government --
12 the corporation is rich with earnings and profits.
13 Would the Government be saying: Oh, aha. But we have to
14 go through the motions of first seeing was this a
15 distribution with respect to stock?

16 I thought that the idea of was it "a
17 distribution with respect to stock" refers to was it --
18 was the corporation -- was there to be any quid pro quo?
19 That is, the shareholder gets money from the
20 corporation. Is the shareholder expected to pay it
21 back, or is it just that it comes out of the corporation
22 into the shareholder's pocket with no expectation by the
23 corporation to get it back?

24 I thought that that's what "with respect to
25 stock" means instead of "with respect to salary," "with

1 respect to loan." And that's what I thought was the
2 understanding of the term. Am I wrong about it?

3 MS. MAYNARD: That is half of the
4 understanding of the term. I do think it is, as
5 Petitioner says, a term of art. There are two parts to
6 the term of art with respect to stock, Your Honor.

7 It is, as you say, funds that you receive
8 without consideration. But it is also funds that you
9 receive solely because of your status as a shareholder.

10 JUSTICE SCALIA: But that was -- we're just
11 not on the same page here. That's not what the -- the
12 decision you're defending said.

13 The decision you're defending did not say
14 that it was incumbent on the defendant to show that it
15 was with respect to stock. They said it was incumbent
16 on the defendant to show that it was intended to be a
17 return of capital.

18 MS. MAYNARD: Well, that's --

19 JUSTICE SCALIA: And that's just a wholly
20 different issue, and it seems to me the best you can get
21 out of this case, the way you're arguing it, is a remand
22 for them to apply the proper test.

23 MS. MAYNARD: I think the test that I'm
24 articulating is the Ninth Circuit's test in this
25 circumstance, Your Honor. In Miller, which is the

1 genesis of the Ninth Circuit's test, the court said --
2 and this is on page 545 at 1214 -- "We, therefore,
3 conclude that whether diverted funds constitute
4 constructive corporate distributions" -- and that would
5 include dividends, return of capital, or capital gain --
6 "depends on the factual circumstances involved in each
7 case under consideration."

8 And then it went on to say, before a
9 defendant could proffer a defense of return of capital,
10 the taxpayer had to make some demonstration that --
11 such distributions were intended to be such a return of
12 capital --

13 JUSTICE BREYER: It depends on what
14 you mean by that. The Ninth Circuit says, quote, about
15 what he has to show, that he has to show "not merely that
16 the funds could have been a return of capital, but that
17 the funds were, in fact, the return of capital at the
18 time of transfer."

19 Then, they go on to say, since there was no
20 evidence that they were considered, intended or recorded
21 on the corporate records as a return of capital at the
22 time they were made, then it isn't a return of capital.

23 Now, I thought everybody thinks that's
24 wrong, because you might have an absolute distribution
25 that absolutely counts as a distribution to every

1 shareholder in the corporation. And at the time they
2 all think the company's going to make a billion dollars,
3 but it just turns out that they have a loss of a billion
4 dollars, in which case at the end of the tax year that
5 would count as a return of capital if the basis were
6 high enough, and it would not count as a dividend. Am I
7 wrong?

8 MS. MAYNARD: No. You may not know at the
9 time the funds are taken whether or not they are return
10 of capital or dividend --

11 JUSTICE BREYER: All right, fine. So if we
12 do not know, that's the end of the Ninth Circuit test,
13 isn't it? Because the Ninth Circuit test says: What we
14 want to do is to look at the books at the time of the
15 distribution and see if it is entered on those books as
16 a return of capital. That's how I read it.

17 MS. MAYNARD: If you -- it would
18 be more accurate to say: At the time, was it intended,
19 as objectively manifested from all the facts and
20 circumstances, to be a distribution --

21 JUSTICE BREYER: No. No. It was not. What
22 they thought at the time they distributed it was
23 fabulous dividends because we are going to be rich.

24 MS. MAYNARD: But if --

25 JUSTICE BREYER: My example was they just

1 made a little mistake. Instead, the corporation is
2 close to bankrupt, so there are no earnings or profits.
3 Is it then a return of capital or not?

4 MS. MAYNARD: It could be a return of
5 capital depending on the person's stock.

6 JUSTICE BREYER: The basis. He has more
7 than enough basis. He has a \$14 trillion basis, okay?
8 So there is no problem about that.

9 MS. MAYNARD: But here he -- the defendant
10 --

11 JUSTICE BREYER: All right. And so it is a
12 return of capital. So, therefore, the test is wrong.

13 MS. MAYNARD: It would be a return -- but
14 the point, Your Honor, is that the test is whether or
15 not at the time the funds were taken, the corporation
16 intended to be making a distribution with respect to its
17 stock.

18 JUSTICE SOUTER: Well, aren't you -- aren't
19 you saying not that the -- that the test of intent that
20 the Ninth Circuit used is, in itself, a sufficient test;
21 but that, rather -- and correct me if I'm wrong, because
22 I thought this was the basis really of your argument.

23 I thought the Government, in effect, was
24 saying in order to treat it as a return of capital, it
25 is a necessary condition that it be intended to be

1 treated as a return of capital.

2 But that is not a sufficient condition,
3 because if, in fact, it turns out, as in Justice
4 Breyer's example, that there are no earnings, then under
5 301 it can't be treated as -- as a dividend. And only
6 then, under 301, would it be treated as a return of
7 capital.

8 So the conditions are, No. 1 necessary
9 intent; No. 2, a determination at the end of the year
10 that, in fact, there were no earnings.

11 Conversely, if at the end of the year there
12 are profits, even though the first necessary condition,
13 intent, was satisfied, under 301 that would not be
14 enough; and the Government would treat it as income.

15 Isn't that the nub of your position?

16 MS. MAYNARD: If it were with respect to
17 stock and there were --

18 JUSTICE SOUTER: Yes. Yes.

19 MS. MAYNARD: -- earning and profits, and it
20 would be income --

21 JUSTICE SCALIA: I doubt that. Then --
22 then, you would say, when it is not a criminal
23 prosecution for failure to pay taxes, so long as
24 somebody, when they take the money -- intended to be a
25 return of dividends, it does not become a return of

1 capital. Are you sure you're willing to live with that
2 intent requirement?

3 MS. MAYNARD: If at the time the corporation
4 made a distribution, Your Honor --

5 JUSTICE SCALIA: At the time -- is it
6 important for the tax treatment that at the time of the
7 distribution it be intended to be either a return of
8 capital or dividends? Does that make the difference as
9 to whether you're going to be able to tax it or not?

10 MS. MAYNARD: It depends in all cases, in
11 both criminal and civil cases -- and in that -- to that
12 extent the Government doesn't agree with the Ninth
13 Circuit's reasoning -- in all cases whether or not
14 something gets the tax treatment set forth in 301(a)
15 depends on whether or not it's a distribution with
16 respect to stock.

17 JUSTICE SCALIA: Well, I'm not -- we are not
18 talking about distribution.

19 MS. MAYNARD: Okay, I'm sorry. I
20 misunderstood your question.

21 JUSTICE SCALIA: We are talking about the
22 intent that it be a return of capital or not.

23 MS. MAYNARD: If it -- if the
24 Government -- if it was intended at the time it was paid
25 out to either be a dividend or a return of capital or a

1 capital gain --

2 JUSTICE SCALIA: Either one.

3 MS. MAYNARD: -- that would be enough to
4 satisfy the "with respect to stock" --

5 JUSTICE SCALIA: It could be anything at
6 all. So in other words, there is no preliminary
7 requirement that you intend that it be a return of
8 capital. Right. So if the court of appeals said that
9 here, it was wrong.

10 MS. MAYNARD: I think if the court chooses
11 to read their test that rigidly, I don't believe that
12 the Petitioner understood it that way.

13 JUSTICE SOUTER: Well I -- let me -- I just
14 want to get clear on how you understand it. I gave you
15 one alternative in which you defend the Ninth Circuit.
16 Justice Scalia has given you another alternative in
17 which you don't defend the Ninth Circuit. Which --
18 which are you going to take?

19 MS. MAYNARD: I must not understand. There
20 are three elements. I want to make clear there is an
21 additional element, Your Honor, to the defense than the
22 two you laid out.

23 That there would also -- the taxpayer must
24 have a sufficient basis in his stock to cover the amount
25 of the diverted funds for it to be treated as a return

1 of capital.

2 JUSTICE BREYER: Can I try a third example?
3 Because I think an example might help.

4 Let us imagine that the company distributes
5 \$10,000 on June 1 to every shareholder.

6 Let us imagine that every shareholder has a
7 basis of a trillion dollars in his stock. There is no
8 problem about basis. There is no problem about the
9 nature of the distribution.

10 Let us imagine they put in the corporate
11 records on June 1: This is a very valuable corporation;
12 we are going to make a fortune; and this is a dividend.
13 They write it down.

14 Now, unfortunately, four weeks later the
15 bottom falls out of the market, and it is not a dividend
16 for the reason that they have no profits that year.
17 Now, is it not under ordinary tax law a return of
18 capital?

19 MS. MAYNARD: Yes, Your Honor.

20 JUSTICE BREYER: Okay.

21 MS. MAYNARD: If he had--

22 JUSTICE BREYER: That -- once you say
23 yes, then the Ninth Circuit must be wrong because the
24 Ninth Circuit said we do not look to see what happens.

25 MS. MAYNARD: If that's how --

1 JUSTICE BREYER: A month later, we look just
2 to see how it's characterized by the corporation at the
3 moment of the transfer.

4 MS. MAYNARD: If one reads the Ninth
5 Circuit's test that rigidly --

6 JUSTICE BREYER: Well, that's what they
7 said.

8 MS. MAYNARD: -- perhaps that would be
9 right. But I believe if one looks back to Miller, you
10 can see that the Ninth Circuit is talking about whether
11 or not it was a constructive distribution.

12 JUSTICE SOUTER: Yes, but why talk about
13 that at all? I mean, on Justice Breyer's third and
14 simplest example, he is basically saying let Section 301
15 make the determination, in effect, at the end of the
16 year, when we know what the actual situation of the
17 corporation is. If you wait and see, 301 takes care of
18 it, and you don't have to get into the -- sort of the
19 metaphysics of intent.

20 MS. MAYNARD: Well, there is a threshold
21 requirement to 301 treatment, Your Honor.

22 JUSTICE SOUTER: Yes. Distribution with --
23 distribution with respect to stock.

24 MS. MAYNARD: Right. And there --

25 JUSTICE SOUTER: And I think he was assuming

1 and I'm assuming that -- that that condition is met.
2 But, in order to meet that condition, you don't have to
3 have a specific intent that the -- on the part of the
4 corporation that the distribution either be a return of
5 capital or that the distribution either be a dividend.
6 It simply has to be a distribution to this guy because
7 he is a stockholder.

8 MS. MAYNARD: That's right, Your Honor. We
9 agree with that.

10 JUSTICE SOUTER: Okay.

11 MS. MAYNARD: If he had testified here that
12 he believed he was receiving a dividend at the time he
13 took these funds, we believe that would be sufficient to
14 meet the threshold requirement.

15 JUSTICE SCALIA: He wants the chance to argue
16 that. He was not given a chance to argue.

17 MS. MAYNARD: I believe you can tell from
18 his proffer, Your Honor, that he understood his test was
19 to show that these were intended to be some sort of
20 constructive distributions.

21 JUSTICE GINSBURG: Was there anything in the
22 Tax Court at all that used the words "as having any
23 significance for this determination whether there was a
24 tax evasion here with respect to its stock"? Was there
25 any -- any hint that those -- those words were

1 controlling?

2 MS. MAYNARD: In the Ninth Circuit?

3 JUSTICE GINSBURG: In the tax court

4 originally. Was this a -- this was in the tax court?

5 MS. MAYNARD: No, Your Honor.

6 JUSTICE GINSBURG: This is a criminal case.

7 MS. MAYNARD: A criminal case, yes.

8 JUSTICE GINSBURG: Okay. In the trial court
9 first.

10 MS. MAYNARD: In -- in -- the rule has been
11 clear in the Ninth Circuit since 1976 that you had to
12 make a showing that there was an intent at the time the
13 moneys were paid to make a constructive distribution.

14 So, no, there was no need to go back to
15 first principles and argue where in the statute that
16 rule was grounded; but the Government has made this
17 argument and made it in seeking en banc rehearing in
18 D'Agostino, in 1998.

19 So this is not a new argument. When -- when
20 the issue was reopened and they sought en banc review,
21 the Government --

22 JUSTICE STEVENS: Mr. Maynard, can I can
23 ask you sort of an elementary, stupid question? What
24 is the Government's theory as to what this money was? Is
25 it the theory that it was a dividend or that it was salary?

1 MS. MAYNARD: The Government's theory of the
2 case, Your Honor -- but I'd like to step back and
3 explain it after I tell you what it was. The
4 Government's theory of the case was that this money was
5 stolen from the corporation. But in a criminal case, in
6 order to show a tax deficiency for purposes of tax
7 evasion or --

8 JUSTICE STEVENS: So your theory, just to be
9 sure I understand, it was not salary; it was not a
10 dividend; it was the proceeds of an embezzlement or
11 theft?

12 MS. MAYNARD: That was as we argued it to
13 the jury, Your Honor. But there is no need in -- for
14 the Government to characterize in a tax -- for
15 purposes of a criminal case, this Court's decision in
16 Holland makes clear that in order to prove the tax
17 deficiency element of a tax evasion case, or here a
18 false statement with respect to income for the false
19 return counts, the Government need prove only two
20 things:

21 One, that the Defendant received a
22 substantial amount of funds that he did not report on
23 his income taxes.

24 And, two, that the funds came from a likely
25 source of taxable income.

1 JUSTICE STEVENS: It does not have to prove
2 that it was income.

3 MS. MAYNARD: It has to prove that it came
4 from a likely source of taxable income. And we
5 prove that here, Your Honor --

6 JUSTICE STEVENS: I just want to be sure I
7 have the right answer. You do not have to prove that it
8 was income?

9 MS. MAYNARD: That is a proof -- that it's
10 income. We don't have to label what type of income it
11 is.

12 JUSTICE SOUTER: It's income to him. You
13 would be taking a different position if you thought you
14 could attribute it to the corporation and tax the
15 corporation, too.

16 MS. MAYNARD: The fact that it's -- it's
17 income to him. It may or may not be income to the
18 corporation. We also believe it was income to the
19 corporation.

20 JUSTICE SOUTER: Right. And if you want to
21 go after the corporation, you are specifically going to
22 take the position in this guy's case that, in fact, it
23 was income to the corporation. If there is no income to
24 the corporation, then you don't care, and that's the
25 situation you're in here.

1 MS. MAYNARD: It was income to the
2 corporation, Your Honor, even here.

3 JUSTICE SOUTER: But it was not profits; it
4 was not taxable income.

5 MS. MAYNARD: Yes. It should have been
6 income to the corporation, and --

7 JUSTICE SOUTER: It was not taxable income,
8 because there was no profit.

9 MS. MAYNARD: Yes, it should have been.
10 Yes, Your Honor, it should have been taxable income to
11 the corporation: this income that was coming to the
12 corporation that he diverted before it hit the corporate
13 -- in lots of instances -- before it hit the corporation's
14 books. In other instances, he took money from the
15 corporation and put it to his personal use.

16 CHIEF JUSTICE ROBERTS: I thought --

17 JUSTICE KENNEDY: Under your response to
18 Justice Stevens, once you show that it was from a likely
19 source of income that he received it, it's unreported,
20 then it's the defendant's burden to go ahead and show
21 this was a 301 distribution, that I had a basis that
22 absorbed it, or that there were no earnings and profits.
23 That's all for the defendant.

24 MS. MAYNARD: The Government retains the
25 ultimate burden of proof at all times, Your Honor, to

1 prove it beyond a reasonable doubt.

2 CHIEF JUSTICE ROBERTS: Well, the court
3 didn't let the taxpayer submit evidence. He came
4 forward and said: Look, there's an issue here despite
5 the return of capital. I would have thought at that
6 point the burden shifted to you again. That burden --
7 having met that burden of production or at least tried
8 to, the burden would shift to you to show, no, it's not
9 a return of capital, it's a dividend.

10 MS. MAYNARD: Here he -- in order to make
11 the -- to make out a case, to be allowed to present a
12 defense to the jury, Your Honor, that the funds are
13 nontaxable, the defense must have some basis in fact.
14 And here he proffered nothing to show that this was a
15 dividend or a return of capital at the time it was made.

16 CHIEF JUSTICE ROBERTS: He said in his
17 proffer that he would present expert testimony that this
18 -- the corporation didn't have profits and earnings, and
19 therefore it was a return of capital. And the district
20 court said no, you don't get to do that.

21 MS. MAYNARD: In his -- I think this is his
22 proffer, the relevant portion of it, is in the JA on
23 page 97.

24 CHIEF JUSTICE ROBERTS: Right.

25 MS. MAYNARD: And it says: "Alternatively,

1 the expert will explain that if the moneys were not
2 loans or advances or if Boulware did not use the moneys
3 for corporate purposes, then as the controlling
4 shareholder, the moneys could be deemed a constructive
5 return" -- "a constructive dividend or return of capital
6 to Boulware, which may or may not be income, depending
7 on whether or not HIE" -- the corporation -- "had
8 earnings and profits for the years when the moneys were
9 obtained by Boulware."

10 That's all he proffered, an expert who would
11 testify that it could have been either dividends,
12 Justice Breyer, or a return of capital. So he did
13 realize that he needed to show --

14 CHIEF JUSTICE ROBERTS: No. In the
15 district court -- the district court said that's not
16 relevant, it's not relevant whether they could be
17 classified as dividends. I'm quoting from your brief on
18 page 8: "It is not relevant whether the funds could
19 have been classified as a return of capital or a
20 dividend at the time when they were diverted," because,
21 he said, what was relevant is -- is the intent, whether
22 they were in fact treated as return of capital.

23 MS. MAYNARD: That's right, Your Honor, and
24 our position is that in both civil and criminal cases
25 before something can be treated under the tax treatment

1 in 301(c), it must meet 301(a), which requires that,
2 under all the facts and circumstances it in fact be a
3 distribution, either a dividend or return of capital.
4 And all his proffer testifies -- all his proffer offered
5 is that it theoretically could be deemed a dividend or
6 could be deemed a return of capital.

7 JUSTICE SOUTER: I think -- maybe he was
8 simply getting at the fact that under 301, assuming the
9 possibilities of non-301 treatment are excluded, under
10 301 it will be treated either as a dividend or as a
11 return of capital, depending on the corporate books for
12 that year, and he wasn't making a proffer at that point
13 precisely as to what those corporate books would show,
14 but he was making a proffer that, under 301, it would
15 either be classified as a dividend or as a return of
16 capital. And wasn't that enough to -- to get him -- get
17 him the right to introduce the evidence?

18 MS. MAYNARD: No, Your Honor. In our view,
19 301(a), the language with respect to its stock, and the
20 regulations have so interpreted it and the legislative
21 history makes clear that it was added to the 1954 Code
22 specifically to show that, before distributions can
23 receive that treatment, regardless of what the facts
24 are about E and P and regardless of what the facts are
25 about the basis, it has to have been a corporate

1 distribution with respect to the stock.

2 CHIEF JUSTICE ROBERTS: Well, but if he is
3 making a proffer of saying it depends upon whether or not
4 there's adequate earnings or not, isn't he plainly
5 saying that that means it's with respect to my stock?
6 Because if he were getting it, for example, as an
7 employee for consideration, it wouldn't matter whether
8 there were sufficient earnings or not. But when he says
9 it depends on whether there's sufficient earnings, it
10 seems to me that that's clearly notifying you that he's
11 saying it's with respect to his stock.

12 MS. MAYNARD: This proffer also has factual
13 proffers in it, Your Honor, and none of the factual
14 proffers go to the fact that it was with respect to
15 stock. The Petitioner testified --

16 JUSTICE SCALIA: He said -- and it seems to
17 me that this is enough to put you on notice -- "Boulware
18 will present further evidence that all of the alleged
19 unreported income was either a loan or advance or was
20 used by Boulware for corporate purposes or for the
21 benefit of HIE."

22 MS. MAYNARD: He --

23 JUSTICE SCALIA: Now, "for corporate
24 purposes" would include either a return of capital or a
25 dividend, payment out to shareholders.

1 MS. MAYNARD: No, Your Honor. No, Your
2 Honor, it wouldn't. For corporate purposes -- and he
3 testified here, and he testified as to those three
4 things. He testified that he thought the moneys were
5 always corporate moneys. In other words, that he'd been
6 given them to use them to buy coffee and do other things
7 that were for the corporation. He testified that,
8 alternatively, he thought they were loans to him and
9 that he was going to repay them. And alternatively he
10 thought that they were corporate advances to him. The
11 jury was instructed on all those things and rejected
12 them in convicting him.

13 But he did not testify that he thought he
14 was being paid a dividend. He did not testify that he
15 thought he was being paid a return of capital. And the
16 reason he proffered an expert is because he doesn't
17 believe there is this first element of the defense, at
18 bottom, that the Government believes that there is, and
19 that in 301(a)'s threshold requirement, with respect
20 to stock -- and if you trace back the civil cases, and
21 the basis in the D'Agostino rule is based on civil cases
22 interpreting the old code.

23 JUSTICE GINSBURG: Tell me about the civil
24 case. There would be a tax deficiency, and wouldn't the
25 Government have to say what were the elements of the tax

1 deficiency?

2 You said in a criminal case they don't have
3 to characterize it at all. You just say he got -- he
4 has money on which tax hasn't been paid, and there was a
5 likely source of income. But now you're in a deficiency
6 mode, and the Government asserts a deficiency. Doesn't
7 it have to say what the elements of the deficiency are?
8 And what would it say in this case?

9 MS. MAYNARD: Well, in this case the
10 Government's position at bottom is that he stole these
11 funds, but that -- but in the criminal case it didn't
12 need to characterize it.

13 I think -- and if I can take a common
14 criminal -- a common civil situation, Your Honor, where
15 a corporation comes in and tries to deduct a salary that
16 it pays to its controlling shareholder and/or to, say, the
17 spouse of the controlling shareholder who is also a
18 shareholder, and the services that that person has
19 provided, the corporation has called it a salary and
20 deducted it as necessary business expenses, and the
21 Service comes in and says that's -- we're going to
22 disallow that deduction and then that's litigated in the
23 Tax Court.

24 In that situation, the Government does often
25 argue that that -- the excess -- you know, say this

1 person at home is providing \$10,000 in bookkeeping
2 services to the corporation, when in fact a net value, a
3 net worth, fair market value of \$10,000 of services, but
4 being paid \$500,000, and the corporation is deducting it
5 as a necessary business expense of \$500,000. The issue
6 in that case will turn on whether or not there was an
7 intent to compensate for services, whether or not the
8 services are reasonable, and the Government may well
9 come in and say --

10 JUSTICE GINSBURG: Well, let's take this
11 case. Let's take this case and not some hypothetical,
12 and where -- on the civil side -- the Government is
13 asserting a deficiency. Just change one thing. The
14 corporation is rich with earnings and profits. What
15 would the notice of deficiency say?

16 MS. MAYNARD: You know, I -- to be honest
17 with you, Your Honor, I don't know, but the --

18 JUSTICE GINSBURG: Wouldn't the Government
19 want to take the position that this is a dividend and
20 not something else, if that were the case?

21 MS. MAYNARD: The Government --

22 JUSTICE GINSBURG: If there were earnings
23 and profits.

24 MS. MAYNARD: The Government might want to
25 take that position, Your Honor. On the facts of this

1 case, the Government's position is that he stole these
2 funds. But in a hypothetical situation like this case,
3 if the Government wanted to take the position, it is our
4 view here and certainly if you adopt the rule that we're
5 arguing for, that 301(a) -- that there must be -- the
6 facts and circumstances must suggest that the moneys
7 were taken out with respect to the stock because of the
8 person's status as a shareholder.

9 JUSTICE STEVENS: Ms. Maynard, may I just go
10 back to your hypothetical for a second? In the closely
11 held corporation situation you describe where they pay a
12 huge salary to the wife of the president and they decide
13 you can't deduct that, that's really a dividend --
14 that's what the Government normally does in that
15 situation. And don't they decide it's a dividend
16 irrespective of the intent of the company making the
17 distribution?

18 MS. MAYNARD: Well, in that situation --

19 JUSTICE STEVENS: So there's no attempt on
20 the part of them to satisfy the "with respect to stock"
21 requirement?

22 MS. MAYNARD: Well, the express intent, Your
23 Honor, is belied by all the facts and circumstances. I
24 mean, just to be clear, the Government is arguing for an
25 objective test here --

1 JUSTICE STEVENS: Yes, but the only fact and
2 circumstance in your hypothetical is they paid them a
3 million dollars when they only earned \$100,000?

4 MS. MAYNARD: Right.

5 JUSTICE STEVENS: That's clearly with
6 respect to stock --

7 MS. MAYNARD: Yes.

8 JUSTICE STEVENS: -- regardless of intent?

9 MS. MAYNARD: No, Your Honor. All the facts
10 and circumstances would show that the expressed intent
11 was not the actual intent and that the -- what's really
12 going on -- and that's what you're asking in all these
13 cases, what's really going on? In what way did this
14 person get the payment, and why did they get the
15 payment? Why did the corporation make a payment to this
16 person?

17 JUSTICE SCALIA: Surely he is entitled to
18 try to prove that. And I'm still hung up on your
19 assertion that he made no proffer on it below.

20 Here's another portion of the joint
21 appendix. The expert, his expert, he says, will further
22 explain that if Boulware used -- this is on page 97,
23 bottom of 97: "If Boulware used the moneys for
24 corporate purposes, the moneys were not income to
25 Boulware. Alternatively, the expert will explain that

1 if the moneys were not loans or advances or if Boulware
2 did not use the moneys for corporate purposes, then as
3 the controlling shareholder, the moneys could be deemed
4 a constructive dividend or a return of capital to
5 Boulware, which may or may not be income depending on
6 whether or not HIE had earnings."

7 That seems to me presenting the claim that
8 he asserts he should have been given an opportunity to
9 present.

10 MS. MAYNARD: That's the language on which I
11 rely to show that he's proffered nothing in basis in
12 facts, Your Honor. In order to present a defense to the
13 jury --

14 CHIEF JUSTICE ROBERTS: This is a criminal
15 case. He's presented the argument, but don't you have
16 the burden of showing as an element of tax deficiency
17 that what he's proffering there is not true?

18 MS. MAYNARD: The Government doesn't -- it's
19 clear under Holland -- have to refute every hypothetical
20 nontaxable source. The defendant in the Second
21 Circuit's Leonard decision and in Bok makes this
22 clear -- there must be some basis in fact. And this is
23 just an expert proffer. He offered no facts.

24 JUSTICE KENNEDY: Let me get something
25 clear. They wish to introduce evidence. They wish to

1 introduce evidence. And you say, oh, well, the proffer
2 is no good because there is no basis, so there was no
3 evidence. That's circular. I don't understand that.

4 MS. MAYNARD: They wish to introduce expert
5 evidence that it could be deemed, as a legal matter --

6 JUSTICE KENNEDY: Oh, I see.

7 MS. MAYNARD: They don't have --

8 JUSTICE KENNEDY: And you say there was no
9 other evidence in the record that the expert could use
10 for that testimony?

11 MS. MAYNARD: Exactly, Your Honor. In fact,
12 the Ninth Circuit's decision, on Pet. App. 6, makes that
13 clear. "Boulware presented no concrete proof that the
14 amounts were considered, intended, or recorded on the
15 corporate records as a return of capital."

16 CHIEF JUSTICE ROBERTS: No, that's not right.
17 He says right here that it may or may not be income
18 depending on a fact, not an expert's opinion, whether or
19 not HIE had earnings and profits for the years when the
20 moneys were obtained by Boulware. That's a question of
21 fact. You look at the corporate books. You get the
22 accountant on to testify. It's not an expert's view on
23 what's legally relevant.

24 MS. MAYNARD: But that fact goes to the
25 second element. And what we're disputing is sufficiency

1 on the first element, which is that it must have been a
2 corporate distribution with respect to the
3 corporation's stock.

4 CHIEF JUSTICE ROBERTS: Well, it's only
5 relevant if the question he is trying to submit, whether
6 they are earnings and profits or not, which will affect
7 its treatment. It's only relevant if it's with respect
8 to stock.

9 MS. MAYNARD: Right, Your Honor. And he
10 presented absolutely no factual basis --

11 JUSTICE BREYER: But we don't -- we are not
12 certain on that one, I think, because of the cases he
13 said before would this be a possible holding. If it was
14 a distribution in respect to the stock, and if he had
15 sufficient basis, then if there were no earnings and
16 profits in the corporation during the year, it would be
17 treated as a tax deficiency -- no tax deficiency or it
18 would be a return of capital. Insofar as the Ninth
19 Circuit says something to the contrary, it is wrong.

20 Now, we remand to decide whether the --
21 whether he intended to prove and produced enough to show
22 they didn't have the earnings and profits and also to
23 consider the question of whether this was a distribution
24 in respect to stock.

25 MS. MAYNARD: If you were -- if you are

1 going to remand, Your Honor --

2 JUSTICE BREYER: Does the Government have
3 any objection to what I just said?

4 MS. MAYNARD: Well, if you're going to
5 remand, Your Honor, all three elements should be opened.
6 The Government's view is that he knew that he needed --
7 that the Ninth Circuit's rule required him to proffer on
8 the first element, that, in other words, that it was
9 intended to be a constructive corporate distribution by
10 somebody, that there was any evidence -- this is not a high
11 burden. He could have testified he thought it was a
12 constructive distribution intent. Either he could have
13 testified it was a dividend, or he could have testified
14 he thought it was a return of capital.

15 Mr. Monago also testified, Your Honor, that
16 it was not -- there were no dividends during the
17 relevant period. So there is testimony in the
18 Government's case that there were no dividends in the
19 relevant period and no returns of capital during the
20 relevant period. And he proffered no basis in fact to
21 believe that what happened here nor do any of the facts
22 suggest that what happened here, unlike in our excessive
23 salary case, Your Honor, where the government books it
24 as a deductible business expense, and one can infer from
25 the fact that it's such an unreasonable salary that it

1 must have been earnings and profits. Here the facts of
2 record are that --

3 CHIEF JUSTICE ROBERTS: Well, please --

4 MS. MAYNARD: There is no way to infer from
5 the way in which he diverted these funds that these
6 funds were with respect to stocks.

7 CHIEF JUSTICE ROBERTS: Thank you,
8 Ms. Maynard.

9 Mr. Cline, you have four -- ten minutes
10 remaining.

11 REBUTTAL ARGUMENT OF JOHN D. CLINE

12 ON BEHALF OF THE PETITIONER

13 MR. CLINE: Your Honor, I just want to make
14 a few quick points.

15 The phrase "with respect to stock" was never
16 discussed in the district court at all. It was never
17 discussed before the court of appeals panel at all. It
18 was never the basis in the lower courts for the
19 Government's position that Mr. Boulware could not assert
20 the return-of-capital defense.

21 The Government's sole argument, from the
22 time it moved to exclude Mr. Boulware's testimony on
23 this issue and his evidence on this issue to the time
24 that it sought to prevent him from getting a jury
25 instruction on this issue, the Government's only

1 argument was Miller, and in particular the Miller
2 requirement that there be an intent, a contemporaneous
3 intent that the distribution be a return of capital.

4 JUSTICE ALITO: Do you think --

5 JUSTICE SCALIA: Even so, no harm no foul,
6 if, in fact, you hadn't proffered any evidence that
7 would enable you to meet the "in respect of stock"
8 requirement. Now, what do you say to the contention
9 that you hadn't proffered anything?

10 MR. CLINE: I say several things, Justice
11 Scalia. First of all, I think there was an adequate
12 proffer at page 97 of the joint appendix.

13 Second, at pages 62 through 66 of the joint
14 appendix, Mr. Boulware specifically invokes Truesdell
15 and the -- and the D'Agostino no earnings, no profits --

16 JUSTICE KENNEDY: Well, at 97, are you
17 saying that the expert would have brought with him
18 financial records to show earnings and profits and
19 basis? Because I interpret the Government as saying
20 there was nothing for him to testify to because there
21 was no other -- the basic data was not in the record.

22 MR. CLINE: Justice Kennedy, there actually
23 is a fair amount of basis data in the record. And I can
24 quickly refer the Court to the portions of the joint
25 appendix. There is testimony, for example, that

1 Mr. Boulware contributed a water company valud at
2 roughly \$1.7 million dollars to HIE. That's at joint
3 appendix 70 through 73, 116 through 23, 147 through 51.

4 There's evidence that he contributed a
5 coffee processing and wholesaling business valued at
6 roughly \$1.8 million. That's at joint appendix 123
7 through 27, 151 through 53.

8 There was evidence that he spent money on
9 coffee beans for --

10 JUSTICE BREYER: But those are different.
11 Those are whether that's a corporate purpose. I think
12 the question here is, as I started, I thought that this
13 expert was going to testify that there were no earnings
14 and profits in the relevant year. Having read it more
15 closely, it seems to me that that is not what the expert
16 is going to testify. Rather, he's going to say if there
17 were no earnings and profits, then it is a return of
18 capital if the basis is high enough. He's going to
19 testify to that legal proposition.

20 So, my question is, is there any proffer of
21 evidence here where the taxpayer says I want a chance to
22 show there were no earnings or profits?

23 MR. CLINE: Justice Breyer --

24 JUSTICE BREYER: Where is it?

25 MR. CLINE: That's how I read the portion of

1 the joint appendix at pages 62 through 66 that I
2 referred to where Mr. Boulware invokes that rule.

3 Now, the problem here was that at no
4 point -- from the very beginning, the Government brought
5 this issue to the fore by filing a motion in limine. And
6 the sole focus of the Government's motion in limine was
7 the Miller contemporaneous intent rule, and that was the
8 sole focus of the discussion. That's all anyone talked
9 about in the district court.

10 And so, Justice Breyer, the proffer is not
11 as fulsome as I might hope, but it's clear that
12 Mr. Boulware sought the opportunity to present earnings
13 and profits and basis information through expert
14 testimony.

15 JUSTICE GINSBURG: Do you recognize that he
16 would have the burden? If he said this corporation had
17 no earnings and profits so what I got was a return of
18 capital, it would be his burden to show that?

19 MR. CLINE: I think, Justice Ginsburg, that
20 under the rule in Bok and under the rule that the
21 parties proceeded under in the district court in this
22 case, whether or not it's the correct rule, Mr. Boulware
23 had the burden of producing some evidence, some evidence
24 of the earnings and profits and the basis issues. Then
25 the burden of persuasion --

1 JUSTICE GINSBURG: Coming forward, he had
2 the burden of coming forward?

3 MR. CLINE: Just the burden of coming
4 forward with some evidence, even if it's weak evidence
5 or not credible evidence, just to put the issue in play.
6 Then the burden of persuasion beyond a reasonable doubt
7 rests with the Government.

8 CHIEF JUSTICE ROBERTS: Where is that
9 evidence? If he has the burden of coming forward with
10 it, I assume that means in the proffer. And where is
11 it?

12 MR. CLINE: The evidence, Your Honor, is in
13 the record where I have previously identified.

14 CHIEF JUSTICE ROBERTS: Justice Breyer's
15 point is that that isn't directed to that issue. It's
16 directed to the issue of whether he was using the funds
17 for a corporate purpose.

18 MR. CLINE: Actually, Your Honor, it was --
19 it was -- the evidence that came into the record came
20 into the record more or less by happenstance because the
21 district court had prohibited any evidence of return of
22 capital.

23 CHIEF JUSTICE ROBERTS: And that evidence
24 came in after the proffer, didn't it?

25 MR. CLINE: No. It came in throughout the

1 trial, actually. This issue --

2 CHIEF JUSTICE ROBERTS: Well, but this was a
3 motion in limine which is before the trial.

4 MR. CLINE: No. The motion in limine was
5 actually filed June 30th, which is, I think, the third
6 day of trial. And the issue was litigated continuously
7 throughout the trial up until, I think, July 11th, which
8 was a day or two before it ended. This issue came up
9 repeatedly throughout the trial.

10 JUSTICE BREYER: So what did happen there?
11 I've been looking at page 62 through 66. They are
12 dancing around the issue. It's fair to say that they
13 wouldn't be having these four pages unless they are
14 thinking of return of capital as a defense, but they
15 don't actually say it.

16 MR. CLINE: Justice Breyer, had the issue
17 not been limited to the Miller contemporaneous intent
18 requirement --

19 JUSTICE BREYER: They would have raised it.

20 MR. CLINE: -- I believe that Mr. Boulware
21 would have presented expert testimony that would, in
22 fact, have at least put into play the issue of earnings
23 and profits and basis.

24 JUSTICE SOUTER: Well am I -- am I right
25 that all he would have to do in order to satisfy that

1 burden would be this: He would have the option, which I
2 gather he availed himself of, to show that, in fact, the
3 -- the funds were loans or non-income to him.

4 And he would also have had the option to
5 follow that by putting on the corporate accountant
6 saying: This guy is a stockholder. It's what the
7 corporate books show. In fact, that's not in dispute.

8 No. 2, the corporation didn't have any
9 profits that year. No. 3, if the money was diverted, if
10 the money was corporate funds, the only thing left under
11 301 is to treat it as a return of capital. And if, in
12 fact, the funds exceeded his basis, to treat it as a
13 capital gain.

14 So all he had to do, in effect, to make the
15 proffer, as I understand it, is to say: If you don't
16 believe me that this was non-income like a loan, then
17 all I have to do is to put in the evidence that the
18 corporation didn't have any -- any profits that year,
19 and Section 301 will take care of the rest of it.
20 Because you have to conclude that it's either a return
21 of capital or a capital gain.

22 Is that fair? Is that correct?

23 MR. CLINE: I think that's basically right,
24 Justice Souter, and --

25 JUSTICE SCALIA: Well, wait. Doesn't he

1 have to show, still show, that it's with respect to
2 stock?

3 MR. CLINE: Yes, but --

4 JUSTICE SCALIA: That one little element:
5 That he has to show the distribution was not because
6 this was his girlfriend, but it was with respect to
7 stock, and the record is -- is that the intent?

8 JUSTICE SOUTER: But doesn't -- doesn't he
9 suffice, on a going forward burden, simply to show that
10 he is a stockholder?

11 MR. CLINE: I think so, Justice Souter, and
12 I think --

13 JUSTICE SOUTER: I mean I agree with Justice
14 Scalia, but doesn't he make it at least to the point of
15 putting the Government to its proof by showing that he
16 is a stockholder?

17 MR. CLINE: That he is a stockholder, and
18 that he did not receive this money in any nonstockholder
19 capacity.

20 JUSTICE SOUTER: Yes.

21 MR. CLINE: For example, for income or
22 something like that. And I think the record is probably
23 adequate as it stands. Now, he was clearly a
24 stockholder. He would not have received this money had
25 he not been a stockholder.

1 CHIEF JUSTICE ROBERTS: Well, it's kind of
2 hard to say it's with respect to stock when the other
3 stockholder doesn't get any.

4 MR. CLINE: Chief Justice Roberts, the
5 cases, again, are uniform -- and we cite them, I think,
6 at footnote 8 of our reply brief -- that you can have a
7 constructive distribution even if there are no corporate
8 formalities, even if it's a disproportionate
9 distribution, even if other stockholders don't share it.
10 And, again, that's a position that the Government
11 argues.

12 CHIEF JUSTICE ROBERTS: What page in your
13 brief did you say?

14 MR. CLINE: I believe it is -- the cases are
15 cited, I believe, at footnote 8 of our reply brief. Let
16 me just make sure.

17 CHIEF JUSTICE ROBERTS: The reply brief?

18 MR. CLINE: It's footnote -- I'm sorry.
19 It's footnote 3 on page 8, and there is a whole series
20 of cases. And, again, as far as I know, Mr. Chief
21 Justice, there is no law to the contrary, and this is a
22 position that the Government, itself, argues.

23 JUSTICE SCALIA: The issue is whether the
24 Government wants to convict more -- more malfeasors or
25 whether it wants to collect more money, and the latter

1 obviously prevails in the cases, right?

2 MR. CLINE: But, Justice Scalia, it seems to
3 prevail only in this case, and I would be astonished if
4 counsel argues that the Government views Mr. Boulware as
5 having stolen this money from the corporation. I would
6 be astonished if the Government would accept a theft
7 deduction, if HIE argued for it, when the Government
8 seeks to collect these -- the corporate income from HIE.
9 Unless the court has further questions --

10 CHIEF JUSTICE ROBERTS: Thank you, counsel.
11 The case is submitted.

12 (Whereupon, at 11:52 a.m., the case in the
13 above-entitled matter was submitted.)

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